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Alessandro Benocci

Purposes and Tools of the Market for Corporate Control

55-72

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Purposes and Tools of the Market for Corporate Control

by

ALESSANDRO BENOCCI*

The theme of the market for corporate control features among the most important issues of corporate governance and financial markets. This forces to reflect on the effects produced by regulations on control changes. In this regard, this paper aims to contribute to the establishment of certain methodological rules in order to develop an analytical model that can serve as a tool for an ex-ante evaluation of a regulation of the market for corporate control and may illustrate the impact of a given takeover regulation on the policy purposes it aims to achieve. To this end, the paper intends to identify (i) the traditional policy purposes of a takeover regulation, (ii) the traditional regulatory tools that are available for market regulators, (iii) the impact of each regulatory tool on each policy purpose, (iv) the impact of a given combination of regulatory tools on the overall policy purposes and, ultimately, (v) the ex-ante rating that can be given to a specific takeover regulation.

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* Assistant Professor of Business Law, University of Pisa, Italy. This article is dedicated to the memory of Franco Belli, Professor of Banking Law at the University of Siena, unforgettable master of life and science. I also owe a debt of gratitude to John Lowry of University College London and Jesse Fried of Harvard University for their support and advice. I sincerely thank the two anonymous referees for their valuable and constructive suggestions. Liability for all errors and omissions remains with the author.

I. Introduction

This paper aims to contribute to the development of a theoretical model that can serve as a tool for an *ex-ante* evaluation of a regulation of the market for corporate control and therefore for an impact assessment of a possible regulatory structure on certain desirable goals of legal policy. Especially in the field of transfer of corporate control, it is essential not so much to know what a rule states, but why that rule states something. Furthermore, it is essential to consider not only current regulations, but also to look back in order to understand what may happen tomorrow both in terms of best involvement in any policy debates and in terms of understanding of the possible changes in the law. I will structure my considerations with this in mind and I will focus more on the economic analysis of law than on the hermeneutics, and more on the policy of law than on a review of current legislation.

A regulation of the market for corporate control is simultaneously a tool both of corporate governance and of financial markets. As a tool of corporate governance, any takeover regulation directly affects the level of mobility of the ownership structure of companies operating in a given system and, consequently, affects the degree of stability and the possibility of alternation in the ownership and management of any company.¹ The levels of stability or mobility and monitoring dynamics also affect the likelihood of removing incompetent or unfair entrepreneurs and, therefore, the opportunity for new business skills to emerge. In this way, they contribute to achieving the typical goals of corporate governance, which involve curbing the opportunism of managers and controlling shareholders, on the one hand, and enhancing the efficiency of corporate management, on the other.² As an instrument of financial markets,

1 See AA Berle and GC Means, *The Modern Corporation and Private Property* (New York 1932), 3; R Romano, 'A Guide to Take-Overs: Theory, Evidence and Regulation', in KJ Hopt and E Wymeersch (eds), *European Takeovers: Law and Practice* (Oxford 1992), 3; PG Jaeger, 'Gli azionisti: spunti per una discussione' [1993] *Giurisprudenza commerciale* 23, 28.

2 In support of the brief summary outlined in the text, we may observe the following. Firstly, the presence of limited mobility of control prevents the emergence of new management skills and hence hinders the achievement of the objectives of corporate governance. Consequently, higher mobility of the ownership structure and the creation of a proper market for corporate control can be regarded as highly efficient instruments for furthering the goals of corporate governance. Secondly, low mobility of control is not in itself a sign of inefficiency. In fact, as regards efficient allocation of resources, mobility of control increases efficiency only if it favours the rise of suitable management. Furthermore, considerable mobility of control that penalizes incumbent managers regardless of their ability may be a serious disincentive to perform their duties appropriately. However, since the acquisition of managerial skills is undoubtedly favoured by exercising business activities, a high mobility of control and the possibility of a change in management are

takeover regulation also indirectly affects the final objectives that, as such, financial markets have the task to fulfil. If it is indeed likely that an adequate takeover regulation contributes to enabling efficient allocation of corporate control and governance, then it will be equally true that, ultimately, such regulation will also help to ensure an efficient allocation of economic resources and of savings in general.³

Given this, a regulation of the market for corporate control regulates both the particular commodity traded on that market (i.e. the corporate control) and the possible techniques for the transfer of that commodity. As regards the first point, the relevant concept of corporate control is that contextualized within the horizon of the ownership structure of a company and its mobility. Therefore, it manifests itself as “control by shareholding”, which consequently permits us to identify the concept of corporate control with the “shareholding of an amount such as to allow the owner to exercise (*de jure* or *de facto*, alone or jointly, directly or indirectly) a dominant influence on the shareholders’ meetings of the company”.⁴ On the second point, transfer of corporate control can be achieved through a variety of circulatory techniques. Among them,

also non-consensual conditions necessary not only to remove managers that are inept or culpable but also to bring out hidden entrepreneurial skills. See HG Manne, ‘Mergers and the Market for Corporate Control’ [1965] *Journal of Political Economy* 73, 115; MC Jensen, ‘Agency Costs of Free cash-flow, Corporate finance and Takeovers’ [1986] *American Economic Review* 659, 670.

3 See L Enriques, *Mercato del controllo societario e tutela degli investitori. La disciplina dell’opa obbligatoria* (Bologna 2002), 11.

4 The notion of “corporate control” briefly proposed here is for the purposes of this research only and is based on the many contributions that have questioned the existence or otherwise of a unitary notion of corporate control. On this basis, control can be considered as a relationship between an “active subject” and a “passive subject”, whereby the former can make their decisions affect the fate of the latter through certain “means” (dominant or decisive influence). However, this research paper deals with the issue of the corporate ownership and of the mobility of this ownership. Given that, the concept of “control” *tout court* is not as relevant for the purposes considered here, as the narrower “control by shareholding”. This choice affects the definition as internal (not external or by agreement), *de jure* or *de facto*, alone or joint, direct or indirect control. No constraints should be applied to the definition of the “active subject” of control, which therefore may be another company, or another collective organization or even individuals. On the other hand, the definition of the “passive subject” must be narrowed down, as in the context of this research it only comprises companies. For the purposes considered here, the term “corporate control” has to be understood as an amount of shares sufficient to guarantee that whoever holds them can also exercise, *de jure* or *de facto*, alone or jointly, directly or indirectly, the dominant influence at shareholders’ meetings. See P Davies and KJ Hopt, ‘Control Transactions’, in RR Kraakman and others (eds), *The Anatomy of Corporate Law. A Comparative and Functional Approach* (Oxford 2004), 157; M Notari, *La nozione di “controllo” nella legislazione antitrust* (Milano 1996), 217; P Ferro-Luzzi and PG Marchetti, ‘Riflessioni sul gruppo creditizio’ [1994] *Giurisprudenza*

there are two that stand out: the “private treaty” and the “public offer to the target company’s shareholders to acquire the related corporate control” (the so-called takeover bid). The former is the ordinary process that leads to the signing of an equally ordinary transfer agreement and that follows the rules prescribed by Contract Law in general and by the sale-purchase contracts regulations in particular.⁵ The latter is a process that is functionally similar, but structurally different. In fact, the takeover bid starts with a binding offer relating to a certain amount of shares and is addressed by the offeror to all the shareholders of the target company. The next stage is the adhesion by the offerees, who accept the offer unconditionally; and the process ends – when successful – with the transfer of the shares and the payment of the amount due.⁶ The combination of all the above elements allows us to understand what the concept of “market for corporate control” is, i.e. a virtual place for the transfer of shareholdings that allows the owner to exercise a dominant influence on the shareholders’ meetings of the company by two principal means, by private treaty or by a takeover bid.

The fact that the theme of the market for corporate control and the mobility of the ownership structure features among the most important issues of corporate governance and financial markets, forces us to reflect on the effects produced by regulations on changes in control. In this regard, it is necessary to establish certain methodological rules whereby we may scrutinize such a legal system (both from a legal policy perspective and from the perspective of evaluating existing law) in order to develop an analytical model that may illustrate the impact of a given takeover regulation on the policy purposes it aims to achieve. To this end, it is necessary to identify (i) the traditional policy purposes of a takeover regulation, (ii) the traditional regulatory tools that are available for market regulators, (iii) the impact of each regulatory tool on each policy purpose, (iv) the impact of a given combination of regulatory tools on the overall policy purposes and, ultimately, (v) the *ex-ante* rating that can be given to a specific takeover regulation.

commerciale 442, 449; M Lamandini, *Il “controllo”. Nozioni e “tipo” nella legislazione economica* (Milano 1995), 11.

5 It should be added that private agreement differs depending on whether it concerns a preformed controlling interest of shares or gradual acquisitions of the shares on the market, with the goal of gaining a controlling interest of the target company. In this regard, see M Stella Richter jr., *“Trasferimento del controllo” e rapporti tra soci* (Milano 1996), 95.

6 See A Dignam and JP Lowry, *Company Law* (Oxford 2009), 80; LG Picone, *Le offerte pubbliche di acquisto* (Milano 1999), 2.

II. *Purposes of a Takeover Regulation*

The literature is not unanimous as regards the identification of the traditional policy purposes of a takeover regulation, but we may identify such purposes, with a certain approximation, by starting from a situation where transfers of corporate control are not specifically regulated. The interests that remain unprotected in such a situation (and which are seen as deserving of protection) will necessarily emerge as policy purposes of any regulation that may be provided. We could assume an unregulated situation – a realistic hypothesis given that it is true that, in the US, there is a federal law dating back to the 30s, but it is also true that in Europe we had to wait for the Directive 2004/25/EC and that, in many EU Countries, specific rules have been introduced only with the Directive transposition, while the introduction in other EU Countries of a first form of regulation was – however – fairly recent; in UK, the experience of the City Code on Takeovers and Mergers dates back to the 60s, but an accomplished regulation was not provided until the Companies Act 2006; in France, a general framework existed since the 70s, but a special regulation was introduced just by the Law no. 531/1989; in Italy, by the Law no. 149/1992; in Spain, by the Royal Decree no. 279/1984.⁷ Were we to do this, the possible scenarios in the event of a transfer of corporate control are the following: (a) existence of an agreement between raiders and controlling shareholders of the target company (so-called “friendly” takeover); (b) absence of an agreement between raiders and controlling shareholders of the target company, with the target company not being controllable because its shareholders only have *de facto* control (so-called “hostile” takeover); (c) absence of an agreement between raiders and controlling shareholders of the target company with the target company not being controllable because its shareholders also have *de iure* control. The third scenario however, may be shelved immediately as in this case no problem arises, whatever the choice regarding the regulation or non-regulation of the transfer of corporate control (unless we fantasize about a highly unlikely expropriation hypothesis). We will thus consider the first two scenarios.

In the presence of scenario (a) (agreement between raiders and controlling shareholders of the target company), the transfer of corporate control takes place by private treaty. This raises the following issues.⁸ Firstly, the ownership of corporate control passes from the seller to the purchaser upon the payment of a sum that includes not only the market value of the shares acquired, but also a so-called “majority bonus” that can be configured as a “plus-value”

7 See GK Morse, “The City Code on Takeovers and Mergers – Self Regulation or Self Protection?” [1991] *Journal of Business Law* 509, 513; R Skog, ‘Se l’O.P.A. obbligatoria sia davvero necessaria. Riflessioni critiche alla luce del sistema svedese (Does Sweden Need a Mandatory Bid Rule? A Critical Analysis)’ [1995] *Rivista delle società* 967, 988.

8 In this case, the private agreement will concern a preformed controlling interest.

corresponding to the “plus-power” connected with the holding of corporate control. In such a situation, the controlling shareholders of the target company (and they alone) will be free to leave the company and receive the majority bonus. On the other hand, the minority shareholders of the same company will not only be unable to leave the company, but will also be barred from participating in the sharing of the majority bonus and, will hence suffer a clear disparity of treatment.⁹ Secondly, if the transfer of corporate control is carried out by private treaty this may take place in a confidential manner and may thus occur without the minority shareholders being informed in any way. The minority shareholders may therefore perceive their investment as being subject to adverse effects induced by unforeseen “surprises”, due to the opacity of the market.¹⁰ Thirdly, if it is true that an easy transferability of the controlling interest may have a positive effect on the possibility of replacing inefficient ownership and management with efficient ownership and management, the opposite is also true. In fact, the free market mechanism does not necessarily lead to an adequate level of selection of management skills: when agreed, the transfer of control may also be made by a raider who plans to gain private benefits to offset the financial effort involved and may lead to a “plundering” of the target company.¹¹ Ultimately, this scenario leads to the strong emergence of the need for both adequate contendibility and equal treatment and transparency and, therefore, protection of minority shareholders. When this is lacking, the results in terms of corporate governance (we would say, the micro-economic outcomes) will be those described above. However, even at market level (we would say, at the macroeconomic level), the results may easily be sub-optimal, because the financial market will reduce the degree of credibility and investors will be deterred from channelling their savings through the financial sector circuits, thus preventing the financial market from fulfilling its duty of increasing the efficiency of the allocation of savings and, ultimately, of the entire economic system.¹²

In the presence of scenario (b) (no agreement between raiders and controlling shareholders of the controllable target company), the transfer of corporate control can take place either by private treaty or by takeover bid. If the transfer of corporate control takes place by private treaty in addition to most of the problems seen above, there will be further problems arising from the fact that, in this case, the subject of the agreed sale will not simply be a preformed controlling interest, but will regard several small tranches of shares, belonging

9 See SJ Grossman and O Hart, ‘An Analysis of the Principal-Agent problem’ [1983] *Econometrica* 7, 51.

10 See Stella Richter jr., “*Trasferimento del controllo*” e rapporti tra soci, *op cit*, 96.

11 See Enriques, *Mercato del controllo societario e tutela degli investitori*, *op cit*, 19.

12 See LA Bebchuck and A Ferrell, ‘A New Approach to Takeover Law and Regulatory Competition’ [2001] *Virginia Law Review* 87, 111.

to non-controlling shareholders, that will lead to a share mopping on the stock market with the consequent risk of speculation.¹³ If the transfer of corporate control takes place by an unregulated and voluntary takeover bid, then a problem arises. In fact, the board of the target company may adopt defense techniques that, in the absence of procedural rules, could be undertaken without constraint and therefore might harm the regular trading process.¹⁴ By contrast, the takeover bid offers doubtless advantages. On the one hand, it requires raiders to come out into the open immediately and this has a positive effect on the perceived need for transparency. On the other hand, it allows minority shareholders to participate in the full or partial sharing of any majority bonus paid, and this in turn positively affects the other perceived need for equal treatment between majority and minority shareholders.¹⁵

The analysis of the situation of the so-called “free market for corporate control” clearly shows two distinct needs that, in policy debates, have been taken as the principal purposes of a takeover regulation: on the one hand, the aim of protecting minority shareholders that mainly relates to warranty profiles; on the other hand, the aim of contendibility for corporate control, which mainly relates to efficiency profiles. These needs are known to the European regulator and the Directive 2004/25/EC clearly shows this.

1. Protection of Minority Shareholders

As regards the first purpose (the protection of minority shareholders), this responds to two different needs. On the one hand, the protection of small

13 See Enriques, *Mercato del controllo societario e tutela degli investitori*, *op cit*, 20.

14 See LA Bebchuck, ‘The Case Against Board Veto in Corporate Takeovers’ [2002] *University of Chicago Law Review* 973, 980; LA Bebchuck and A Ferrell, ‘Federalism and Corporate Law: the Race to Protect Managers from Takeovers’ [1999] *Columbia Law Review* 1168, 1171; P Davies, ‘The Regulation of Defensive Tactics in the United Kingdom and the United States’, in KJ Hopt and E Wymeersch (eds), *European Takeovers: Law and Practice* (Oxford 1992), 195. In Italian literature, see also R Costi, *Il mercato mobiliare* (Torino 1999), 82, in which the Author provides examples of defensive strategies, dividing them into three categories. Firstly, among the “acts that aim to increase the necessary cost to achieve the amount of shares that the bidder intends to acquire,” we find capital increases and the conversion of shares without voting rights to shares with voting rights. Secondly, of the “operations aimed at changing the characteristics of the target company assets” there are the transfer of goods, mergers and spin-offs; among the “disruptive behaviours” there are the counter bid on the shares of the offeror, “golden parachute” provisions for the current management or, finally, the acquisition of companies that would make a successful bid incompatible with antitrust legislation.

15 See Bebchuck and Ferrell, ‘A New Approach to Takeover Law and Regulatory Competition’, *op cit*, 113.

shareholders reduces the cost of capital and increases the supply of equity for companies. In fact, when small shareholders fear expropriation of their resources for the benefit of controlling shareholders, they will only be willing to invest their savings in equity if the remuneration takes into account the risk of expropriation that they face. Consequently; the cost of capital will be high and the financial structure of companies will be oriented towards the use of alternative ways of financing such as bank loans. Hence, market capitalization crucially depends on the rights and protection provided to small shareholders; indeed, at the basis of the protection provided to small shareholders there is also a motive of economic efficiency, i.e. to avoid a distorted corporate finance structure. On the other hand, and more traditionally, protecting minority shareholders is required in order to ensure equal treatment among all the shareholders of the company; this principle does not arise from any economic reasoning, but rather reflects one of the fundamental principles of law. All this is clear from the second Recital of the Directive, which states that “it is necessary to protect the interests of holders of the securities of companies, in particular those with minority holdings, when those companies are the subject of takeover bids or of changes of control”.

The purpose of the protection of minority shareholders may, however, be achieved by attempting to implement the following two intermediate goals: firstly, the purpose of transparency, which can concern both the corporate governance and its ownership structure; secondly, the purpose of equal treatment between majority shareholders and minority shareholders.

The intermediate goal of transparency – regarding corporate ownership and governance – aims to allow the market to assess correctly the company’s results, thus strengthening both the ability of investors (including those wishing to gain corporate control) to make considered investments, while also strengthening the financial market’s credibility, which is essential to ensure that savings turn to the brokering channels with confidence. “It is necessary to create Community-wide clarity and transparency”, reads the third Recital of the Directive, while Recitals (12) and (13) say that an offeror should inform the holders of securities of the terms of the bid and the supervisory authority of the decision to launch a bid as soon as possible “in order to reduce the scope for insider dealing”.¹⁶

The intermediate goal of equal treatment between majority and minority shareholders can then be broken down further: when transfers of corporate control are imminent, equal treatment between the two categories of shareholders can

16 See P Davies, ‘The Notion of Equality in European Takeovers Regulation’, in J Payne (ed), *Takeovers in English and German Law* (Cambridge 2002), 9; W Andrews, ‘The Stockholder’s Right to Equal Opportunity in the Sale of Shares’ [1965] *Harvard Law Review* 505, 512.

actually affect both the amount and the price of the transferable shares. In this regard, we saw earlier that when there is a “friendly takeover” in an unregulated market for corporate control, the ownership of the controlling interest passes from the majority shareholders of the target company to the raider, with the payment of a majority bonus that is not extended to the minority shareholders. Acknowledging this economic disparity between majority and minority shareholders led to the establishment, in terms of public policy, of the principle of equal treatment regarding the price of the shares sold, which would obviously be maximized should minority shareholders participate in the distribution of the entire control bonus over all the sold shares: in this respect, Recital (9) of the Directive takes care to establish that the Member States should ensure such equal treatment by obliging the person who has acquired control’s company securities to make an offer to the holders of that company’s securities “at an equitable price”. However, we cannot forget that the disparity between majority and minority shareholders may concern not only the price of the sold shares, but also the amount of transferable securities. An expression of unequal treatment can thus be found in the fact that while majority shareholders are free to decide whether to sell the corporate control, and to whom, minority shareholders have no say in the matter, although the changes in the ownership structure may have important implications on their equity investment too. Therefore, policy debates take into consideration the goal of equal treatment, also as regards the amount of transferable securities that, in the case of maximisation would give all shareholders – and not just majority shareholders – the right to sell all their shares and leave the company (the so-called “exit right”). For minority shareholders, this opportunity would be an additional form of protection, with effects very similar to those of a withdrawal, because it would allow minority groups to sell shares in order to express distrust in the new manager of their savings and in fact, Recital (9) of the Directive also states that the person who has acquired control’s company securities should be obliged by the Member States to make an offer “to all the holders of that company’s securities for all their holdings”.

2. Contendibility for Corporate Control

The second purpose (the contendibility for corporate control), fully responds to an economic logic. At least from a theoretical point of view, benefits in terms of increased allocative efficiency related to the purpose of contendibility would be of two types: enterprise resources would be entrusted to those managers best able to use them and management targets would be better aligned with those of the company’s shareholders.

Through the pursuit of contendibility, investors and the market may supervise and monitor entrepreneurs continuously to ensure that corporate control is

allocated and practiced efficiently. In fact, investors and the market must have direct and indirect supervision tools through which they can identify and correct abuses or errors in a timely manner, with the option – as a last resort – of bringing about a non-consensual change in corporate control.¹⁷ The pursuit of contendibility is also designed to remove the excessive costs and obstacles related to the acquisition of controlling interest. On the one hand, takeovers allow the replacement of less efficient managers with more efficient management. On the other hand, the fear of being replaced would have a disciplinary effect on the current managers, who would be forced to refrain from inefficient behaviors and, on the positive side, would feel obliged to provide high returns to their shareholders, in order to induce them not to withdraw their investment. Indeed, Recital (19) of the Directive states categorically that Member States should take the necessary measures to afford any offeror the possibility of acquiring majority interests in other companies and of fully exercising control of them. Some interpreters then argue that, if the threat of takeovers has such a positive effect on the corporate management, then the market for corporate control should not be hindered because it would not only ensure an efficient allocation of resources in the interest of the entire social community, but also offer an additional form of protection of minority shareholders.¹⁸ However, after observing many takeovers that took place in the United States in the '80s, other interpreters reached the opposite conclusion, as they found that takeovers may also be motivated by considerations that have nothing to do with economic efficiency, such as assets division, managers' delusions of grandeur, etc.¹⁹

3. *Relationships and Interactions*

The academic literature broadly agrees that the protection of minority shareholders and the contendibility for corporate control may actually be considered as the main policy purposes of a takeover regulation and that these two aims are in clear conflict and in substantial trade-off: in fact, an increased protection of minority shareholders may decrease the ability of the controlling shareholders to extract private benefits and – consequently – may decrease the

17 See JC Coffee, 'Regulating the Market for Corporate Control' [1984] *Columbia Law Review* 1145, 1282.

18 See F Carbonetti, 'La nuova disciplina delle offerte pubbliche di acquisto' [1998] *Rivista delle società* 1358, 1361, that adds that "the market egalitarianism may certainly justify imposing the burden of guaranteeing fair treatment of shareholders; yet it does not justify the mandatory bid as the only mechanism for acquiring control".

19 See A Dyck and L Zingales, 'Private Benefits of Control: an International Comparison' [2004] *Journal of Finance* 537, 564.

activism in the market for corporate control.²⁰ However, the literature is traditionally divided as to which aim should be pursued with greater resolution. As seen above, some authors have historically felt that pursuing contendibility for corporate control allows indirectly to ensure also an adequate level of protection of minority shareholders.²¹ Other authors argue the opposite view.²² Recently, policy debates have revealed also an intermediate position, according to which takeovers should be neither hampered nor promoted, as it is true that “takeovers may be both value-creating and value-decreasing, but there is no way to tell *ex ante* whether they are of the former or the latter kind” and therefore it is desirable to adopt a so-called “neutral approach”.²³

More realistically, however we believe that the described trade-off not only suggests to avoid extreme solutions in choosing between the two conflicting purposes, but also makes their joint pursuing through equidistant approaches particularly difficult. These latter approaches may obviously be a hope, but we have to point out how the extent to which the two aims are pursued is the effect of a decision, mainly political; the regulation of the market for corporate control can therefore be seen as the result of the political vision of the regulator about the degree of achievement of the two aims mentioned above; vision that is not necessarily immutable, but that can indeed vary depending on the financial system considered, the socio-economic context and cultural tradition and the various ideological positions. This position is easily supportable by observing not only the presence of different takeover regulations from State to State, but also the alternation, within the same State, of completely different regulations.

III. Tools of a Takeover Regulation

Once the two traditional policy purposes of a takeover regulation have been identified, the existence of a certain conflict between those goals has been recognised and the necessary political nature of the relevant trade-off solution has been clarified and all the above is borne in mind, it is necessary to consider

20 See SJ Grossman and O Hart, ‘Takeover Bids, the Free-rider Problem, and the Theory of Corporation’ [1980] *Bell Journal of Economics* 11, 42.

21 See Manne, ‘Mergers and the Market for Corporate Control’ *op cit*, 110.

22 See J Stein, ‘Takeover Threats and Managerial Myopia’ [1988] *Journal of Political Economy* 16, 61; A Shleifer and R Vishny ‘Management Entrenchment: The Case of Manager-Specific Investment’ [1989] *Journal of Financial Economics*, 25, 123.

23 See L Enriques, R Gilson and AM Paces, ‘The Case for an Unbiased Takeover Law (with an Application to the European Union)’ [2013] *Harvard Business Law Review* 85, 117; L Enriques ‘European Takeover Law: the Case for a Neutral Approach’ in F Panunzi (ed), *Institutions and Markets* (Milan 2010), 26.

what instruments are present in regulators' "tool-box" in this rather special area. In particular, it is necessary to investigate what traditional tools market regulators have at their disposal when implementing a takeover regulation and what the impact of these tools is on each purpose, whether positive, neutral or negative. In fact, the creation of a regulatory system and the possibility of achieving a certain point of equilibrium in the trade-off solution depends on how these tools are assembled. However, the ability to provide a critical assessment of a given regulatory system depends on a knowledge of these tools. By observing regulatory traditions in this area, it is plausible to argue that the creation and assessment of a takeover regulation depends on a variety of tools, here distinguishable into "primary" and "secondary" instruments.

"Primary" instruments are those levers that regulators are forced to take into account, with the result that – according to certain doctrine²⁴ – even their non-adoption is in itself a clear choice of legal policy that cannot be considered neutral. This category includes (A) the presence or absence of procedural rules for corporate control transactions and (B) the presence or absence of a mandatory bid rule (MBR).

"Secondary" instruments are those levers that regulators may choose to use only in presence of an MBR. In the absence of an MBR, the problem of their desirability does not arise, because such a problem exists only if an MBR is present. This category includes (1) the nature of conditions of the MBR, (2) the presence or absence of the rule that requires, when an MBR is pending, the extension of the chance to sell their shares to all the target company's shareholders (the so-called "totalitarian rule") and (3) the nature of the criteria for determining the offer price when an MBR is pending.

1. Primary Instruments

It has already been stated that the category of instruments defined as "primary" includes (A) the presence or absence of procedural rules for the corporate control transactions and (B) the presence or absence of an MBR.

With regard to the first regulatory lever, it is necessary to make a preliminary consideration. All evolved legal systems have regulations regarding the circulation of goods in general, in the form of general law on the transfer of ownership of things. These regulations are split into a procedural part (provisions regarding the act and, therefore, the ways in which the contract is concluded) and a substantial part (provisions regarding the relationship and, therefore, the effects of the conclusion of the contract). As regards the procedural aspect in

24 See N Irti, *L'ordine giuridico del mercato* (Bari 1998), 11.

such legal systems, anyone wishing to acquire goods may address his purchase proposal to a specific recipient who is the current owner of that good and wait for acceptance, or otherwise may address his purchase proposal to an undetermined recipient – i.e. the public – and wait for one or more of the current owners of that good to adhere to the offer. When the transfer involves the “goods-corporate control”, the ways in which the contract are concluded do not differ and, as mentioned above, may be represented by a “private treaty” (when the acquisition proposal is addressed to an identifiable recipient) or by a “public offer” (when the acquisition proposal is addressed to an undetermined recipient, i.e. the target company’s shareholders). However, what differs is the nature of the goods exchanged, because the “goods-corporate control” has peculiar and distinctive connotations because of its quantitative and qualitative relevance both at a macro-economic and at a micro-economic level. In fact, the relationship between the “transfer of goods in general” and the “transfer of corporate control in particular” can be considered as a relationship between *genus* and *species*, simply because of the special features of the goods transferred. This special circumstance would then be able to justify the presence of a “special law of transfer of ownership of corporate control”, which could in turn legitimately split depending whether the way in which the contract is concluded is by an acquisition proposal to an identifiable recipient (“private treaty”) or to an undetermined recipient (“public offer to the target company’s shareholders”).²⁵ At EU level, special procedural rules for the private treaty do not exist yet, but there are some special procedural rules for the public offer which are represented for example by the presence of certain obligations of disclosure and communication (Articles 6 and 8 of the Directive), by the passivity rule (Article 9) and by the neutralization of multiple voting shares (Article 11). This regulatory tool hence expresses the degree

25 Once what is justifiable has been clarified, we must still discuss what is hypothetically possible. With respect to the provisions of law for transfer of ownership of things, legislators may in fact address the issue of procedural rules for the transfer of corporate control in four ways: (i) they may decide not to envisage any special rights for the transfer of corporate control whether by private agreement or by takeover bid, thus applying the applicable rules of law to both, i.e. that regarding ordinary proposal and acceptance for the former and public offers to the latter; (ii) they may decide to set up a special law for transfer of corporate control for both private agreements and takeover bids, thus applying the specific provisions put in place for each while law will regulate only the remaining issues; (iii) they may decide to set up a special right of transfer of corporate control for private agreements, but not for public takeover bids, thus applying the specific provisions envisaged to the former, while the public takeover bids will be subject to the provisions of law relating to public offers; (iv) they may decide to set up a special law of transfer of corporate control for public takeover bids, but not for private agreements, thus applying the specific provisions envisaged to the former, while private agreements will be subject to the provisions of law relating to proposal and acceptance. See N Irti, *L'età della decodificazione* (Milano 1989), 23.

of rigour that regulators choose for the procedural regulation for the corporate control transactions. Having said that, it is now possible to consider what the impact of the possible presence of control transactions' special procedural rules is on the above-mentioned policy purposes. Before proceeding, it should be pointed out that the degree of rigour that regulators can confer on a take-over regulation by using special procedural rules is influenced by two distinct factors. Firstly, the level of restrictiveness of rules that may be established to regulate private treaties and public offers is very important. Less restrictive rules (e.g. because rules do not exist or because rules exist but are not strict with regard to self-defence techniques) will have a positive impact on the contendibility of corporate control and a negative impact on the protection of minority shareholders. Conversely, more restrictive rules (e.g. because rules are strict with regard to self-defence techniques or communication obligations) will adversely affect the contendibility of corporate control while having a positive effect on the protection of minority shareholders. Secondly, the scope of the rules possibly established to regulate private treaties and public offers is also very important. The greater breadth of less restrictive rules, or the lesser breadth of stricter rules, will have a positive impact on the contendibility of corporate control and a negative impact on the protection of minority shareholders and, conversely, the smaller amplitude of less restrictive rules or the greater amplitude of stricter rules will adversely affect the contendibility of corporate control while having a positive effect on the protection of minority shareholders.²⁶

Once the extent of the impact of the first lever on the policy purposes has been clarified, the assessment of the impact of the second regulatory instrument (the presence or absence of an MBR) on the same goals becomes more intuitive. The presence of an MBR clearly increases the level of transparency, as it requires the acquisition proposal to be made publicly. However, the corporate control transaction is more burdensome. The presence of an MBR will have an adverse effect on the contendibility of corporate control and a positive effect on the protection of minority shareholders. By contrast, the absence of an MBR decreases both the level of transparency and the burden of the transaction, thus positively affecting the contendibility and negatively affecting the protection of minority shareholders. The Takeover Bids Directive makes a clear choice and opts for the introduction of the MBR at European level, by providing in Article 5 that, "where a natural or legal person holds securities of a company which give him/her a specified percentage of voting rights in that company, Member States shall ensure that such a person is required to make a bid".

26 See FH Easterbrook and DR Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' [1981] *Harvard Law Review* 1161, 1168.

2. *Secondary Instruments*

It has been said that the category of instruments defined as “secondary” (i.e. only usable in presence of an MBR) includes (1) the nature of conditions of the MBR, (2) the presence or absence of the rule that requires, when an MBR is pending, the extension of the chance to sell their shares to all target company’s shareholders and (3) the nature of the criteria for determining the offer price when an MBR is pending.

Doctrine and jurisprudence have long debated the nature of conditions of the MBR. Traditionally, the conditions of the MBR are alternately represented, on the one hand, by the intention to acquire or the acquisition of corporate control or, on the other hand, by the passing of a fixed threshold of the target company’s share capital. If the first condition is preferred, then any form of transfer of control will lead to an obligation to launch a takeover bid and this will have a positive impact on the protection of minority shareholders, but adversely affect the contendibility. If the second condition is preferred (as the Directive has opted for, when Article 5 refers to “a specified percentage of voting rights”), then there are a number of considerations to take into account. Firstly, forcing those who pass a share capital’s fixed threshold (and not those who acquire an unclearly identified “corporate control”) to launch a takeover bid brings a greater certainty in the law and in the market, because it takes into account an objective, and objectively detectable, condition. In doing so, the protection of minority shareholders and transparency will be better pursued.²⁷ Secondly, a pre-established fixed threshold should make it possible to pursue even greater contendibility. Given that the obligation to launch a takeover bid would not operate below the threshold, it would enable great freedom of movement for those who intend to take over the company within the limits of the threshold; therefore, below the threshold, a person would be able to buy and sell the company’s shares freely and without any obligation to launch a takeover bid.²⁸ While remaining below the threshold then, transfers for corporate control may also occur without any obligation to launch a takeover bid. Thirdly, the introduction of a fixed threshold may have a positive effect on contendibility, but its actual operation might also have an adverse effect. In fact, an obligation to launch a takeover bid might also arise when a person passes the threshold without purchasing the corporate control. Should this be the case, the choice to use the passing of a fixed threshold should be accompanied by the choice of which fixed threshold may be used. A very high

27 See Davies, ‘The Notion of Equality in European Takeovers Regulation’, *op cit*, 14; Andrews, ‘The Stockholder’s Right to Equal Opportunity in the Sale of Shares’, *op cit*, 515. As noted by Costi, *Il mercato mobiliare*, *op cit*, 86, the probable assumption is that the threshold fixed coincides with the controlling interest.

28 See JC Coffee, ‘Regulating the Market for Corporate Control’, *op cit*, 1289.

threshold would facilitate transfers of control of a company and its contendibility, but probably would weaken the protection of minority shareholders, because if the transfer of control occurred frequently without the obligation to launch a takeover bid, then a regulation inspired to equal treatment and transparency “would be triggered” only rarely.²⁹ Conversely, a very low threshold would ensure a stronger protection of minority shareholders, but would rigidify the market for corporate control and reduce contendibility, thus obtaining the opposite effect to that which the choice of a fixed threshold aimed to produce.³⁰ On this point, the Directive does not make a clear choice, as Paragraph 3 of Article 5 states that “the percentage of voting rights which confers control and the method of its calculation shall be determined by the rules of the Member States in which the company has its registered office”, opening – however – a path to piecemeal solutions.

With regard to the presence or absence of the rule that requires, when an MBR is pending, the extension of the chance to sell their shares to all target company’s shareholders, the presence of the totalitarian rule increases the chance for minority shareholders to exit, as well as the burdensomeness of the transaction and will adversely affect contendibility and positively affect the protection of minority shareholders. Conversely, the absence of the totalitarian rule decreases the opportunity for minority shareholders to exit as well as the burdensomeness of the transaction and, therefore, will have a positive impact on the contendibility and a negative impact on the protection of minority shareholders. The Directive opts for the first solution and – still in Article 5 – provides that the bid “shall be addressed to all the securities’ holders for all their holdings”.

With regard to the nature of the criteria for determining the offer price when an MBR is pending, the presence of mechanisms that allow minority shareholders to obtain the same price paid by the new controlling shareholder to acquire control, increases the chance of minority shareholders to participate in the distribution of the bonus for control as well as the burdensomeness of the transaction and, therefore, negatively affect the contendibility and positively affect the protection of minority shareholders. Conversely, the absence of such mechanisms decreases the opportunity of minority shareholders to participate in the distribution of the bonus for control as well as the burdensomeness of the transaction and, therefore, will have a positive impact on contendibility and a negative impact on the protection of minority shareholders. The Directive makes a balanced choice by introducing the notion of “equitable price” as “the highest price paid for the securities by the offeror over a period, to be

29 See Davies and Hopt, ‘Control Transactions’, *op cit*, 161.

30 See F Belli, ‘Alla soglia del 30% scatta l’Opa obbligatoria’ [1998] Guida al diritto de Il Sole-24 Ore 141, 143.

determined by Member States, of not less than six months and not more than twelve before the bid”.

IV. Conclusion

The combination of all the regulatory tools described above directly expresses the combination of the policy purposes pursued by the regulators in building a regulatory system and – in its assessment – represents a means of understanding and interpretation of the related results. Therefore, the political nature that is intrinsic to the regulatory choices makes it difficult to attempt to formulate an absolute judgment on a given regulation; if this is true, then a regulation assessment must necessarily be made in a comparative way. In this regard, the diversity of the structures of the financial systems, the transformation of the socio-economic contexts, and the fragmentation and change both of cultural traditions and of the political positions show not only the presence of different takeover regulations from State to State, but also a succession of different regulatory systems within the same State.

During the early 90s, regulators of several EU Countries (e.g. Italy, France) developed a strong sensitivity to the issue of the protection of minority shareholders and opted for models with the MBR characterized also by the presence of special procedural rules for all the takeover bids (communication duties and passivity rule) which would therefore tend to sacrifice contendibility.³¹ However, due to the particular combination of the various levers, in most cases, the models adopted by the individual Member States seemed to reach a more refined balance point. Compared to the pre-90s regimes, for example, the degree of protection of minority shareholders improved also because of the presence of a MBR, often configured as totalitarian and often aimed at promoting a still reasonable price (for example, the so-called weighted average price of the shares in the last 12 months). However, even the efficiency profiles are improved. Despite the presence of a mandatory-and-totalitarian bid rule, there is also a positive impact on contendibility, thanks to both the presence of a fixed threshold (often 30%), and the prediction of the preventive-and-voluntary takeover bid as hypothesis of exemption from the MBR, as well as the particular criteria for determining the offer price. This is the background for the debate on the European takeover bids that led to the adoption of the Takeover Bids Directive.³² What is important is the fact that the Directive tries to introduce a common playing field at the EU level. However, the need for

31 See R La Porta and others, ‘Corporate Ownership around the World’ [1999] *Journal of Finance* 471, 480.

32 See B Clarke, ‘European Union Articles 9 and 11 of the Takeover Directive (2004/25) and the Market for Corporate Control’ [2006] *Journal of Business Law* 355, 361.

harmonization is substantially frustrated by the fact that, with reference to some regulatory tools (passivity rule, multiple voting shares and – as seen above – conditions of the MBR), the Directive introduces the so-called “optional arrangements” (Article 12), which allow individual Member States to provide for derogations that, ultimately, are unable to make the European market truly “common” as regards corporate control. This circumstance – combined with the approach of the financial crisis – generated a greater risk for the more highly regulated and weaker companies (for example, the Italian ones) of being targets of hostile takeovers by the less regulated and stronger companies (for example, the German ones) and therefore allows a better understanding of subsequent developments of the various legal systems in the field. In fact, the implementing regulations (for example, the Italian ones) have introduced several changes to previous regulatory tools: new exceptions to the passivity rule; the so-called reciprocity rule, that is the *ex lege* disapplication of the passivity rule when the takeover bid is launched by a company which is not subject to a similar obligation; the amendment in a stricter sense of the criteria for determining the price, which becomes equal to the highest price of the shares registered in the last 12 months. All this shows how the national regulators have gradually moved towards greater protection of minority shareholders and lesser contendibility for corporate control, with the result of curbing efficiency profiles and the mobility of corporate ownership. And all this, not only for greater sensitivity towards profiles of fairness, but also – I would say – as a form of self-defence against a backlash of protectionism coming from other Member States, fuelled by the combination of the lack of harmonization and the recent financial crisis.³³

That said – and regardless of this – what is relevant is that the proposed analysis model seems to allow, on the one hand and given specific policy purposes, to indicate the possible regulatory tools to pursue those purposes and, on the other side and given a determined takeovers regulation, to make a detailed *ex-ante* assessment in targeting efficiency profiles or fairness profiles. Ultimately, the proposed model would serve to more clearly interpret a period of the past and to imagine possible future developments.

33 See Enriques, Gilson and Paces, ‘The Case for an Umbiased Takeover Law’ *op cit*, 117.