Creeping Acquisitions in Europe: Enabling Companies to Be Better Safe than Sorry

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Abstract

Creeping acquisitions - grabs of a company's de facto control without the launch of a formal tender offer – are an acquisition technique that presents many risks. Not only can stock prices be negatively affected in the short term (after the acquirer is satisfied by the stake it accumulates, the stock price is likely to drop below pre-acquisition values and the remaining shareholders are stuck with minority shares), but such acquisitions can also have long ranging consequences for the market for corporate control (too many acquisitions by suboptimal acquirers, as well as permanent loss of a company's contestability status and therefore of any prospects to obtain a control premium), as well as in the governance of a company (de facto control can lead to the extraction of higher private benefits of control). Notwithstanding all such risks, EU corporate and M&A laws largely fail to address the issue, both at the European level and in individual member states. As a result, European public companies can easily become the target of a creeping acquisition, whereas poison pills and other defensive mechanisms have shielded U.S. companies quite effectively. This paper argues that a legislative overhaul of current regimes - especially of the mandatory bid system - to address creeping acquisitions may well be overreaching given the drawbacks of one-size-fits-all solutions and the risk of shutting down the market for corporate control or clamping down hedge fund activism. Instead, this paper recommends a lift on existing limitations to a company's freedom to determine its preferred level of openness to creeping acquisitions (and takeovers more generally). European legislation should provide an optional regime whereby companies can select effective arrangements to thwart or limit creeping acquisitions.

Keywords: Corporate Governance, Mergers and Acquisitions, Takeovers, Creeping Acquisition, Tender Offer, Mandatory Bid Rule, Poison Pill, Enabling Rules, Hedge Fund Activism, Substantial Acquisition Rules, European Takeover Regulation

JEL Classifications: D21, G32, G34, G38, K22

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Abstract

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I. INTRODUCTION

Corporate governance and mergers and acquisitions ("M&A") markets around the world testify of a significant evolution in the last few decades: thanks to changes in ownership structures and business practices, shareholders have gotten increasingly more powerful, and can sometimes be considered virtually, and however jointly, in control even in dispersed ownership companies.[1]

That has been since long the case in the United Kingdom, where institutional investors have often been able to coalesce and keep management on a tight leash.[2] The same is ever more true for the U.S. as well. Traditionally passive institutional investors, thanks both to law reforms and to the sheer size of their aggregate and individual holdings, now massively exercise their voting rights in U.S. companies and take sides with specialized corporate governance intermediaries, namely activist hedge funds, who aim to discipline management in a way that was previously possible only via a hostile bid.[3]

Even in continental Europe, despite the lower degree of average ownership dispersion,[4] activist investors have agitated for change, especially – but not exclusively – in companies with no controlling shareholder (or coalition).[5] In Europe, activists can

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[1] *See generally* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PENN. L. REV. 1907, 1909-26 (2013).

[2] *See* Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2034-41 (1994).

[3] *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 889-901 (2013); Rock, *supra* note 1, at 1922-23.

[4] *See e.g.* Julian Franks, Colin Mayer, Paolo Volpin & Hannes F. Wagner, *The Life Cycle of Family Ownership: International Evidence*, 25 REV. FIN. STUD. 1675 (2012).

[5] *See* Marco Becht, Julian Franks & Jeremy Grant, *Hedge Fund Activism in Europe* 8-24, ECGI Finance Working Paper No. 283/2010, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616340 (last visited Jul. 28, 2014) (providing evidence on hedge fund activism in France, Germany, Italy, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom); Jan Fichtner, *Activist Hedge Funds and the Erosion of Rhenish Capitalism:*

even lever upon corporate law rules that are traditionally much more shareholder-empowering than in the U.S.[6]

In this environment, the agency problems the market for corporate control traditionally tackled can also be addressed by the "market for corporate influence,"[7] which does not require any single shareholder to gain full control, let alone to take the company private. To be sure, the market for corporate control complements and reinforces the market for corporate influence, because both activists and third parties having gained interest in the target following an activist's campaign may force change via a takeover bid.[8] Yet, other things equal, a full-blown change in control by way of a (hostile) takeover is less necessary than in the past to bring change to a company's strategies.

In the new landscape, aggressive strategies that in the past may have been condoned as the necessary evil in a world where unsolicited takeovers were (at least according to some) a force for good can now be judged more evenly for the risk they pose to a company and its shareholders. One of such strategies is the creeping acquisition ("CA"), that is, the more or less surreptitious building of a stake large enough to secure control, negative control or at least the assurance that full control can be acquired at low cost, given the low probability of competitive bids and resistance.

The Impact of Impatient Capital, CCGES/CCEAE Working Paper 17 (2009) at 17-22 *available at* http://ccges.apps01.yorku.ca/wp/wp-content/uploads/2008/12/Activist-hedge-funds-and-the-erosion-of-Rhenish-capitalism1.pdf (last visited July 28, 2014) (describing hedge fund activism in Germany); Massimo Belcredi & Luca Enriques, *Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: The Case of Italy* 23-29, ECGI Law Working Paper No. 225/2013, *available at* http://ssrn.com/abstract=2325421 (last visited Jul. 28, 2014) (providing anecdotal evidence on shareholder activism in companies with a controlling shareholder or a controlling coalition in Italy).

[6] *See generally* Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697, 738-44 (2005).

[7] The expression was coined by Brian Cheffins & John Armour, *The Past, Present and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 58-60 (2011).

[8] *See e.g.* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1040-42 (2007).

CAs are a familiar feature of the market for corporate control in Europe. A few examples from European M&A practice in the last fifteen years will suffice to illustrate how CAs can be used to aim for control, or to facilitate acquisition thereof at a later stage.[9]

A. LVMH/Gucci. Between January 7 and January 18, 1999, luxury giant LVMH accumulated a 26.7% stake in fashion house Gucci NV, a Dutch corporation with dual listing on the NYSE and Amsterdam Stock Exchange.[10] By January 25, LVMH's stake in Gucci was approximately 34.4%: the bulk of the shares was purchased privately from strategic and institutional investors, while about twenty percent of the stake was purchased on the market.[11] LVMH declared it had no intention to launch a full-blown tender offer for the remaining shares (back then, there was no requirement to launch a bid following acquisition of control in the Netherlands),[12] thus acknowledging that it was essentially trying to obtain control through a CA.[13] In February, after LVMH refused to enter into a standstill agreement as a preliminary step towards a potential deal the companies' CEOs had been discussing, Gucci finally responded by issuing new shares pursuant to an employee stock ownership plan and diluting LVMH to twenty-six percent.[14] Subsequently, Gucci granted a forty percent stock lock-up to LVMH's

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[9] As any other acquisition technique CAs can well fail their purpose of granting control to the acquirer, as some of the examples illustrate.

[10] *The 30-Month Fight for Gucci*, 3 THE M&A JOURNAL, I (2002), *available at* http://www.themandajournal.com/sample_issue/sample.asp (last visited Jul. 28, 2014).

[11] *Id.*

[12] *See* Luca Enriques, *The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization as Rent-Seeking? in* REFORMING COMPANY LAW AND TAKEOVER LAW IN EUROPE 767, 795 n.108, (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004).

[13] *A Bid for Gucci? Not Now, LVMH Says*, N.Y. TIMES, January 14, 1999, *available at* http://www.nytimes.com/1999/01/14/business/international-briefs-a-bid-for-gucci-not-now-lvmh-says.html (last visited Jul. 28, 2014); *LVMH Raises Its Stake in Gucci to 26.7%*, N.Y. TIMES, January 18, 1999, *available at* http://www.nytimes.com/1999/01/18/business/lvmh-raises-its-stake-in-gucci-to-26.7.html (last visited Jul. 28, 2014).

[14] Bryan Burrough, *Gucci and Goliath*, VANITY FAIR, July 1999, 5, *available at* http://www.vanityfair.com/culture/features/1999/07/lvmh-gucci (page 5 of 7) (last visited Jul. 28, 2014).

competitor, PPR.[15] At that point, LVMH launched a full-blown tender offer and, having been diluted to twenty percent, commenced litigation against Gucci and PPR, which in turn countersued.[16] In the end, the three parties settled and Gucci ultimately fell under PPR's control, but LVMH got out with a substantial capital gain: while its hostile acquisition was successfully rejected because of the effective use by Gucci of the defensive tools offered by Dutch corporate law,[17] LVMH was eventually able to score a hefty profit out of the attempted CA.[18]

B. NASDAQ/LSEG. A few months after rejecting a £1.6 billion offer from Macquarie Bank, in March 2006, the London Stock Exchange Group ("LSEG") received a £2.4 billion bid from NASDAQ, which LSEG rejected as well.[19] Shortly thereafter, NASDAQ dropped its bid and purchased shares from LSEG's then largest shareholder and in the open market.[20] Having built a stake close to twenty-nine percent, NASDAQ launched a new offer in November 2006.[21] NASDAQ's increased stake in LSEG ensured that no competitive bids would arise.[22] However, the offer failed as only

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[15] *Id.* at 6.

[16] *See* John Carreyrou, *PPR to Gain Control of LVMH, Ending Bitter Industry Dispute*, WALL ST. J., Sept. 11, 2001, *available at* http://online.wsj.com/article/0,,SB1000107727807086136.djm,00.html (last visited Jul. 28, 2014).

[17] *See generally* Abe de Jong & Ailsa Röell, *Financing and Control in The Netherlands: A Historical Perspective*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS, 467, 484-91 (Randall K. Morck ed.; 2005).

[18] *Id.*

[19] Edgar Ortega & Nandini Sukumar, *Nasdaq Buys 15 Percent Stake in LSE for $782 Million (Update5)*, BLOOMBERG, April 11, 2006, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aY106PolhKUQ&refer=us (last visited Jul. 28, 2014).

[20] *Id.*

[21] *London Stock Exchange's Tumultuous History of Bids*, THE TELEGRAPH, September 2, 2011 *available at* http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8311679/London-Stock-Exchanges-tumultuous-history-of-bids.html (last visited Jul. 28, 2014).

[22] *LSE Woos Tokyo after US Bid Fails*, BBC NEWS, Feb. 11, 2007, *available at* http://news.bbc.co.uk/2/hi/business/6351555.stm (last visited Jul. 28, 2014).

an additional 0.4% accepted it[23] and NASDAQ ultimately abandoned the acquisition attempt in 2007, when it sold its LSEG stake to Borse Dubai.[24]

C. Schaeffler/Continental. In 2008, Schaeffler AG, a German company, stealthily built a thirty-six percent stake in Continental AG via direct purchases (2.97%), physically settled equity swaps (4.95%) and various cash-settled equity swap contracts (twenty-eight percent), before launching a takeover bid aimed to purchase up to 49 percent of Continental shares.[25] This 2008 case was especially controversial, because the acquirer took advantage of a loophole in the German ownership disclosure rules to announce its takeover plan only after it had secured the thirty-six percent block.[26] After an unsuccessful legal challenge focusing on the use of swaps to hide ownership before the German regulator, Continental capitulated and Schaeffler reached the desired stake of forty-nine percent via a low-premium tender offer for all outstanding shares.[27]

D. Lactalis/Parmalat. On March 18, 2011, French dairy company Lactalis disclosed a five percent stake in post-bankruptcy and widely-held Italian dairy company Parmalat, together with an equity swap contract for an additional seven percent of Parmalat shares.[28] In the next few days, Lactalis bought the blocks held by three activist funds that were planning to engage in a proxy contest for the board election, thereby

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[23] *Id.*

[24] Niklas Magnusson & Will McSheehy, *Dubai to Buy Stakes in Nasdaq, LSE; Strikes OMX Deal (Update3)*, Bloomberg, Sept. 20, 2007, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aqzGAS7oAezg&refer=home (last visited Jul. 28, 2014).

[25] See Dirk A. Zetzsche, *Hidden Ownership in Europe: BAFin's Decision in* Schaeffler v. Continental, 10 EUR. BUS. ORG. L. REV. 115, 118-19 (2009).

[26] *Id.* at 126-27 (reporting the German regulator's conclusion that Schaeffler had not violated German securities laws by failing to disclose its holdings via derivatives in Continental).

[27] *Id.* at 125-26.

[28] *See* Consob publicly available information at http://www.consob.it/main/emittenti/societa_quotate/query_partecipazioni_r.html?queryid=partecip_r&title=PARMALAT%20SPA&resultmethod=partecip_r&search=1 (last visited Jul. 28, 2014).

increasing its direct stake to 13,96%.[29] It also secured an additional eight percent via equity swaps, thereby getting close to the Italian threshold for the mandatory bid (thirty percent).[30] In the same period, backed by the Italian Government and Parmalat's management, one of Italy's two main banks (Banca Intesa) was trying to organize a pool of Italian investors to secure control of Parmalat in Italian hands.[31] However, the twenty-nine percent stake built by Lactalis basically put an end to Banca Intesa's takeover plan,[32] which could only have succeeded by launching a much more expensive competing tender offer for 100% of the shares. Instead, a few weeks later, Lactalis launched a voluntary tender offer on 100% of the shares for a price that was seven percent lower than what it paid to the three activist funds for their blocks.[33]

This paper focuses on CAs to discuss what their regulation should be in Europe. Part II outlines the potential perils of CAs. As some of the previous examples illustrate, from the standpoint of target shareholders,[34] CAs are more dangerous than full-blown takeover bids. First, all of the long-standing requirements aiming to ensure disclosure

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[29] *Id*.

[30] *Id*.

[31] *See e.g. Parmalat, in Campo Ferrero-Intesa. E Confindustria Plaude la Cordata Italiana*, AdnKronos, March 24, 2011 *available at* http://www.adnkronos.com/IGN/News/Economia/Parmalat-in-campo-Ferrero-Intesa-E-Confindustria-plaude-a-cordata-italiana_311825826803.html (last visited Jul. 28, 2014).

[32] *See e.g.* Giorgio Meletti, *Così Lactalis e gli amici italiani hanno spolpato ancora la Parmalat*, June 13, 2013 *available at* http://www.ilfattoquotidiano.it/2013/06/13/cosi-lactalis-e-amici-italiani-hanno-spolpato-ancora-parmalat/625383/ (last visited Jul. 28, 2014).

[33] Belcredi & Enriques, *supra* note 5, at 22.

[34] We focus on shareholders here for the reasons highlighted in Luca Enriques, Ronald J. Gilson, & Alessio M. Pacces, *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, 7-8 ECGI Law Working Paper No. 212/2013, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2258926 (last visited Jul. 28, 2014):

> takeovers are merely one way in which corporations respond to changes in economic conditions. … the scope and the features of the safety net protecting individuals and communities against the effects of economic and regulatory change are only relevant to the takeover debate if takeover regulation is the best (or the only) protection tool available. Because we have not seen that position carefully presented in the takeover debate, our discussion of takeover regulation in the following does not further consider it.

and equal treatment and to avoid pressure to tender[35] pending a takeover bid do not apply to CAs.[36] Second, following a CA, the remaining minority shareholders can kiss goodbye to the prospects of getting a control premium in the near future. Third, even when a full-blown tender offer follows a CA, the likelihood of a competing bid goes down considerably, allowing the bidder to offer a lower premium.

Part III describes the rise and fall of CAs in the U.S. and how in the 1980s the combined action of federal and state legislation, on the one hand, and the poison pill and Delaware courts' broad endorsement thereof, on the other, thwarted CAs.

Part IV describes how EU law handles CAs: it first analyzes what could be considered the main "anti-CA" devices present in current European legislation, namely in the Transparency Directive[37] and in the Takeover Bids Directive,[38] and comes to the

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[35] Pressure to tender is a phenomenon peculiar of the tender offer structure: it is the risk that shareholders tender their shares to a low-ball bid even if they believe it is not in their best interest to do so: tendering represents a second-best strategy given the risk of being stuck with lower-value minority shares after an acquisition succeeds. *See generally* Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1722-23 (1985). This scenario is the result of a "rational" failure by shareholder to coordinate to reject the low-ball offer because of collective action dynamics. Partial bids and two-tier front-end loaded tender offer are inherently more problematic (the Delaware judiciary labels such offers as structurally coercive, following Ronald J. Gilson & Reiner Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is there Substance to Proportionality Review?* 44 BUS. LAW. 247, 260 (1989)) given that even if all shareholders tender, they would still be stuck with minority shares if the bidder succeeds. Over the years, jurisdictions have adopted limitations to a bidder's freedom to shape its bid, which are aimed at addressing pressure to tender: certain disclosures, minimum tendering periods, pro-rata rules, best-price rules, bans or limits to partial offers, minimum acceptance conditions, second-rounds of tendering periods and takeover defenses are some of the many devices jurisdictions have resorted to. For an analysis of European equal treatment rules as a limit to divide-and-rule strategies by bidders, *see* Paul. L. Davies, *The Notion of Equality in European Takeover Regulation*, *in* TAKEOVERS IN ENGLISH AND GERMAN LAW 9, 13-16 (Jennifer Payne ed., 2002).

[36] Unless of course the acquirer itself chooses to launch a tender offer. Clearly, if the tender offer is launched at a later stage, the tender offer rules will not protect shareholders from the initial phase of the acquisition, the CA itself.

[37] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, Dec. 31, 2004, 38-57), as last amended by Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 (OJ L 294, Nov. 6, 2013, 13-27) [hereinafter Transparency Directive].

conclusion that such devices are insufficient to substantially curb CAs. Next, we turn our attention to obstacles to defending against creeping acquirers in the EU (both at the European and member state level), showing that the legality of certain company-enacted contractual devices that could effectively curb CAs is at least doubtful as a matter of European law. In Part V we argue against tackling CAs via new mandatory rules, such as refinements to the regulation of mandatory bids. In Part VI, we call for a reform granting companies more leeway in devising defenses against creeping acquisitions, which we believe would be the best option from a European policy perspective. Part VII concludes.

II. A FRAMEWORK TO ASSESS THE PROBLEMS WITH CREEPING ACQUISITIONS

The pros and cons of CAs can be analyzed by looking at (1) their effect on stock prices during, and in the immediate aftermath of, the CA, (2) their effect on allocative efficiency in the market for corporate control and (3) their corporate governance implications.

A. Short-term Impact on Stock Prices. The immediate effects of CAs on the stock price of the target company are ambivalent. On the one hand, CAs drive the target's stock up and bring liquidity, both positive features. On the other, such effects tend to be temporary (they vanish as soon as the acquirer stops purchasing when it gets to the desired ownership level)[39] and only benefit those stockholders who sell to the acquirer:[40] CAs leave several market participants stuck with post-acquisition minority

[38] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OJ L 142, Apr. 30, 2004, 12-23) [hereinafter Takeover Bids Directive].

[39] Maureen F. Baker, *Proposed SEC Regulation of Market Sweeps: Should Market Sweeps Be Governed by the Williams Act?*, 56 FORD. L. REV. 797, 811 n.114 (1988).

[40] *See* Bebchuk, *supra* note 35, at 1789.

shares.[41] Also, given the unregulated nature of a CA, even shareholders who sell their shares in the street sweep have no guarantee they are selling at the highest price paid by the acquirer, which is typically what happens in a tender offer under the existing best price rules present in virtually all jurisdictions.[42] This is why some have argued that the lack of disclosure in a street sweep, especially on the intentions of the acquirer, generates uninformed selling decisions that should be addressed by regulators.[43]

B. Impact on the Market for Corporate Control. Commentators disagree on the efficiency effects of CAs on the market for corporate control. Some argue a free market for corporate control where unregulated CAs can prosper would make such market more vibrant.[44] Together with hostile takeovers, the so-called disciplinary theory goes,

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[41] *See* Lucian A. Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 917 (1987) ("[T]he post-takeover value of minority shares is generally lower than the bid price"). Although the statement is made in relation to acquisitions via a tender offer, it equally applies with respect to a CA.

[42] *See generally* SEC Rule 14(d)(10)(a)(2) promulgated under the Securities Exchange Act of 1934, §§ 13(d)-(f), 14(d)-(f), Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454 (1968), as subsequently amended [hereinafter the Williams Act], amending the Securities Exchange Act of 1934, 48 Stat. 881 et seq (1934) (codified as amended at 15 U.S.C. §§78a et seq.) [hereinafter the Exchange Act] (establishing the best price rule) *and* Article 3, par 1(a), Takeover Bids Directive providing that Member States ensure that "all holders of the securities of an offeree company of the same class must be afforded equivalent treatment…," which principle Member States have generally implemented, among other things, by each imposing its version of a best price rule: *see e.g.* Rule 6.2(a) of the City Code on Takeovers and Mergers for the U.K. *and* Article 42, par. 2, Consob Regulation no. 11971 of May 14, 1999, as amended, for Italy. *But see* Daniel R. Fischel, *Efficient Capital Market Theory, The Market for Corporate Control, and The Regulation of Cash Tender Offers*, 57 TEX. L REV. 1, 9-10 (1978) (explaining the mechanics of the best price rule under the Williams Act and questioning its purpose).

[43] Baker, *supra* note 39, at 809-810.

[44] *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1174-79 (1981) (positing that the monitoring role played by potential acquirers as well as the continual threat of takeover provides an accountability and discipline which reduces agency costs and consequently leads to higher share prices); Daniel R. Fischel, *Efficient Capital Market Theory, The Market for Corporate Control, and The Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 9-14 & 26 (1978) (arguing against regulatory requirements that reduce incentives for potential acquirers to monitor incumbent management, and thus impede the effective functioning of the market for corporate control); *see also* Dale A. Oesterle, *The Rise and Fall of Street Sweep Takeovers*, 1989 DUKE L.J. 202, 204-205 (1989) ("[P]roponents of government regulation ought to advocate legislation that revitalizes, not restricts, street sweeps."); Alan Schwartz, *The Fairness of Tender*

CAs represent optimal tools to curb agency costs in large corporations by sanctioning inefficient managing teams who cannot keep the stock price high enough to avoid a strike. This approach has raised criticism: it is countered that a proliferation of low-premium acquisitions, whether through a CA or a full-blown tender offer, represents a mere redistribution of wealth to the acquirer from the target shareholders.[45] In particular, shareholders' distorted choices are likely to determine the outcomes of attempted CAs, which in turn lead to inefficient acquisitions.[46]

Note that, after the CA, the acquirer might decide not to increase its stake; or it might decide to proceed with a full-blown tender offer. Either way, the acquirer knows the CA has decreased the likelihood of a rival bid and therefore the possibility for an auction to obtain control.[47] Similarly, even in situations in which the CA is insufficient to fully award working control, thanks to the accumulated stake the creeping acquirer

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Offer Prices in Utilitarian Theory, 17 J. LEGAL STUD. 165 (1988) (advocating for the same type of passive regime as Easterbrook and Fischel).

[45] *See* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1041-46 (1982) (illustrating that in the context of a "rule of passivity" for incumbent management, acquirers would "offer much smaller premiums" and could "acquire the target for a small premium" resulting not in a social gain but rather in a redistribution of wealth between shareholders of the target and acquirer).

[46] For an illustration, *see* Bebchuk, *supra* note 35, at 1788-89, noting that the acquisition attempt might be successful even if the majority of shareholders oppose it:

> [t]he main reason for this possibility of a distorted outcome is that shareholders approached by the buyer might agree to sell their shares even if their estimate of the independent target's per-share value exceeds [the per-share acquisition price]. For one thing, an approached shareholder will certainly sell his shares as long as his estimate of the independent target's per-share value is lower than the . . . price offered by the buyer: the shareholder will view the acquisition as making him better off, and he will be indifferent to the fact that an acquisition will make nonselling shareholders worse off. Furthermore, even assuming that shareholders would not sell their shares unless they judge the independent target's per-share value to be lower than [the per-share acquisition price], the outcome might still be distorted because of the buyer's ability to gain effective control without acquiring a majority ownership (footnotes omitted).

[47] *See* Jeremy Bulow, Ming Huang & Paul Klemperer, *Toeholds and Takeovers*, 107 J. POL. ECON. 427, 428-31 (1999) (finding that toeholds help buyers win an auction, sometimes at much cheaper terms and, as a consequence, a de facto controlling shareholder may be effectively immune to rival offers).

will still be standing in the driver's seat as soon as a full acquisition is to take place. True, if all the creeping acquirer is looking for is a resale of the control block to someone else later on, by the time of the exit, it will bargain for the best possible price. However, if the second transaction does not trigger the obligation to launch an offer for the remaining shares[48] the creeping acquirer will be the only one to make a profit out of its exit and will be replaced by a new de facto controller (or significant blockholder) as the virtually sole gatekeeper for any possible future control transaction.

In all such circumstances, companies run the risk of being taken over once and for all not by a higher value user willing to pay a premium but by someone quick to act at no real premium for all shareholders.[49] This would imply not only that shareholders of a once-potential target would lose the prospect of selling their stock at a substantial premium, but also that the control of such company would no longer be contestable and

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[48] Such an obligation might rise, as the case may be, pursuant to a mandatory bid regime or to a premium sharing doctrine (which may work, as it does in Delaware, as an exception to a more general doctrine that does not normally require sharing the control premium with other shareholders: *see generally* Einer Elhauge, *The Triggering Function of Sale of Control Doctrine*, 59 U. CHI. L. REV. 1465, 1467 (1992)).

[49] For a general discussion on how a *lassaiz faire* takeover regime would encourage quick acquisitions via low-premium offers and would not effectively prevent inefficient transactions, *see* Lucian A. Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL STUD. 197, 203-04 & 217-19 (1988). In contrast to such a regime, Professor Bebchuk argues for a "sole owner" standard in which acquisitions occur only when they are the most efficient, measured by whether the value of the assets to the bidder exceed the value of the assets to the seller. *Id*. at 203-04. Professor Bebchuk proposes the use of a delay period to allow for emergence of competing acquisition offers as well as an arrangement whereby target shareholders can approve or disapprove of the acquisition in pre-vote mechanisms. *See id.* at 221-29; *See also* Lucian A. Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 931-38 (proposing a system, to allow individual shareholders to act as "sole owners" of assets and remove "distorted choice" from the tender offer decision by requiring that bids provide for the decoupling of the decision of whether to tender or not and from the decision of whether to approve the bid or reject it); Bebchuk, *supra* note 45, at 1052-55 (arguing that a delay to facilitate competing bids for a target is beneficial and would lead to more efficient transactions in the market for corporate control). *But see contra* Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, (1988) (efficiency does not require that assets move immediately to the highest value user, as any transfer of an asset to a higher value user would be efficient) *and* Alan Schwartz, *The Sole Owner Standard Reviewed*, 17 J. LEGAL STUD. 231, (1988) (responding to Professor Bebchuk's criticism of Professor Schwartz's "market standard").

shareholders would face, to put it as Delaware courts have, a permanent "loss of voting rights"[50] without being compensated with a premium.

C. Impact on Corporate Governance. On the governance front, the controlling stake built as a result of a CA may help realign the interests of directors and shareholders given the monitoring role of the new controller: performance is said to benefit from it.[51] However, even if *managerial* agency costs are reduced, as a trade-off, a different type of agency costs will emerge: the ones stemming from the relationship between the controlling stockholder and the minority stockholders, which are a typical by-product of concentrated ownership.[52]

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[50] *See* Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 42-43 (Del. 1994), which stated that the Paramount directors were obligated to seek the best value reasonably available for stockholders to compensate for the imminent loss of voting power following the change in control of Paramount ("[W]hen a majority of a corporation's voting shares are acquired by a single person or entity . . ., there is a significant diminution in the voting power of those who thereby become minority stockholders").

[51] *See* Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461, 465 & 471-74 (1986) (illustrating how the presence of a large shareholder can effectively monitor management and influence changes that improve operating performance); Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 47-49 (2012) ("The literature in law, economics, and finance has long recognized that the presence of outside blockholders—and particularly blockholders willing to invest in monitoring and disciplining management—is beneficial for investors."). While not written in the context of creeping acquisitions, Professors Bebchuk and Jackson addressed the disciplinary and performance improvements associated with large blockholders accumulating minority positions that allow for the exercise of significant influence as opposed to outright control. *See id*. In that same vein, a related study has illustrated the monitoring-, disciplinary-, and performance-related improvements associated with hedge fund activists who, despite not having a controlling stake, tend to hold significant minority stakes. *See* Alon Brav, Wei Jiang, Frank Partnoy, & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 4 J. FIN. 1729, 1732 & 1774 (2008).

[52] *See e.g.* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 785-786 (2003) (discussing the trade-off in agency costs between incumbent management and a controlling shareholder as well as how agency problems arise in the presence of a controlling shareholder because of the likelihood that a controlling shareholder will extract private benefits of control); Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 19-20, ECGI Finance Working Paper No. 2/2002 (updated August 2005), *available at* http://ssrn.com/abstract_id=343461 (last visited Jul. 28, 2014). *Cf. also* Bebchuk, *supra* note 35, at 1763 ("In contrast to acquiring a non-controlling block, acquiring a controlling block transforms the independent target into a company with a controlling shareholder. The acquisition is likely to affect the

Additionally, the lower the control block the acquirer is satisfied with, the less the alignment with the minority shareholders and, consequently, the greater the acquirer's incentives to extract private benefits of control to their detriment.[53]

D. Ambiguous Data. Unfortunately, we are aware of no recent studies that test the welfare effects of CAs empirically.[54] Yet, there is a sizeable literature both on the efficiency of takeovers and on the impact of investments by hedge fund activists. While the massive empirical evidence on takeovers is far from univocal in confirming the virtues of takeover activity,[55] studies on activism by hedge funds tend to confirm the view that investments by such market players result in positive abnormal returns for other investors both in the immediate aftermath of the purchase announcement and in the longer term.[56] The samples surveyed by this literature cover very few investments

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way in which the target is run and the allocation of the target's assets. It affects not only the position of the selling shareholders but also that of the non-selling shareholders").

[53] Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 QUART. J. ECON. 957, 967-68, 986 (1994); John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?* 21 DEL. J. CORP. L. 359, 397-98 (1996):

> [A]s the acquirer is forced to assemble a larger block to gain control, the private benefits of control dissipate correspondingly. Put simply, while a ten percent shareholder who misappropriates corporate funds steals ninety percent of its resulting gains from the other shareholders, a thirty percent shareholder effectively misappropriates only seventy percent from the others and thirty percent from itself. Similarly, the larger and more costly the controlling block that must be assembled to enjoy the private benefits of control, the smaller the likely gains from exploitation of such private benefits (i.e., excessive compensation or unfair self-dealing) will look in relation to this initial acquisition cost (footnotes omitted).

[54] This should come as no surprise with respect to evidence related to the U.S. market, given the absence of CA activity for U.S. targets in the last 30 years or so. For a description of the CA phenomenon in the U.S. M&A market, *see infra* Part III.

[55] *Compare* Sandra Betton, B. Espen Eckbo & Karin S. Thorburn, *Corporate Takeovers, in* 2 HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 291, 356-72 (B. Espen Eckbo ed., 2d ed. 2008) (finding that the combined returns of target and acquiring companies are positive on average) *with* Klaus Gugler, Dennis C. Mueller, Michael Weichselbaumer & B. Burcin Yurtoglu, *Market Optimism and Merger Waves,* 33 MGMT. DECISION ECON. 159 (2012) (providing evidence that the long-term effects of takeovers are negative on average).

[56] *See* Alon Brav, Wei Jiang, Frank Portnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1755-60 (2008); Alon Brav, Wei Jiang & Hyunseob Kim, *Hedge Fund Activism: A Review*, 4 FOUND. & TRENDS FIN. 185, 192 & 213-22;

in which the acquirer was actually seeking control of the target.[57] In fact, hedge fund activists usually buy a significant minority stake in a company and then seek to exert influence via shareholder voice to effect changes in the company's management, operations, and/or policy without acquiring (stock-based) control themselves.[58] Thus,

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Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism* 15-26 (July 2013), *available at* http://papers.ssrn.com/abstract=2291577 (last visited Jul. 28, 2014); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 207-11 (2009); Robert Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 362-75 (2009); Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Risk, and Product Market Competition* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 17517, 2011), *available at* http://www.nber .org/papers/w17517.pdf (last visited Jul. 28, 2014).

[57] April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors* 36, ECGI Finance Working Paper No. 140, 2006, *available at* http://ssrn.com/abstract_id=913362 (last visited Jul. 28, 2014) ("[H]edge funds and other entrepreneurial activists typically do not seek control of the target"). *See also* Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 466 (2013) ("[G]iven that activist hedge funds are not mainly aggressive and do not seek control, they do not undermine the role of the board of directors"); Alon Brav, Wei Jiang, Frank Partnoy, & Randall Thomas, *supra* note 56, at 1732 ("Despite their frequently aggressive behavior, activist hedge funds do not typically seek control in target companies"); Soumyadri Chattopadhyaya, *The Effectiveness of Being Invisible: Hedge Funds, Hidden Ownership and Corporate Governance*, EUR. COMP. FIN. L. REV. 305, 312-313 (2010).

[58] Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 466 (2013). Notably, hedge fund activist target companies with greater institutional ownership and analyst coverage than other companies. *See* Alon Brav, Wei Jiang, Frank Partnoy, & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 4 J. FIN. 1729, 1730 & 1753 (2008). This may be because hedge fund activists rely on cooperation with management or fellow shareholders for implementation of value-enhancing objectives. *See id*. at 1732, 1748 & 1753; Kahan & Rock, *supra* note 8, at 1088-89; William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO L.J. 1375, 1397 (2007); Bebchuk & Jackson, *supra* note 51, at 52 (because hedge fund activists hold minority stakes in the target company, they will only be able to effect change they view as value-increasing if they can convince fellow shareholders that the proposed course of action is the correct one). True, in recent times activists have successfully managed to appoint their nominees to boards of U.S. corporations and in certain circumstances campaigns have resulted in activists controlling the board. *See* David A. Katz & Laura A. McIntosh, *Heightened Activist Attacks on Boards of Directors*, New York Law Journal, July 24, 2014 *available at* http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.23471.14.pdf (last visited Jul. 28, 2014). However, if board control is awarded to a hedge fund as a result of its success in waging a proxy fight, it is because shareholders have determined that is a better course of action for the company than sticking with the incumbent directors. We do not ignore that the directors newly appointed by the hedge fund activist can favor such investor at the expense of other minority shareholders (for instance, by redeeming a poison pill and allowing the activist to increment its stake in the company to a de facto control situation and possibly up to a de jure controlling stake). Still, we believe that in such

data on hedge fund investments cannot be a substitute for actual empirical evidence on the consequences of CAs.

Yet, it is important to acknowledge that the boundaries between shareholder activism, CAs, and full-blown acquisitions are hazy: the three phenomena easily overlap, and synergies and complementarities between them are significant. As Brian Cheffins and John Armour note, "seeking influence and seeking control constitute points on a continuum rather than being fully distinct corporate governance phenomena."[59] A CA may be functional to an aggressive strategy by a hedge fund, which may resort to de facto positive or negative control to force change on a recalcitrant board. As we have noticed already,[60] a CA may just be a first step toward a full blown 100 percent acquisition, which in turn may or may not create value. Finally, the market for corporate influence itself relies on the working of the market for corporate control, because the corporate strategy an activist may pursue could well require a (hostile) takeover if other means of persuasion do not work.[61]

Our preliminary conclusion is thus that, while there may be a case for having rules in place to curb value-destroying CAs, policymakers should tread extremely carefully in shaping them, lest they throw the baby with the bathwater.

III. A LOOK OVERSEAS: WHATEVER HAPPENED TO CREEPING ACQUISITIONS IN THE U.S.?

circumstances, in virtually all major jurisdictions, we would enter in the realm of change of control and conflicted transactions and boards would be subject to some heightened scrutiny. In Delaware, for instance, such a move would most likely trigger *Revlon* (Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, (Del. 1986) (under *Revlon* duties the role of directors switches "from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company[;]" *id.* at 182).

[59] Cheffins & Armour, *supra* note 7, at 59.

[60] *See supra* text accompanying notes 45-47.

[61] Think of a company whose entrenched management refuses to merge with another company where synergies among the two would be large.

In the U.S. CAs were common in the 1970s and early 1980s, but have been dormant for quite a long time now as a result of the successful efforts to thwart the most abusive acquisition techniques, which occurred in the mid-to-late 1980s.[62]

In the American market, unsolicited acquisitions of various shapes and forms (most notably, cash tender offers) started to replace proxy fights as means to effect a change in control during the mid-1950s (and became quite common in the early 1960s).[63] Obtaining a majority of the voting stock was not even necessary given the dynamics of dispersed ownership, which can guarantee de facto control at levels below the fifty percent threshold. Acquirers could thus secure, via market purchases (with or without a parallel tender offer),[64] significant toeholds that would give them a strong clout in the governance of the given corporation.[65]

Before the passage of the Williams Act, there were almost no limits to an acquirer's ability to secretly accumulate a significant stake: no reporting requirements on minimum levels of equity ownership, no duties to launch a formal tender offer even

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[62] Dale Oesterle was already sanctioning the demise of the technique in a 1989 article (*see* Oesterle*, supra* note 44, at 203 & 233-44 ("Recent modifications to state antitakeover legislation, poison pill plans, and Federal Trade Commission . . . rules under the Hart-Scott-Rodino Act have all but killed street sweeps. Rules proposed by the SEC and bills pending in Congress aim, perhaps unnecessarily, to supply the coup de grace" (footnotes omitted)).

Note however that although not much has happened since then, Wall Street practitioners have recently been warning clients on some activity by raider-activist "tag teams" who are exploiting "loopholes to create a new template of hostile acquisitions" via complex financial instruments and "covert accumulations" of large blocks of stock. *See* Memorandum from Wachtell, Lipton, Rosen & Katz, A New Takeover Threat: Symbiotic Activism (Apr. 25, 2014). *See also* Katz & McIntosh, *supra* note 58 (discussing "a new paradigm where activist investors actually seek to acquire control of companies without paying any control premium by pursuing all or a majority of the seats on a board of directors through a proxy contest").

[63] John Pound, *The Rise of the Political Model of Corporate Governance and Control*, 68 N.Y.U. L. REV. 1003, 1015-16 (1993).

[64] In his account of the rise and fall of street sweeps in the U.S. during the 1980s, Oesterle, *supra* note 44, at 205 notes that "[s]treet sweeps rarely occur[red] without a prior tender offer or as a single method of acquisition."

[65] *Id.* at 217 ("Prior to 1968, bidders used short-lived public offers, known as 'Saturday night specials' to buy limited amounts of target stock without full disclosure and on a first-come, first-served basis").

in the presence of a series of coordinated open market purchases, no effective devices for directors to react—all in all, an unregulated market in which an acquirer could become a company's most significant, if not controlling, shareholder almost overnight.[66]

The Williams Act introduced disclosure and procedural rules with the intent to chill acquisitions that would occur outside of the tender offer main road, while at the same time making sure that tender offers themselves were subject to several constraints for an acquirer. At the risk of oversimplifying, the two main devices embedded in the Williams Act to limit CAs were: (i) Section 13(d) required disclosure on the acquisition of beneficial ownership of five percent[67] or more within 10 days of passing the threshold[68] and (ii) the re-characterization of a series of purchases (in the open market or otherwise) as a tender offer and the applicability of its regime (mandatory disclosure, all holders rule, best price rule, pro-rata rule, etc.) if a CA meets certain conditions.[69]

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[66] ROBERT C. CLARK, CORPORATE LAW 546-47 (1986).

[67] Originally the Williams Act had a 10% threshold requirement, which a 1970 amendment lowered to 5%: *see* Bebchuk & Jackson, *supra* note 51, at 45.

[68] Under Section 13(d) of the Williams Act, investors crossing a five-percent ownership threshold have ten days to disclose that ownership stake. *See* 15 U.S.C. §78m(d)(1) (Williams Act, Section 13(d)). *Compare* Letter from Wachtell Lipton Rosen & Katz to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Mar. 7, 2011), *available at* http://www.sec.gov/rules/petitions/2011/petn4-624.pdf (petitioning the SEC to "close" Section 13(d)'s ten-day window because "[i]n today's world, ten days in an eternity") *and* Stephen Bainbridge, *The Long Overdue Closure of the 10-Day Reporting Window Under Section 13(d) Remains Overdue*, Mar. 31, 2014, *available at* http://www.professorbainbridge.com/professorbainbridgecom/2014/03/the-long-overdue-closure-of-the-10-day- reporting-window-under-section-13d.html (last visited Jul. 28, 2014) *with* Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr. & Wei Jiang, *Pre-Disclosure Accumulations By Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 31 (2013) (arguing against any tightening of the ten-day disclosure period by stating that arguments to shorten the disclosure period are founded on incorrect factual premises and lacking any empirical support).

[69] Importantly, the Williams Act provides no definition of "tender offer." Congress appears to have expected the SEC to provide guidance on what methods of acquisition would constitute a tender offer. Oesterle, *supra* note 44, at 219-20. However, on multiple occasions the SEC has rejected attempts to objectively define "tender offer." THOMAS HAZEN, THE LAW OF SECURITIES REGULATION 388 (6th ed. 2009). The SEC has resisted establishing objective standards for determining whether a tender offer exists because of "the dynamic nature of [the] transactions [involved] and the need for the Williams Act to be interpreted flexibly." Sec. Act Rel. No. 33-5731 (Aug. 2, 1976). Despite the absence of a clear definition,

Was the Williams Act effective in chilling CAs? Not really, because acquirers could still plan around it, even though the SEC's refusal to come up with a bright-line definition of tender offer sought to make pre-planning more complex.[70]

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the SEC has developed an eight-factor test to guide identification of a tender offer. *Id*. The eight factors are: (i) active and widespread solicitation of public shareholders; (ii) solicitation for a substantial percentage of the issuer's stock; (iii) whether the offer to purchase is made at a premium over prevailing market price; (iv) whether the terms of the offer are firm rather than negotiable; (v) whether the offer is contingent on the tender of a fixed minimum number of shares, often subject to a fixed maximum number to be purchased; (vi) whether the offer is open only for a limited period of time; (vii) whether the offerees are subject to pressure to sell their stock; and (viii) the existence of public announcements of a purchasing program that precede or accompany a rapid accumulation of stock. *See also* Wellman v. Dickinson, 475 F.Supp 783, 823-24 (S.D.N.Y. 1979) (discussing the SEC's suggestions in an amicus brief as to what elements are "characteristic of a tender offer"). These guidelines are meant to be broad and weighed. HAZEN, *supra*, at 389. For this reason, any predictability to arise from the factors should originate in case law. *Id*. However, judicial interpretation of the SEC's guidelines is unclear and varied. Oesterle, *supra* note 44, at 224; *see also* SEC v. Carter Hawley Hale Stores, Inc. 760 F.2d 945 (9th Cir. 1985). *But see* Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2nd Cir. 1985) (refusing to defer to the SEC's eight factor test).

Notably, some large block, open-market purchases and "street sweeps" occurring over a short time were found not to be tender offers. *See* Braascan Ltd. V. Edper Equities Ltd, 477 F.Supp. 773 (S.D.N.Y. 1979) (purchase of 25% of a company's stock over a two day period not a tender offer when only a single factor form the SEC's guidelines is present); SEC v. Carter Hawly Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985) ("street sweep" of target's own stock not a tender offer despite being designed to defeat a hostile offer); Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985) (purchase of 25% of a target's shares not a tender offer despite occurring upon withdrawal of a tender offer). *But see* S-G Securities, Inc. v. Fuqua Investment Co., 466 F.Supp. 1114 (D.Mass. 1978) (finding a tender offer when there was a quick acquisition of shares following a public announcement of the intention to purchase a block of shares in the target). Importantly, privately negotiated purchases have been found under certain circumstances to constitute tender offers, but results can be varied. *Compare* Wellman v. Dickinson, 475 F.Supp 783 (S.D.N.Y. 1979) (finding secret offers for 35% of a company's outstanding shares with a short-period of time for offerees to make a decision to be a tender offer) *with* Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978) (acquisition of 10% of a company not a tender offer when the offeror and offeree agree on secrecy of the transaction) *and* Astronics Corp. v. Protective Closures Co., Inc., 561 F.Supp. 329 (W.D.N.Y. 1983) (acquisition of 51% of a company's shares not a tender offer in the absence of most factors from the SEC's guidelines).

In the case of either a privately negotiated or open market purchase, any transaction that appears to "defeat the protections of the Williams Act" may be found to be a tender offer. HAZEN, *supra*, at 391-92. For criticism of the SEC's eight-part test, *see* Oesterle, *supra* note 44, at 222-23 ("[The] test is hopelessly inadequate. . . . The test is useless.").

[70] To be sure, the need to protect solicitees pending a CA/street sweep should be distinguished from the need to protect target shareholders in the context of an upcoming acquisition of working control. The first one is a pressure to tender issue (a pure M&A problem), the latter is a loss of voting rights issue (an M&A-meets-corporate governance problem). True, the boundaries can be blurred, but it is appropriate to keep the two issues separated: in the U.S., the former calls for an in-depth analysis of what

The fatal blow to CAs came from state law, in the form of antitakeover statutes, on the one hand, and endorsement of poison pills, on the other.

Three types of antitakeover statutes are said to be aimed at curbing CAs: (i) so-called redemption or appraisal statutes,[71] which give target shareholders the right to tender their shares back to the target for the acquisition price, and de facto operate like the European mandatory bid rule (MBR);[72] (ii) business combination (or moratorium) statutes,[73] which prohibit second-stage mergers or business combinations for a specified period of time unless a required amount of disinterested shareholders approve the transaction, on the assumption that the acquirer will sooner or later need 100% to pledge the target's assets and refinance;[74] and (iii) control share acquisition statutes,[75] which may eliminate an acquirer's right to vote its acquired control shares when the acquisition is not approved by a majority of the target's preexisting shareholders: albeit the least discretionary, control share acquisition statutes can have severe effects on street sweeps, because the acquirer is in no position to condition the purchases to obtaining shareholder approval.[76]

Companies didn't simply lobby for legislatures to help them out. In the early 1980s takeover defenses were everywhere: staggered boards, supermajority requirements, defensive acquisitions, the "Pac-man" defense, crown jewel divestitures, stock buybacks, buyouts, and white knights, were only a sample of the various devices

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constitutes a tender offer, while the latter deals mainly with the issue of when a change of control takes place. Interestingly, in countries with more concentration of stock ownership, the triggering of a tender offer regime should be, all else being equal, less of a concern for an acquirer, because it would be comparatively easier to find sellers with sizeable stakes to buy from.

[71] *See e.g.*, IND. CODE ANN. § 23-1-44-8.

[72] *See infra* text preceding note 100. *See also See* Oesterle, *supra* note 44, at 235.

[73] *See e.g.*, DEL. CODE ANN. tit. 8, § 203.

[74] *See* Oesterle, *supra* note 44, at 235.

[75] *See, e.g.*, IND. CODE ANN. § 23-1-42-9.

[76] *See* Oesterle, *supra* note 44, at 235-36.

companies deployed.[77] But what really killed CAs was the poison pill. In its "flip-in" form, it gives subscription rights to purchase stock at a considerable discount if any person (alone or acting as a group) acquires a stake in the company in excess of a given threshold (normally, ranging from fifteen to twenty percent): such rights can be exercised by all shareholders with the exception of the person or group crossing the applicable threshold.[78] However, the board can "redeem the pill," i.e. cancel the rights plan and, effectively, consent to the acquisition.[79] Hence, a flip-in plan threatens a potential acquirer with significant economic and voting dilution unless the target's board redeems such subscription rights.[80]

The pill is effective for two reasons. First, no shareholder action is needed either for its adoption (so long as the charter, as it always does, authorizes, essentially without any substantial limits, directors to issue shares of blank-check preferred stock, as well as common stock)[81] or for its redemption. Second, the pill really works as a deterrent: the threat of dilution for an unsolicited acquirer is so effective that the triggering of the pill is virtually never needed: the mere fact that the pill is in place compels an acquirer to either try to negotiate a friendly deal with the board or to replace the board through a proxy contest to get rid of the pill.[82] In sum, pills virtually never entail the actual need to issue the dilutive stock pursuant to the plan.

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[77] *See generally* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 731-72 (2d ed.,1995).

[78] For the mechanics of the pill, *see* Wachtell, Lipton, Rosen & Katz, The Share Purchase Rights Plan, Memo, March 1994, as excerpted in GILSON & BLACK, *supra* note 77, at 741-42.

[79] *Id.*

[80] Jeffrey N. Gordon, *An American Perspective on Anti-takeover Laws in the EU: The German Example*, *in* REFORMING COMPANY LAW AND TAKEOVER LAW IN EUROPE 541, 549 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004) ("[T]he flip-in pill operates through a discriminatory issuance of cheap shares that would massively dilute the hostile bidder's stake").

[81] GILSON & BLACK, *supra* note 77, at 747.

[82] John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be? in* REFORMING COMPANY LAW AND TAKEOVER LAW IN EUROPE, *supra* note 80, 677,

When companies started adopting en masse the flip-in plans, CAs were left with no place in the market: given the risk of being severely diluted in the stock ownership of a target company, no acquirer dared to trigger the pill. Over the years, for reasons not necessarily linked with pushing back CAs, pill triggering thresholds have progressively been reduced: while they ranged from 10 to 20% when they were introduced in the mid-1980s, they can now go as low as 5%.[83] This means that for companies that do have a pill in place, no acquirer can, without first obtaining green light from the board, accumulate anything in excess of those percentages—arguably quite afar from de facto control. Companies that do not have a pill in place can always react and adopt one as soon as they realize somebody is making a street sweep, which can be promptly detected by looking at a sudden rally of the stock or, clearly, at 13D disclosures: these companies (those without a pill) are said to have a "shadow pill" in place.[84]

A couple of additional remarks on the effectiveness of the pill are in order. First, when dealing with pill decisions, although directors are traditionally considered to be in charge in deciding the outcome of a hostile takeover of a Delaware corporation in a sort of "just say no" fashion, shareholders nevertheless may have the power to reverse the

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681 n.18. *See also* Jordan M. Barry & John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses*, 160 U. PA. L. REV. 633, 643-44 (2012).

[83] *See* Selectica, Inc. v. Versata Enterprises, Inc., 5 A.3d 586, 605-607 (Del. 2010) (upholding use of a poison pill with a 4.99% triggering threshold). Further, companies can now discriminate among shareholders with regard to who may trigger a poison pill. *See* Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 312-313 (Del. Ch. 2010) (upholding use of a poison pill with a 20% triggering threshold that could only be triggered by shareholders other than the founder), aff'd 15 A.3d 218 (Del. 2011).

[84] John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, 287 (2000): "[A]ll Delaware firms (except those few with other governance terms that would impede pill adoption) have had a shadow pill in place, witting or not." Clearly, these pills deter a little less than true pills: consider for example a fifteen percent threshold pill—at the very least, with a shadow pill, an acquirer would have some freedom to build a toehold before the board realizes what is happening and reacts (*but see id.* at 289 n.69, noting that antitakeover statutes, shark repellents and notification duties in antitrust legislation limit such freedom: "[P]re-bid pills are necessary to block creeping bids only at small firms that lack shark repellents in states without [antitakeover] statutes"). With a pill in place, an acquirer is limited to whatever threshold the pill gets triggered at.

outcome via a vote establishing a new board that will redeem the pill.[85] To be sure, that is not the case in practice when other factors are at work that constrain the exercise of such shareholder power: as one of us pointed out elsewhere, shareholders may lack the power to determine the outcome of a takeover bid, because of corporate law rules, principles and/or practices acting as barriers to shareholder power (think of staggered boards, limits to director removability, shareholders' inability to call special meetings or to act by written consent, supermajority rules, proxy and conflict of interest regimes).[86]

Second, at least when its threshold is set at more than 5% (and maybe even in that case), a pill does not prevent those who want to buy full control (100%) from building a toehold (just below the trigger), possibly to hedge against the risk of being outbid by a rival acquirer; however, pills do rule out acquirers who just seek de facto control and hence are arguably more inclined to exploit minority shareholders via extraction of private benefits of control (otherwise they would normally buy them out).

All in all, Delaware companies can count on a device that is not only handy, because it is easy and quick to implement, but also quite adaptive to the circumstances of the actual acquisition. If directors think it is in the best interest of shareholders for the company to be acquired, they can redeem the pill and allow the acquisition to go through, i.e., normally, let shareholders decide upon it by tendering their shares or refusing to do so in the ensuing non-coercive tender offer.[87] If directors make the wrong

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[85] Unocal v. Mesa Petroleum, 493 A.2d 946, 959 (Del. 1985) ("If the shareholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out"); Moran v. Household Int'l Inc., 500 A.2d 1346, 1354 (Del. 1985) (quoting the *Unocal* passage above).

[86] Matteo Gatti, *The Power to Decide on Takeovers: Directors or Shareholders, What Difference Does It Make?*, 36-52 (August 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2329891 (last visited Jul. 28, 2014), 20 FORD. J. CORP. FIN. L. (forthcoming 2014).

[87] With the heavy use of stock options and the clause providing for accelerated vesting in the event of a takeover, the incentives of US companies' CEOs are much aligned with those of shareholders: Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 896-99 & 915 (2002) (arguing that, given the role

call in failing to redeem the pill, shareholder can override their veto by replacing them at the next annual meeting.[88] As a result, poison pills froze CAs in the US without excessively hampering the market for corporate control and, so far at least, the market for corporate influence.

IV. CREEPING ACQUISITIONS AND THE LAW IN THE EUROPEAN UNION

This Part describes the legal rules that affect CAs throughout the European Union. First, we analyze provisions that act as a curb to such transactions, i.e. the ownership disclosure rules in the Transparency Directive and the mandatory bid rule (MBR) in the Takeover Bids Directive (section A). Then we focus on rules that constrain target companies' ability to self-protect against the risk of a CA (section B). Finally, we wonder whether directors have an active duty to oppose to CAs that are detrimental to shareholders (section C). This Part shows that the law in Europe, far from "largely block[ing]" creeping acquisitions,[89] is in fact much more favorable to CAs than in the United States.

A. Legal Obstacles to Creeping Acquisitions in Europe. Let us first focus on how the European Union and member states legislations make CAs more difficult and costly via ownership disclosure and takeover bids rules.

1. The Transparency Directive and Ownership Disclosure Rules. As last amended in 2013, the Transparency Directive contains harmonization provisions on

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played by independent directors, executive compensation and the ensuing realignment of interests between directors and shareholders, instead of thwarting acquisitions, poison pills are a beneficial tool for shareholders because of higher premia and a higher number of friendly deals).

[88] The picture is more complicated if a staggered board is in place. *See infra* note 130 and accompanying text.

[89] John C. Coffee, Jr., *Hedge Fund Activism: New Myths and Old Realities*, The CLS Blue Sky Blog, 19 May 2014, *available at* http://clsbluesky.law.columbia.edu/2014/05/19/hedge-fund-activism-new-myths-and-old-realities/ (last visited Jul. 28, 2014).

disclosure duties for significant holders of shares admitted to trading on a regulated market. Specifically, a person who, as a result of an acquisition of shares, reaches or exceeds the five percent threshold, as well as any threshold that is multiple of five percent up to thirty percent (or 1/3 of voting capital, if the member state selects that threshold in lieu of thirty percent), must notify the issuer promptly and in any event within four trading days.[90]

As amended in 2013, the Directive rules out "gold-plating," i.e. member states' ability to impose super-equivalent requirements, but with two important exceptions.[91] First, it allows member states to adopt thresholds lower than five percent and in addition to those provided for in the Directive. In fact, some member states, including Italy, Spain,[92] and the U.K., have imposed thresholds lower than five percent, while France has left some room for individual companies' choices on that.[93]

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[90] Article 9 Transparency Directive.

[91] Article 3(1a) Transparency Directive. A third exception relates to measures "adopted in relation to takeover bids, merger transactions and other transactions affecting the ownership or control of companies." We are unaware of national super-equivalent rules that may fall under this category as opposed to the other two.

[92] Spain provides for a 3 percent threshold, but 1 percent is sufficient to trigger disclosure if the acquirer is domiciled in a country that Spanish regulators consider to be a tax haven. *See* Real Decreto 1362/2007, de 19 de octubre, por el que se desarrolla la Ley 24/1988, de 28 de julio, del Mercado de Valores, en relación con los requisitos de transparencia relativos a la información sobre los emisores cuyos valores estén admitidos a negociación en un mercado secundario oficial o en otro mercado regulado de la Unión Europea (BOE 252, Oct. 20, 2007, 42692-42708), articles 23 & 32.

[93] Italy has traditionally imposed the lowest threshold (two percent): however, it recently chose to relax the framework in favor of those building a stake: Consob's 2011 amendments to deal with long positions held via cash-settled equity derivatives now distinguish between physically owned shares, shares held via physically settled equity derivatives (potential holdings), and other long positions. *See* Article 119, Consob Regulation on Issuers, as amended *available at* http://www.consob.it/mainen/documenti/english/laws/reg11971e.htm (last visited Jul. 28, 2014). The initial threshold for disclosure of potential holdings is now five percent (it was previously two percent), while other long positions have to be aggregated with physically owned shares and potential holdings and disclosure thereof is only due if the aggregate holding (physically owned shares plus potential holdings plus other long positions) is above ten percent. *Id.* As a consequence, a raider may now build an undisclosed ten percent long position, provided that it does not hold more than two percent in physical shares and no more than five percent via physically settled derivatives. *Id.* These 2011 provisions will have to be changed once the revised Transparency Directive is implemented.

Second, the Directive gives a green light on more stringent requirements on matters covered by Article 12, *i.e.*, *inter alia*, on the timing and contents of disclosure.[94] Some member states, notably France and Germany, now require acquirers of a stake higher than ten percent to declare their intentions vis-à-vis the target,[95] a litigation-intensive disclosure item in the US experience, but probably less of a problem in Europe, where securities litigation is, as of yet, undeveloped.[96]

Following the U.K.'s lead, the 2013 amendments also extend ownership disclosure rules to cash-settled derivatives, requiring aggregation of holdings and derivatives according to the so-called single-basket approach at the five percent level.[97]

Disclosure duties such as those described above do help in contrasting CAs, by making them more costly both directly (disclosure itself is costly) and indirectly (building a toehold can become more expensive, if purchases cannot be concentrated before the required disclosure, because the share price moves upwards as a

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The U.K. went instead in the opposite direction when dealing with cash-settled derivatives: under the rules issued in 2009, a single basket approach was adopted, such that the obligation to disclose an equity stake also arises when a long economic interest higher than 3 percent results from aggregating physically owned shares, physically settled derivatives and cash-settled derivatives (calculated on a delta-adjusted basis). *See* FCA Disclosure and Transparency Rules, Ch. 5, as amended. Such is also the approach on aggregation of derivatives and physically owned shares later adopted by Germany. *See* Act Strengthening Investor Protection and Improving the Functioning of the Capital Markets of 5 April 2011.

France's statutory threshold is no lower than the Directive's. However, companies' charters may provide for an obligation to disclose one's holdings above a threshold the company may set at a level between 0.5% and five percent. Article L233-7-III, Code de Commerce. When that is the case and the company's charter so provides, failure to disclose leads to suspension of voting rights for up to two years, so long as any shareholder holding a given stake (no higher than 5 percent) so requests at the meeting. This is the interpretation of Article L233-7-VI, Code de Commerce, put forth, among others, by PIERRE-HENRI CONAC, FRANCHISSEMENT DE SEUIL, RÉPERTOIRE SOCIÉTÉS DALLOZ 47-48 (2013).

[94] Article 3(1a)(ii) Transparency Directive.

[95] Article L233-7-VII, Code de Commerce (Fr.); §27a, Wertpapierhandelsgesetz (as amended).

[96] *See e.g.* Martin Gelter, *Risk-shifting Through Issuer Liability and Corporate Monitoring* 14 EUR. BUS. ORG. L. REV. 497, 529 (2013) (noting the "relative scarcity of securities litigation in Continental [European] systems"); John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, *in* THE LAW AND ECONOMICS OF CORPORATE GOVERNANCE: CHANGING PERSPECTIVES 213, 229-30 (Alessio M. Pacces ed. 2008) (providing evidence on the virtual absence of securities litigation in the U.K.).

[97] Articles 13 and 13a Transparency Directive.

consequence). Further, disclosure gives a target's management not only a heads-up that something is going on with their stock (something management can probably tell already by looking at abrupt spikes in the market price), but reveals the identity (and, often, the intentions) of the raider. That will allow managers and directors to prepare a defense (so long as takeover regulation and corporate law do not come in the way) or to search for a white knight. But, of course, disclosure rules are *per se* insufficient to fend off creeping acquirers. As shown in Part IV, these duties have long been present in US federal securities regulation, yet did not even come close to ruling out creeping acquisitions.

2. The Takeover Bids Directive and Its Mandatory Bid Rule. As one of us showed in an earlier article, the Takeover Bids Directive does provide for a legal framework which is more favorable to incumbents than to raiders.[98] But, of course, it stops far short of ruling out CAs.

To start with, the Takeover Bids Directive does not contain a definition of what constitutes a tender (or public) offer, thus leaving member states wide discretion in determining under what circumstances a street sweep qualifies as a public offer and is thus subject to its disclosure and procedural rules. In the absence of any guidance in the Takeover Bids Directive, our understanding of member states' law on this issue is that, so long as no uniform announcement is made of the intention to acquire shares at a given price to the public or at least via a central depositor (and, to be on the safe side, less than 150 offerees are contacted), no public offer can be deemed to have been made.[99]

[98] Luca Enriques, *European Takeover Law: The Case for a Neutral Approach*, 22 EUR. BUS. L. REV., 623, 627-32 (2011).

[99] The Prospectus Directive (Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, OJ L 345, December 31, 2003, 64-89, as amended), defines an "offer of securities to the public" as "a communication to persons in any form and

What would seem to be more relevant for our purposes is the MBR, which, under Article 5 of the Directive, requires anyone crossing "a specified percentage of voting rights in that company, giving him/her the control of that company" (a concept to be defined by each member state: para. 3) to make a bid for all the remaining (voting) shares at "an equitable price." Paragraph 4 qualifies as equitable "[t]he highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by member states, of not less than six and not more than 12 months before the bid."[100]

If one looks at the EU provisions only, the MBR contains very little substance.[101] First, no triggering threshold is uniformly mandated. Second, while the Takeover Bids Directive only provides for one exemption, i.e. when the relevant stake is crossed as an outcome of a voluntary bid for 100 percent of the voting shares,[102] and clarifies, as a general principle, that shareholders should be anyhow protected in the event of a change in control,[103] member states may carve out further exemptions from

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by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities" (Article 2(1)(d)), and then exempts offers to less than 150 offerees (Article 3(2)(b)). While such definition and the related exemption cannot be simply transposed into the area of takeover bids, some member states (like Italy and Belgium) have explicitly defined the scope of the Takeover Bids as regards "public offers," by excluding offers to less than 150 securities holders. For Italy *see* Legislative Decree no. 58 of February 24, 1998, Supp. Ord. no. 52/L to Gazz. Uff. no. 71 of March 26, 1998, as last amended by Law Decree no. 91 of June 24, 2014, Gazz. Uff. no. 144 of June 24, 2014, 39-89 [hereinafter Consolidated Act on Financial Intermediation], Article 1, para. 1(v); for Belgium *see* DAMIEN COMEN, PIEN VAN VEERSEN & MICHAËL MEYLAN, PUBLIC TAKEOVER BIDS IN THE BENELUX 19 (2011), available at http://www.loyensloeff.com/nl-NL/News/Publications/Books/Documents/Public%20takeover%20bids%20in%20the%20Benelux_X.pdf (last visited Jul. 28, 2014).

[100] For a more detailed description of the MBR *see* Luca Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?*, 1 EUR. COMP. & FIN. L. REV. 440, 443-44 (2004).

[101] *See id.* at 445-46.

[102] CHRISTOPHE CLERC, FABRICE DEMARIGNY, DIEGO VALIANTE & MIRZHA DE MANUEL ARAMENDÍA, A LEGAL AND ECONOMIC ASSESSMENT OF EUROPEAN TAKEOVER REGULATION 61-65 (Marccus Partners and CEPS 2012).

[103] Article 3(1)(a) Takeover Bids Directive.

the regime, which they appear to have done to a wide extent.[104] Finally, enforcement is key to understanding how the MBR operates in practice.[105] All in all, it is hard to analyze even in very broad terms the MBR's impact on CAs: it heavily depends on choices made at the member state level.

A crucial feature in the EU MBR is "control," i.e. what triggers the MBR. The possible approaches are three: bright-line thresholds, an open-ended definition of control or a combination of the two. Most member states have chosen the first approach, with thresholds ranging from twenty-five percent (in Hungary and, since 2014, Italy, but only for companies with no other shareholder above ten and twenty-five percent, respectively) to one third of the shares (in various countries, including Greece and Luxembourg), with many countries choosing the thirty percent threshold.[106] One member state, Estonia, has adopted an open-ended definition of actual control as the sole trigger for the mandatory bid.[107] Spain has combined a numerical threshold (thirty percent) and actual control (defined as appointment of more than half of the board within twenty-four months) as alternative criteria for triggering the MBR.[108] Finally, up until mid-2014, in Denmark control triggered the MBR, but no control could be found to exist unless one held more than one third of the shares,[109] which is now the threshold other than in exceptional circumstances.[110]

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[104] CLERC ET AL., *supra* note 102, at 64-65 (providing a list of 36 cases of exemption based on a survey of 22 member state laws, including discretionary exemptions granted by supervisory authorities on a case by case basis). *See also infra* text accompanying notes 105-106.

[105] Enriques, *supra* note 100, at 445.

[106] CLERC ET AL., *supra* note 102, at 57. For Italy, *see* Article 106, para. 1-*bis*, Consolidated Act on Financial Intermediation.

[107] CLERC ET AL., *supra* note 102, at 57.

[108] *Id*.

[109] Paul Krüger Andersen, *The Takeover Directive and Corporate Governance: The Danish Experience*, 15 EUR. BUS. L. REV. 1461, 1465 (2004).

[110] The blockholder above one third can still prove that he does not have control. Also, shareholder agreements on directors' election granting someone control of the company trigger the MBR. Jesper-Lau Hansen, e-mail to Luca Enriques, May 13, 2014 (on file with the authors).

A second key feature are exemptions from the MBR, which make the mandatory bid less mandatory than it looks in a number of situations, depending, *inter alia*, on the relative cleverness of raiders' lawyers and the regulators' staff.[111] All member states provide for derogations from the MBR, some of them with pretty lax wording or granting the regulator broad discretion in deciding whether the derogation applies in the individual circumstances of the case.[112]

In the absence of corrective measures at the member state level, the only exemption provided for in the directive, i.e. when the threshold is crossed following a bid for 100% of the shares, lends itself to a perfectly legal pathway to circumvent the MBR: anyone may launch a bid for all of a company's shares at a low price, counting on the number of acceptances that is necessary and sufficient to cross the threshold. This technique does not work if, as in some of the member states, voluntary bids are subject to limitations, like the imposition of conditionality upon a minimum number of acceptances (e.g. such that the bidder crosses fifty percent of the shares following the bid, as in the U.K., Spain, and now Denmark and France) or a requirement that the price cannot be lower than purchases made during a period before the bid (like in Germany, Greece and Romania).[113]

Finally, the Directive does not provide for any extension of the MBR to cases where a long position higher than the relevant threshold is built via derivatives: that can also be an effective way to circumvent the MBR and ensure stable control over the

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[111] Enriques, *supra* note 100, at 445-46.

[112] *See supra* note 104.

[113] CLERC ET AL., *supra* note 102, at 62; REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS: APPLICATION OF DIRECTIVE 2004/25/EC ON TAKEOVER BIDS 8 (COM(2012) 347 final) (*available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf) (last visited Jul. 28, 2014). For France *see* Article L 433-1-2, Code Monetaire et Financier (Monetary and Financial Code) (France), as inserted by Article 5 of Loi 2014-384 of March 29, 2014 "visant à reconquérir l'économie réelle" (literally "aiming to reconquer the real economy"), also known as "Loi Florange."

target, given that a corresponding number of the shares above threshold will be parked in the accounts of the counterparties to the derivative contracts and hence unavailable to potential competitors on the market for corporate control or to unfriendly shareholders.[114] Again, some of the member states have indeed considered a long position higher than the relevant threshold to be equivalent to the physical holding of the corresponding amount of shares.[115] Others may qualify the counterparty to the derivative as holding the shares on the raider's behalf, and thus count them for MBR threshold purposes. However, that will request a dose of creativity on the part of a country's enforcers, which for example the German securities regulator failed to display in the Continental case.[116]

Is the MBR a serious obstacle to CAs? As anticipated, the answer depends on individual member states implementation choices and their regulators' enforcement record. However, the general point can be made here that the MBR and its threshold are, if at all, an ineffective hurdle to prospective street sweepers.

First of all, the threshold, usually between thirty and thirty-three percent, is high—definitely higher than the typical trigger of poison pills (normally ranging between ten and twenty percent[117]): depending on the target's ownership structure, a stake just below the threshold may well be enough to secure working control, or at least

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[114] *See infra* note 116 and accompanying text.

[115] Christophe Clerc & Fabrice Demarigny, *The Takeover Bids Directive Assessment Report*, 38 (2011) (*available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf) (last visited Jul. 28, 2014) (citing the U.K., Spain and Italy).

[116] See *supra* text accompanying notes 25-27. *See also* Pierre-Henri Conac, *Cash-Settled Derivatives as a Takeover Instrument and the Reform of the EU Transparency Directive*, *in* THE EUROPEAN FINANCIAL MARKET IN TRANSITION 52-56 (Hanne Birkmose, Mette Neville & Karsten E. Sørensen eds. 2012).

[117] *See* Bebchuk & Jackson, *supra* note 51, at 56, mentioning that seventy-six percent of companies that have pills have a pill trigger at an ownership threshold of fifteen percent or less, while fifteen percent of such companies have pills triggered by a threshold of ten percent or less.

negative control,[118] and in any event to discourage others from building as high a stake.[119] It should also be high enough to prevent anyone from launching a competing bid, should the acquirer decide to go for full control.

Even in countries that do have a qualitative threshold relying on the "control" concept, so that at least in theory the MBR may be triggered as soon as working control is achieved, the MBR reveals itself to be less of a hurdle for raiders in practice. In fact, in Spain nothing prevents those who build a stake lower than 30%, possibly granting them de facto control, from appointing only half of the directors for the next 24 months and thus gaining merely negative control of the board for that period. After 24 months, they can appoint the whole board with no ensuing obligation to launch a mandatory bid so long as they do not increase their holding.

Second, the MBR may never be triggered even after the relevant threshold is crossed, if either long positions via derivatives are not to be included in the calculation of the acquirer's stake in the target or one of the numerous exemptions applies.[120]

a. The Irish Substantial Acquisition Rules. Drawing inspiration from U.K. City Code rules in force until 2006,[121] Irish takeover law still provides for specific rules

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[118] Of course, the raider will have negative or positive control after building a stake just below the triggering threshold depending on whether other strong and active blockholders, including both corporate and institutional investors, are present, and, relatedly, on the turnout at the target's general meetings.

[119] That does not go, of course, without exception. In 2012, Italian contractor Impregilo had a controlling shareholder since long holding just below the 30 percent threshold that triggers the MBR. A competitor (Salini Costruzioni) built a stake similarly just below 30 percent and then won control via a proxy contest. It later launched a voluntary bid to secure a majority of the shares. *See* Belcredi & Enriques, *supra* note 5, at 26-27.

[120] *See supra* note 104 and accompanying text.

[121] *See* THE TAKEOVER PANEL, PROPOSED ABOLITION OF THE RULES GOVERNING SUBSTANTIAL ACQUISITIONS OF SHARES (2006). *See also* PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 702 (7th ed. 2003) (explaining that

> the SARs were promulgated as a result of a 'dawn raid' in 1980 in which brokers acting for two mining companies succeeded in obtaining in a few minutes a further 11 per cent of the shares of another such company (in which the two companies already held over 13 per cent) by announcing on the floor of the exchange that they were buyers at a price which was 18 per cent

limiting the speed at which anyone can buy shares between 15 and 30 percent. More precisely, the 15 percent threshold can be crossed only via: (i) a tender offer or in connection with it; (ii) an acquisition from a single shareholder; (iii) an acquisition of no more than 10 percent within a period of seven days.[122] Enhanced disclosure duties apply above the 15 percent threshold.[123] The rationale behind substantial acquisition of shares rules is that the target, its shareholders, and potential competing bidders should be informed and be given an opportunity to (re)act before it is too late and de facto control has been acquired on the market.[124]

B. Obstacles to Defenses Against Creeping Acquirers in the EU. European transparency and takeover rules disfavor CAs only mildly, as we have seen in Section A. On top of that, mandatory rules in the Directive formerly known as the Second Company Law Directive[125] and in the Shareholder Rights Directive[126] also hinder companies' ability to self-protect against CAs.

above the current market price. This was regarded as unfair to shareholders since only the institutional ones were, in practice, able to take advantage of the offer).

[122] IRISH TAKEOVER PANEL ACT, 1997, SUBSTANTIAL ACQUISITION RULES (2007), Rules 3, 4, 5 and 7 (whereby further qualifications and exemptions).

[123] *Id*., Rule 6.

[124] *See* Davies, *supra* note 121, at 703.

[125] Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (consolidating Second Council Directive 77/91/EEC of 13 December 1976, also known as the Second Company Law Directive, and subsequent directives amending it (OJ L 315, Nov. 14, 2012, 74-97)) [hereinafter Consolidated Second Company Law Directive].

[126] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ L 184, July 14, 2007, 17-24) [hereinafter, Shareholder Rights Directive].

Before we describe these rules, let us first clarify that the choice some individual member states have made to confirm the board neutrality rule,[127] whether mandatorily or as a default rule, is irrelevant for our purposes. In fact, at the CA stage, in which no tender offer is launched, the board neutrality rule does not even come into play. Whether target directors have thus leeway to choose the best way to respond to a CA to prevent the raider from gaining working control depends on other features of European and member states law.

For the same reasons, a device French companies can avail themselves of, the so-called "Bons Bréton," would be of no help to prevent CAs that are not undertaken in the wake of a full-blown takeover bid. Bons Bréton, to be approved by the general meetings, are rights to subscribe shares at a discount in the event a takeover bid is launched. In the absence of an actual bid, the rights may not be exercised.[128]

There are basically four ways to protect against CAs: first of all, by erecting a structural defense in the form of a voting structure deviating from the one share, one vote principle; second, by tampering with rules on shareholder meetings and resolutions; third, via a US-style flip-in plan; finally, by adopting shark repellants, i.e. charter clauses that allow for a screening of would-be controlling shareholders.

1. Deviations from one-share-one-vote. A company may rule out CAs completely by structuring voting rights in such a way that someone has control over the general meeting and a change of control can only take place with his or her consent. Deviations from the one-share-one-vote principle, such as via multiple voting shares, pyramids, non-voting shares, and other similar devices, allow to reach this outcome. While this may be done without sacrificing liquidity, for example if high-voting shares

[127] Under such a rule, the directors of a target company are compelled to obtain a prior shareholders' authorization when engaging in defensive actions "which may result in the frustration of the bid." Article 9, par. 2, Takeover Bids Directive.

[128] *See* Article L233-32, Code de Commerce (Fr.).

are used, the complete unavailability of a hostile takeover in such a setting may lead to higher agency costs and lower share prices. Interestingly, this is an area where member states have unfettered discretion: no EU directive or regulation tackles deviations from one-share-one-vote.[129]

2. Tampering with shareholder meeting rules. A company (or a member state) may tamper with rules on shareholder meetings to make it harder for anyone acquiring a large stake to gain control over the board and/or to pass certain important shareholder meeting resolutions. Think of supermajorities for directors removal, or, similarly, Delaware companies' use of staggered boards as a complement to poison pills. When a staggered board is, in place, because only one-third of its members are up for election every year, it takes two board elections, and hence at least twelve full months, to gain a majority of directors.[130]

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[129] *See* e.g. Statement of the European Corporate Governance Forum on Proportionality 1 (2007) (*available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/statement_proportionality_en.pdf) (last visited Jul. 28, 2014). The High Level Group of Experts appointed in 2002 by the European Commission put forth a proposal to neutralize deviations from one share one vote in the event of a takeover, but their approach was selective, as it did not tackle pyramids as a tool to separate ownership from control (see Report of the High Level Group of Experts on Issues Related to Takeover Bids 30, 38-39 (2002)). Hence, under a similar regulatory approach pyramids would have prospered even more than before (*see* Luca Enriques, *In Tema di Difese Contro le Opa Ostili: Verso Assetti Proprietari Più Contendibili o Più Piramidali?*, 2002 GIURISPRUDENZA COMMERCIALE vol. I, 108, 110 -112). The optional break-through rule that was ultimately approved (Article 11, Takeover Bids Directive, providing that some deviations from one-share-one-vote, like limitations on voting rights attaching to shares and multiple votes, become ineffective during the bid and after a successful bid) was a trivial attack to deviations to one-share one vote, as virtually all member states opted out of it, while no individual listed company opted into it. *See* CLERC ET AL., *supra* note 102, at 81.

[130] *See* Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 STAN. LAW REV. 887, 890 (2002), who first highlighted the powerful effect of combining poison pills with staggered boards: at the first election, bidders would effectively give target shareholders a put option exercisable a year later: if between the two elections the stock has gone down, the bidder will have to close an acquisition where it is likely overpaying (the stock has gone down while the bidder cannot run the company because it only controls one third of the board); if, however, the target stock has gone up, shareholders (M&A arbitrageurs) would likely not vote for the bidder nominees unless the bidder increases the initial offer.

Note that staggered boards can play a role only if a pill is (or can be put) in place: in jurisdictions where poison pills are not available, the presence of a staggered board would not prevent a bidder from launching and closing a tender offer. In such a scenario, a staggered board would only represent a post-acquisition hassle given that the acquirer would not be able to run the company via a majority of its elective representatives[131] (assuming, of course, that directors cannot be removed in the absence of cause in such circumstance[132]). True, that can discourage prospective bidders who might not like the idea of launching an unsolicited offer for a company they will not be able to immediately fully control. But still, the role staggered boards would play in the absence of structural defenses like poison pills would be far from the powerful "just say no" effect they have in Delaware. That may help explain why staggered boards are virtually non-existent in the EU.[133]

While EU laws are silent on director removal and their term length (with national laws significantly diverging on those issues[134]), the Shareholder Rights Directive has moved the pendulum in the direction of favoring acquirers: its Article 6 requires member states to allow shareholders to add items on the agenda of already convened meetings and even to call a special meeting in case under national law they may only add items on the annual meeting's agenda (para. 1);[135] member states may

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[131] Gatti, *supra* note 86, at 42.

[132] Among the main European jurisdictions, that would be the case in France, Italy, and the U.K., but not in Germany, where a 75% supermajority is required to remove a shareholder-elected supervisory board member. *See* Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: The Interests of Shareholders as a Class*, in REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 55, 58-62 (2d ed. 2009).

[133] According to The Takeover Bids Directive Assessment Report, *supra* note 115, at 307, "staggered boards are not a feature of European company law."

[134] *See* Enriques, Hansmann & Kraakman, *supra* note 132, at 58-62.

[135] The right to call a special meeting is traditionally granted to shareholders in most European jurisdictions. *See* Cools, *supra* note 6, at 750. In contrast, shareholders of Delaware corporations can call special meetings – or act by written consent – only if the organizational documents of the company empower them to that effect. *Cf.* Section 211(d) of the DGCL ("[s]pecial meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the

only provide for a minimum ownership stake for the exercise of such a right, which the Directive caps at 5 percent.[136] What is relevant here is that a member state may not now allow companies greater freedom to limit shareholder proposals.

3. What About Flip-in Plans? Could a European company tackle CAs by putting a poison pill in place? Doubts about whether a US-style flip-in plan would violate any EU company law rules abound:[137] issuance of shares or rights to subscribe shares at a heavy discount to all shareholders except those having crossed a given threshold may run counter to provisions requiring non-discrimination among shareholders who are in the same position[138] and, more seriously, preventing existing shares' dilution in the event that the capital increase resolution does not provide for pre-emption rights in favor of existing shareholders.[139] True, one can argue that a flip-in plan would not contrast with the equal treatment requirement. In fact, it would treat shareholders unequally based on the fact that one or more shareholders (acting as a group) have a stake higher than a given threshold (and therefore can become a de facto controller, which puts him or her in different shoes than other shareholders).[140] But the provision requiring that the issue price be "justif[ied]"[141] would seem to rule out the heavy discount at which rights would be issued under such a plan. Further, the general

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certificate of incorporation or by the bylaws"); Section 228(a) of the DGCL (providing that stockholder action may be taken by written consent in lieu of a meeting unless prohibited by the certificate of incorporation (either expressly or *de facto* by requiring unanimous consent)).

[136] Article 6, para. 2, Shareholder Rights Directive.

[137] *See e.g.* Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PENN. J. INT'L ECON. L. 1, 52-54 (2006).

[138] *See* Article 46 Consolidated Second Company Law Directive.

[139] Article 33 Consolidated Second Company Law Directive.

[140] *See* MATTEO GATTI, OPA E STRUTTURA DEL MERCATO DEL CONTROLLO SOCIETARIO 358-63 (2004). Note that, when validating poison pills in Delaware, the *Moran* court overcame the potential equal treatment obstacle by citing Baker v. Providence & Worcester 378 Del. Supr. A.2d 121, 124 (1977) (*see Moran*, *supra* note 85, at 1351), in which the Delaware Supreme Court distinguished between restrictions based on particular conditions of the shareholders, which are admissible, and restrictions on the stock, which are not.

[141] Article 33(4) Consolidated Second Company Law Directive (requiring a director report *inter alia* "justifying the proposed issue price").

meeting, initially and every five years, would have to authorize the delegation of powers to the board for the issuance of subscription rights.[142]

To be sure, as one of us noticed in a previous article,[143] member states would seem to be unconstrained in their freedom to allow companies to issue financial instruments with rights mirroring, or sufficiently similar to, those of a share, and subscription rights pertaining to such instruments, in which case the rules on equal treatment, pre-emption rights and shareholder meeting powers may fail to apply. Yet, one can easily predict that the stratagem of calling what are shares in substance by another name would not foul courts around the EU, let alone the European Court of Justice itself.[144] It is thus fair to conclude that in the current EU legal framework flip-in plans would not be available to companies wishing to prevent a CA.

4. Shark repellants. Finally, some charter clauses may help stave off CAs while letting shareholders have a final say on the acquisition.

Such is the case, first of all, of voting and ownership caps, i.e. charter clauses providing that no shareholder or group of shareholders acting in concert may vote or own a stake higher than a given percentage of capital.[145] Shareholders may welcome the acquirer, whether ahead of its acquisition or thereafter, by repealing the clause in a special meeting or at the annual meeting. At the meeting, of course, such an acquirer would only be allowed to vote with a number of shares equal to the cap (plus the shares he or she may vote as a proxy of other stockholders), so that the other shareholders would call the shots. The problem with this tool is its rigidity in cases where it would be clearly in the interests of shareholders to approve of the acquirer, the board being of the

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142 Article 29 Consolidated Second Company Law Directive.

143 Enriques, *supra* note 137, at 52-53.

144 *Id*.

145 Germany banned such clauses in 1998. *See* Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), March 6, 1998, BGBL. I at 786, §2, no. 18 (Ger). Italy did so in 2003 other than for privatized and closely held companies, but then repealed the ban in 2014. *See* Article 2351, Civil Code, as amended.

same opinion. In that situation, the hassle of calling a meeting and repealing the clause is a waste of time and money. More importantly, if a supermajority is needed to repeal the clause, a minority may block the transaction or, in case it is concentrated enough, hold out to gain something in exchange for voting in favor.[146]

To be sure, one could imagine a sort of "self-repealing" clause, i.e. a clause making the limit ineffective, so long as some conditions are met. For example, the clause may allow stakes higher than the threshold provided that the acquirer launches a bid for all of the outstanding shares at a given premium over the average share price in a given period. Still, a clause of this kind would suffer from the same problems as the MBR: it may chill efficient takeovers with a premium below the one set in the charter, in which case, again, the only way would be a shareholder meeting resolution repealing the cap, equally at the risk of rejection by a qualified minority; also, it may be under-deterrent if for some external reason (a recession, a financial crisis) the stock is trading at very low levels.

A more flexible tool would be a charter clause requiring board approval for shareholdings higher than a given threshold, with or without limits to the board's discretion in the latter case.[147]

[146] *See infra* note 206.

[147] One could even think of approval by the shareholder meeting as opposed to the board. Whether it would be more appropriate, from a shareholder welfare perspective, to have approval by shareholder as opposed to the board would in our view depend on the specifics of the given company, especially with respect to its ownership structure. In a contestable company, in which share ownership is not so dispersed (think of a company with sizeable blockholders), requiring shareholder approval could raise risks of decisions affected by conflicted voting, especially because blockholders would likely not expect to monetize immediately after the entry of the new shareholder(s) unless they are on the sell side of the transaction in which case the risk of conflict can be even higher. In that scenario, it would probably better to have a board decision on the matter. In the case of a true public company, board and shareholder approval should be indifferent, assuming directors are subject to effective (that is, strong and enforced) fiduciary duties or market tools are available, such as modern-style golden parachutes (see *supra* note 87), to align their interests to shareholders' (and again, even without that assumption, a vetoing board could at least theoretically be ousted by shareholders anyway).

A board approval clause would have two advantages over a voting cap: first, the board may welcome the raider without any further hassle (though at the risk of collusion with a bad-intentioned acquirer); second, a recalcitrant board vetoing an acquirer that shareholders would want to go ahead could be ousted without any need to repeal the charter clause (and hence no risk that, despite the supermajority required across EU jurisdictions to amend the charter,[148] a minority can block the relevant shareholder resolution).

Board approval of large shareholdings would thus be functionally equivalent to a U.S. flip-in plan. One big difference would be in the fact that at existing listed companies shareholders would have to positively grant this power to the board. Companies that are still to go public, unless control is sold to the market at the IPO stage already, may just not find it worth the trouble to insert a clause that may be needed years down the road (when and if the controlling shareholder is diluted below a threshold that makes control contestable). And boards of companies that are already listed may have a hard time credibly committing to exercising discretion in the use of approval power exclusively in the interest of shareholders. That is especially so in light of European CEO compensation practices: not only are these less stock-based than in the U.S., but European policies are suspicious of "golden goodbye" practices. As sufficient evidence of such suspicions one may refer, first, to the criminal case against Mannesmann executives for the grant of an award to the CEO after Vodafone had taken the company over,[149] and, second, to the Commission Recommendation on the regime for the remuneration of directors of listed companies of 30 April 2009.[150]

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[148] *See* Edward Rock et al., *Fundamental Changes*, *in* KRAAKMAN ET AL., *supra* note 132, 183, 186 (supermajority required to amend charter in major EU jurisdictions).

[149] *See e.g.* CURTIS J. MILHAUPT AND KATHARINA PISTOR, LAW AND CAPITALISM Ch. 4 (2008).

[150] Recommendation complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (C(2009) 3177). While non-binding, this Recommendation sets limits on termination payments and share payments and options that,

Board approval for substantive block acquisitions would share another feature with the poison pill within the European framework: the risk of illegality. In fact, Article 46 of Directive 2001/34/EC[151] provides that shares admitted to official listing must be freely negotiable (para. 1). A derogation to this principle, in the form of an approval of purchases of shares e.g. by the board, is only allowed "if the use of the approval clause does not disturb the market" (para. 3). What that means is unclear. As Guido Ferrarini observed, this provision was never meant to promote takeovers, the smooth functioning of the market being its main purpose.[152] Yet, the provision is sufficiently vague as to raise legitimate concerns about the validity of an approval clause.

C. Is There a Duty to Protect the Company Against CAs? Boards have the incentives and the initiation rights to at least try and resist against CAs, although in Europe shareholders have the upper hand in deciding on measures to oppose the CA. Directors do not face the shareholders' collective action problems, which may lead to the latter's inertia in the presence of a CA threat.

The question at this point is whether directors have a duty for to do what is in their powers to prevent a CA, e.g. by convening the general meeting to adopt a shark

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if implemented at the member state level, make it harder for companies to design incentive compensation schemes aligning managers' interests with those of shareholders in the event of a takeover. More precisely, the Recommendation provides that "[t]ermination payments should not exceed a fixed amount or fixed number of years of annual remuneration, which should, in general, not be higher than two years of the non-variable component of remuneration or the equivalent thereof" and that "[s]hares should not vest for at least three years after their award;" further, "[s]hare options or any other right to acquire shares or to be remunerated on the basis of share price movements should not be exercisable for at least three years after their award." *Id.*, §§3.5 and 4,.

[151] Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (OJ L 184, July 6, 2001, 1-66).

[152] *Cf.* Guido Ferrarini, *Le Difese Contro le O.p.a. Ostili: Analisi Economica e Comparazione*, 2000 RIVISTA DELLE SOCIETÀ 737, 746.

repellant or, if legal, a poison pill. That, of course, depends on the many shades director duties may take in individual jurisdictions.

In very general terms, we dare say that, absent special circumstances, no such duty can be held to exist or at least to be capable of successful enforcement. But there can be special circumstances in which directors' inertia might possibly lead to something akin to a violation of their duties to the company and the shareholders. We mention two such circumstances here, yet this is hardly an exclusive list.

First, suppose a shareholder agreement coalescing a group of shareholders together having joint control over the company is about to dissolve (or suppose a shareholder has a lock-up that is about to expire). Suppose also that it is anticipated that some of the shareholders (or the shareholder subject to the lock up) want to sell their shares and no existing shareholder is willing to buy. Rather, there is reason to believe that a well-known looter or, less dramatically, a weaker, less profitable but "fatter" competitor is ready to buy. Should the directors "do something" in these circumstances, i.e., basically, call for a shareholder meeting to approve one of the structural defenses outlined above under section IV.B? Will they be liable if they do nothing and the looter/weaker competitor gains working control over the company?

The second case involves an acquirer who gains the trust of directors, whether by giving them false, but easily verifiable information about his or her intentions or by bribing them, builds the block, and then, having gained control over the board, mismanages the company. Can the directors be held liable for failing to, again, "do something" to fend off such an acquirer?

We leave these questions open to individual member states company law experts.

D. Summary. EU company and securities laws create very low hurdles to CAs. An acquirer may structure its plan to secure the end result of grabbing control in many different ways. As we have seen, applicable laws do not pose significant obstacles to implementing one or more of the following transactions, subject to the disclosure obligations we have highlighted in section IV.A.1:

(i) an acquirer can obtain (positive or negative) de facto control by making stock purchases up to right below the MBR threshold;[153]

(ii) after having reached de facto control, an acquirer can obtain full control (that is, 50% plus one share) by launching a tender offer, which can easily take the form of a low-ball bid, since little resistance can be expected from directors and shareholders by virtue of the fact that the bidder's starting point (de facto control) makes the possibility of any rival bid very unlikely and any resistance by the board short-lived;[154]

(iii) similar to (ii), an acquirer can secure a high toehold with the actual aim of beating a potential rival bidder in an upcoming or actual corporate control contest;[155]

(iv) an acquirer can even use a partial tender offer to achieve de facto control below the MBR threshold.[156]

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[153] This was the plan that LVMH had in mind for Gucci. Ultimately it did not pan out as a result of Gucci's resistance (thanks mainly to Dutch law openness to defensive measures) and the intervention of PPR as a white knight. *See supra* note 17.

[154] *See* the Schaeffler/Continental case mentioned *supra* notes 25-27 and accompanying text, and the Lactalis/Parmalat case described *supra* notes 30-33 and accompanying text.

[155] This was the strategy pursued by Banca Popolare di Lodi in the notorious takeover battle with ABN-AMRO to conquer Italian Bank Antonveneta in the spring of 2005. While the Dutch bank had launched a full-blown tender offer, their Italian rivals, with the informal blessing of the then Governor of the Bank of Italy, and via several purchases of Antonveneta shares by third party allies who were secretly acting in concert, were successful in accumulating a much larger stake than ABN-AMRO's, which was ultimately sufficient to make its tender offer fail and lapse. Ultimately, the Dutch side managed to succeed because Banca Popolare di Lodi and its allies were subsequently found to have breached several provisions of Italian takeover, securities and banking laws. *See Dutch Courage Pays Off*, THE ECONOMIST, Sept. 15, 2005, *available at* http://www.economist.com/node/4416336 (last visited Jul. 28, 2014).

[156] Similarly, in countries where the mandatory bid price may in some circumstances be lower than the highest price paid by the bidder (as is the case in Romania and was the case in Italy before the implementation of the Takeover Bids Directive: *see* Clerc et al., *supra* note 102, at 67), the acquirer can launch a partial tender offer to seek an ownership level higher than the MBR threshold, in which case it will have to make a subsequent offer pursuant to the MBR at a lower price: pressure to tender at the first stage will thus be the most intense.

V. POLICY TOOLS TO ADDRESS CAS (1): MANDATORY RULES

In Part II we observed that CAs can have a negative impact on capital markets, the market for corporate control, and corporate governance. The risk exists that:

(a) only few lucky shareholders get to sell to the creeping acquirer, while the rest of them get stuck with shares that have less value after the CA;[157]

(b) somebody grabs control without paying a full premium (and without giving the target any way to contrast such a move);[158] and

(c) the new de facto controller extracts higher (and possibly unanticipated) private benefits of control.[159]

We also observed that policymakers should be careful in regulating CAs, particularly because any overreaching solution might thwart positive activities such as minority investments by hedge fund activists, which appear to have overall beneficial effects for corporate governance.[160] In Part III, we described how poison pills froze CAs in the US without excessively hampering the market for corporate control and, so far at least, the market for corporate influence. As shown in Part IV, in Europe there are no effective statutory safeguards against CAs; to the contrary, legal obstacles may prevent companies from erecting contractual barriers against CAs and the framework of shareholder meeting rules is actually favorable to potential creeping acquirers.

In the rest of this paper, we first analyze the policy tools a jurisdiction may use to address CAs (Part V) and then propose a balanced solution to mitigate the shortcomings of one-size-fits-all approaches (Part VI).

Preliminarily, we observe that the current trend in jurisdictions that had long endorsed a pro-takeover approach (mainly, France and Italy) is to raise hurdles to

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157 *See supra* Section II.A.
158 *See supra* Section II.B.
159 *See supra* Section II.C.
160 *See supra* the final paragraph in Section II.D.

hostile acquisitions via tender offers: France introduced "bons Bréton," a poison-pill style defense that only operates in the context of a tender offer in 2007,[161] and recently converted the board neutrality rule into an opt-in provision.[162] In the midst of the financial crisis Italy made both the board neutrality rule and the breakthrough rule optional.[163] The unintended consequence of such innovations may well be to make lightly regulated CAs an even more attractive acquisition technique than in the past. We note in passing that hardly can one understand why Member States worry so much about full-blown takeover bids and ignore potentially more dangerous CAs.

Indeed, takeover regulation is partial. Generally speaking, legislatures promulgated rules on tender offers and on change of controlling stakes only: with the exception of ownership disclosure obligations, CAs are (or can be planned by well-advised market players to be) outside the scope of such rules.

Two approaches are available to curb CAs: a mandatory regime or an optional approach. We describe the latter in part VI and focus on mandatory rules here.

We can think of four rule changes to implement a mandatory regime to tackle CAs. First, based on the U.S. experience, a new, broader (and more detailed) definition of a takeover bid[164] could be provided for, so as to encompass street sweeps as well.

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[161] *See supra* text preceding note 128.

[162] *See* Loi 2014-384 of 29 March 2014, *supra* note 113, Article 10(V). The same law may have inadvertently made CAs even more effective as an acquisition tool, having provided that double voting after having held shares for two years is now a default feature of French law. *See id.* at art. 7(V). Hence, unless a company opts out of the new default, a raider may now acquire 15 percent of the shares, wait two years and obtain 30 percent of the votes (just below the threshold for the MBR). *See* Cyril Deniaud & Sophie Vermeille, *Le Projet de Réforme du Régime des Offres Publiques d'Acquisition (OPA) en France: Quels Enjeux pour Notre Pays, Quels Enjeux pour Nos Entreprises et Leurs Actionnaires?*, 2013 REVUE TRIMESTRIELLE DE DROIT FINANCIER, 1, 17 (Issue 4).

[163] *See e.g.* Paul L. Davies, Edmund-Philipp Schuster & Emilie van de Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool? in* COMPANY LAW AND ECONOMIC PROTECTIONISM: NEW CHALLENGES TO EUROPEAN INTEGRATION 105, 142 (Ulf Bernitz & Wolf-Georg Ringe eds. 2010).

[164] The Takeover Bids Directive (article 2(1)(a)) defines a takeover bid as "a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the

Second, based on the Anglo-Irish experience, rules slowing down acquisitions of substantial shares could be envisaged. Third, the MBR could be amended to impose the buyout of minorities as soon as one crosses a threshold lower than the one currently triggering the MBR. Fourth, a legislature could impose an outright prohibition of acquisitions of control via open market or privately negotiated purchases, as Lucian Bebchuk suggested three decades ago.[165] While the former two proposals would neither kill CAs nor impose excessive costs (although ideally, companies should be allowed to opt out at least of rules curbing substantial acquisition of shares within the framework we describe in part VI), extending the scope of the MBR or prohibiting CAs altogether would be bad policy for a number of reasons.[166]

As we have seen, the MBR is the chief device by which EU law (not even intentionally[167]) may curb CAs, but it only does so to the extent that the acquirer actually crosses the relevant threshold, which is something clearly under its decisionmaking sphere. Transactions aimed at obtaining de facto control can ultimately occur because the MBR as implemented throughout the various Member States has thresholds that are generally higher than an ownership level sufficient to confer such control, especially in companies with fully dispersed stock ownership and low shareholder meeting turnout.

acquisition of control of the offeree company in accordance with national law." No further definition of a "public offer" is provided therein.

[165] Bebchuk, *supra* note 35, at 1790-92 (proposing that acquisitions presumptively granting control over the company are to be made either via a merger or a non-coercive takeover bid).

166 Note that regulators could adopt any of the first three proposals separately or jointly. The fourth proposal would instead be an alternative to the others, because it would make the first two superfluous and would effectively act as a superior alternative to the third one in ensuring protection against pressure to tender.

[167] *See infra* note 175.

As a solution, one may think of tinkering with the MBR fixed threshold either by abandoning it in favor of a case-by-case threshold based on "control"[168] or by lowering it to fifteen or twenty percent.[169]

In considering the control-based threshold alternative, the following issues are crucial. First, there is a trade-off between certainty and minority shareholder protection,[170] which comes with picking one solution over the other. Acquirers, companies and possibly the market at large appreciate certainty over what triggers the MBR. Further, if broad discretion is left with the market supervisor, uncertainty would pair with a high risk of politicization in the supervisor's response to the question of whether control has been attained, given the political salience of battles for corporate control.[171]

A second trade-off is the one between certainty and adaptability: to accommodate the former, legislatures in Member States set forth a one-size-fits all fixed threshold as the triggering event that applies across the board to each and every company in the given jurisdiction. Yet, it is well known how much M&A activity

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[168] Italian lawmakers discussed (but later abandoned) such a proposal after Telefonica SA gained control over a vehicle holding approximately twenty-two percent of Telecom Italia and previously controlled jointly by Telefonica and three Italian financial institutions. *See* Francesca Piscioneri & Giuseppe Fonte, *Italy Rule Change Could Complicate T. Italia Takeover*, Reuters, October 24, 2013, *available at* http://www.reuters.com/article/2013/10/24/italy-takeovers-idUSL5N0IE2OI20131024 (last visited Jul. 28, 2014).

[169] French lawmakers discussed whether to lower the MBR threshold to twenty-five percent but finally abandoned the idea. *See* Andréa Bonhour, *Quand Florange Généralise le Droit de Vote Double*, Labrador le Blog, 27 February 2014, *available at* http://blog.labrador.fr/quand-florange-generalise-le-droit-de-vote-double/ (last visited Jul. 28, 2014). As previously noted, Italy finally moved in that direction in 2014 (but only for companies with no shareholder holding more than twenty-five percent of the shares). *See supra* note 106 and accompanying text.

[170] *See* Elhauge, *supra* note 48, at 1496-97.

[171] *Cf.* Enriques, *supra* note 100, at 457 ("[G]reater flexibility [in the rules governing the mandatory bid] would allow supervisory authority officials to make decisions that may be of great value to the powerful people involved in acquisitions).

(including its planning and execution) is shaped by the uniqueness of each company's stock ownership.[172]

Yet, a control-based threshold reveals itself much less of an alternative than it may appear. Such a trigger is either based on a very broad standard (e.g., control as the power to influence, other than on an occasional basis, a company's strategy) or on a bright-line definition (such as Spain's appointment of a majority of the board members). In the latter case, as the Spanish experience itself shows,[173] good lawyers will always be able to devise transaction structures and timings to avoid the trigger of the MBR. In the former case (at least in member states with a formalistic legal culture, i.e. in continental Europe), with time a "case law" would likely develop, which may lead the standard to increasingly resemble a bright-line rule.

If, as we believe, moving to a control trigger is not the appropriate policy response, one might wonder whether lowering the fixed threshold for all companies would address the concerns raised by CAs. For instance, thresholds could be lowered to fifteen or twenty percent, in line with US-style flip-in plans. Policymakers and regulators could also carve rules that only apply to companies with widely dispersed ownership, by either identifying ex ante such companies with some general criteria (and possibly by providing a list of them to ensure some certainty for market participants) and making the lower threshold applicable to them only or by granting exemptions to acquisitions above the thresholds if the relevant company already has a controlling shareholder, whether de iure or de facto.

[172] *See generally* John C. Coates IV, *The Powerful and Pervasive Effects of Ownership on M&A* (June 2010), *available at* http://ssrn.com/abstract=1544500 (last visited Jul. 28, 2014). Interestingly, MBR thresholds are almost double the size of poison pill thresholds (*see supra* note 78 and accompanying text): in other words, when private parties (in the U.S.) self-regulate change of control transactions, they select much lower thresholds.

[173] *See supra* text preceding note 120.

However, we do not believe a mandatory regime like the one sketched out above would be an adequate response to CAs. Many are the potential negatives that would ensue: the new regime could hamper the market for corporate influence; importantly, it would entrench even more those blockholders who are currently between the old and the new, lower threshold.

Again, the diversity in ownership structures[174] make one-size-fits-all takeover regulation inherently not adaptable, as the hypothetical new regime can be too strict for company A (say, a company controlled by a coalition of shareholders) and too lenient for company B (say, a company with dispersed ownership structure).

Last but not least, the MBR itself is hardly adequate to curb CAs anyway.[175] All a mandatory bid does, if triggered, is requiring the acquirer to make a tender offer for all the remaining shares at the highest price paid by the acquirer over a given time window. Careful planning will be enough to make the MBR almost innocuous from the acquirer's perspective. If the acquirer stays just below the threshold, whether fixed or control-based, for the entire period that is relevant for price calculation, it would be then free to launch an offer at whatever price (unless the law provides that the bid must be conditional upon a certain percentage of acceptances).[176] Also, an MBR system in and

[174] *See generally* Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365, 378-83 (showing that albeit certain patterns exist – e.g., the public company model in the U.K. and family controlled companies in Italy -, diverse ownership structures tend to coexist within the same country: for instance, as the size of a company grows, the number of widely held companies tend to increase even in jurisdictions that are generally characterized by a concentrated ownership pattern).

[175] In fact, curbing CAs is not an intended purpose (not even a secondary one) of the MBR. The MBR has other intended purposes (i.e., allowing an equal sharing of control premium, and granting an exit before a controlling shareholder can extract private benefits of control). *See e.g.* Enriques, *supra* note 100, at 448-55. Yet, as a matter of fact, the MBR operates as an indirect limit to CAs (and partial tender offers), because acquirers are not able to build a toehold as large as they please without at some point triggering the MBR. *See* GATTI, *supra* note 140, at 65-68.

[176] *See supra* text preceding note 113.

of itself would clearly not ban partial tender offers for a number of shares below the relevant threshold.

Finally, Bebchuk's suggestion to prohibit CAs would essentially compel any purveyor of corporate control to obtain it only by "using the avenue of a takeover or a merger," both of which would require, in his policy construct, shareholder approval via a voting mechanism.[177] His proposal, while superior to any changes to the MBR in solving the distorted choice issues that CAs raise, suffers from the same overdeterrence problem we mentioned with respect to expanding the MBR reach. Such a rigid ban would risk screening out *ex lege* potentially beneficial investments, with negative ripple effects in the market for corporate control. Furthermore, if the threshold of presumptive control were to be set at a low level for all companies across the board, the market for corporate influence would suffer as well.

Part VI proposes a more nuanced, and possibly more effective in discouraging CAs, policy framework.

VI. POLICY TOOLS TO ADDRESS CAS (2): THE OPTIONALITY APPROACH

The overlaps and complementarities between CAs, hostile bids aimed at full control, and shareholder activism are such that policymakers should tread carefully, and avoid shutting down the market for corporate control or clamping down hedge fund activism in the attempt to tackle (or, in the current political climate, with the excuse of tackling[178]) CAs.

Ideally, balanced rules should be crafted that do not discourage stake-building by well-intentioned investors and value-creating acquirers, thus facilitating the good functioning of the markets for corporate influence and for corporate control, while at the same time preventing bad CAs by looters or suboptimal controllers. Unfortunately, as

[177] *See* Bebchuk, *supra* note 35, at 1790.
[178] *See supra* text accompanying notes 161-163.

one of us with Ronald Gilson and Alessio Pacces argues elsewhere about takeover rules more generally,[179] it is impossible to craft rules that allow for good takeovers to go through while chilling bad ones. It is similarly impossible to devise rules that screen good activists from bad or value-creating CAs from value-destroying ones.

Further, each company is different and has a different optimal exposure to the markets for corporate control and corporate influence. Therefore, policymakers would do best by enacting rules of the game that let individual companies define the balance they deem to fit best for themselves. More precisely, they should refrain from limiting the spectrum of openness to CAs (and takeovers), i.e. from providing inflexible regimes that push companies either to a situation of high contestability or to one of total closure to hostile takeovers.[180] As we have seen, the current framework within the EU, at least if construed as banning certain restrictions to the transfer of shares,[181] fails to allow for such a broad spectrum, by ruling out the mild degree of control incontestability a poison pill (even when coupled with a staggered board), as opposed to deviations from one-share-one-vote, would achieve.

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[179] *See* Enriques, Gilson & Pacces, *supra* note 34, at 8-19.

[180] *Cf.* David D. Haddock, Jonathan R. Macey & Fred S. McChesney, *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701, 741-42 (1987) ("[F]irms differently situated inevitably want different bargaining rules, and are observed to impose different rules on themselves. Consequently, opponents of bargaining must shoulder the burden of showing why these private contractual solutions are undesirable, and why a single rule for all firms would be an improvement" (footnotes omitted)); Barry D. Baysinger & Henry N. Butler, *Antitakeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 VA. L. REV. 1257, 1259 (1985):

> The … theory proposed here is based on the possibility that shareholders have different contractual preferences and on the existence of corporate governance mechanisms other than the market for corporate control. These mechanisms, which include product and managerial labor market competition, provide incentives for managers to act in their shareholders' best interests, and they may adequately discipline managers who attempt to insulate themselves from takeovers. Variations from firm to firm in the effectiveness of alternative governance mechanisms and of shareholder contractual preferences are contingencies that determine whether antitakeover amendments will be adopted" (footnotes omitted).

[181] *See supra* text accompanying notes 151-152.

An optional system is inherently more adaptable to diverse ownership structures and to each company's preferences. Some companies might consider the MBR (as is, or on a modified basis, for instance choosing a higher or lower threshold or switching to a control-based trigger) their preferred option and should be free to make self-regulating choices to that effect. Consequently, they should be free to "opt down" to a lower threshold[182] or, to the opposite, to "opt up,"[183] or even to opt-out of the MBR altogether. Companies should equally be free to opt-up and opt-down with regard to ownership disclosure thresholds.[184] Also, as an alternative or in addition to whatever option they choose on the MBR and ownership thresholds, some companies might consider defenses (any of the defenses surveyed under IV.B, such as poison pills, veto powers over a creeping acquirer, staggered boards and so forth, alone or in combination) as the preferred route to address CA (and/or takeovers more generally).

Generally speaking, legislatures should ensure that companies have the ability to make *effective* choices: statutory restrictions, such as on the availability of poison pills or prior approval for the acquisition of shares over a certain threshold, should be lifted.

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[182] Opt-downs, without more, imply that the public enforcement apparatus should be available also to detect and sanction failure to launch a mandatory bid after crossing the lower-than-default threshold. Of course, jurisdictions may well decide for purely private enforcement in such cases.

[183] In Switzerland, companies are allowed to opt up by increasing the MBR threshold from one third of the voting rights up to forty-nine percent (and may also opt out of the MBR altogether). *See* Klaus J. Hopt, *European Takeover Reform of 2012/2013 — Time to Re-examine the Mandatory Bid*, 15 EUR. BUS. ORG. L. REV. 143, 175-76 (2014) (noting that "24 per cent of the Swiss companies listed on the SWX (59 of 236 issuers) have opted out of the practice and 6 per cent (13 of 236 issuers) have opted up" *id.* at 176). In June 2014, Italy amended its provisions on mandatory bids to allow small and medium listed companies (defined as those with turnover below 300 million euro or market capitalization below 500 million euro), to opt down to a twenty-five percent or up to a forty percent threshold from (the previously mandatory for all) 30 percent threshold. *See* Article 106, para. 1-*ter*, Consolidated Act on Financial Intermediation.

[184] Again, with possibly no public enforcement in case of an opt-down. *See supra* note 182. Private ordering solutions as regards ownership disclosures are advocated by Luca Enriques, Matteo Gargantini & Valerio Novembre, *Mandatory and Contract-based Shareholding Disclosure*, 15 UNIFORM L. REV. 713, 733-38 (2010); Joshua Mitts, *A Private Ordering Solution to Blockholder Disclosure*, 35 N.C. CENT. L. REV. 203, 235-56 (2013) (proposing that issuers have leeway on the timing of blockholding disclosure).

Consider that currently companies do enjoy certain freedoms, which have way farther reaching effects than those devices. Oddly enough, a company may opt-out of the market for corporate control discipline altogether via deviations from one-share, one-vote (which are in fact relatively frequent in the EU[185]), while it cannot do so partially via a poison pill, combined or not with a staggered board.

Hence, the EU should amend its company and securities laws so as to clarify that no EU law obstacle exists to flip-in plans or shark repellants such as those we have described in Part IV.[186] As one of us suggested in an article coauthored with Ronald Gilson and Alessio Pacces, the EU could even go as far as introducing menu rules that companies may opt into, so as to counter companies' tendencies to stick with familiar defaults.[187]

A more delicate question is whether the EU should even *require* member states to allow defenses such as those outlined above or rather defer to member states' choices as regards the degree of openness to the market for corporate control. While one of us argued in favor of such a requirement in the past,[188] this is a matter on which reasonable minds may differ[189] and on which, anyhow, political expediency will have the upper hand.

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[185] *See e.g.* Renée Adams & Daniel Ferreira, *One Share, One Vote: The Empirical Evidence*, ECGI Finance Working Paper No. 177/2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=987488 (last visited Jul. 28, 2014); Faccio & Lang, *supra* note 174, at 384-89.

[186] A related and crucial question that would be left to national policymakers and judges to solve is the standard of review for choices undertaken by management to prevent hostile bids and/or CAs. Because fiduciary duties are both deeply ingrained in national company laws and institutional culture and are traditionally mandatory in nature, there is little we can say about that question, other than to notice that so long as shareholders can replace board members, the case for enhanced scrutiny on board member decisions regarding market for corporate control issues should be carefully weighed.

[187] *See* Enriques, Gilson & Pacces, *supra* note 34, at 43-46.

[188] *Id*.

[189] As both of us are ready to admit, how a flip-in plan or even a board veto would work within each individual country will also depend on how national complementary rules and doctrines, such as

Optional approaches for takeover laws have recently been criticized on a few grounds: lack of uniformity/standardization and potential for conflicted choices by companies.[190]

Giving companies the freedom to opt into tailored regimes would run the risk of confusing the market place, the argument goes, whereas uniform rules carry the benefit of lowering transaction (that is, information) costs, as investors and their advisors would readily know the rules of the game.[191] An easy rebuttal would be to simply point out that current European legislation does all but creating a uniform set of rules for acquisitions: what happened with the board neutrality rule[192] and the various exemptions to the MBR are two of many cases in point.[193] But substantively, as we noted elsewhere, the virtues of uniformity and standardization in company law are exaggerated and often times called for when stronger policy arguments are missing.[194] The market for corporate control differs from consumer markets: not only do "products" naturally tend to be more complex in the former, but also the sums at stake are generally larger. Given the size of market capitalization for companies that can become the target

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fiduciary duties and board election rules, would interact with them, so that a European menu rule may have a very different impact across EU jurisdictions.

[190] *See generally* Hopt, *supra* note 183 at 159, 162, 164 & 171.

[191] *Id.* at 159.

[192] The board neutrality rule, together with its reciprocity feature, is optional at the member state level, i.e. member states (as opposed to their companies unless member states so decide) may choose whether to implement it or not. The only obligation they have is to let companies opt into board neutrality if the member state opts out of it for all companies, i.e. there can be no mandatory no-board neutrality rule (Article 12 Takeover Bids Directive). As one of us noted elsewhere, national legislatures have sixteen different regimes to choose from. Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 EUR. BUS. ORG. L. REV. 553, 558-59 (2005). As a result, Europe's three biggest economies implemented three different regimes: the U.K. adopted the board-neutrality rule, but not the reciprocity option, France has adopted the board neutrality rule and the reciprocity option, and Germany adopted the reciprocity option only but not the board neutrality rule. *Cf.* COMMISSION STAFF WORKING DOCUMENT. REPORT ON THE IMPLEMENTATION OF THE DIRECTIVE ON TAKEOVER BIDS, SEC (2007) 268 (February 21, 2007), at 3-5. In 2014, France switched to a pro-defensive tactics default. *See supra* note 162 and accompanying text.

[193] *See supra* note 104 and accompanying text.

[194] Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT'L ECON. L. 939, 963-64 (2006).

of a CA, it is safe to expect that the market is paying attention to their performance and governance arrangements: as a result, the informational costs are already being spread among analysts and investors. Also, gathering the relevant information with respect to the governance and takeover regime applicable to a listed corporation would not come at high costs (after all, that is what mandatory disclosure of ownership and control features of listed companies is there for[195]). Moreover, uniformity of substantive rules would cut only a tiny fraction of the costs that market players have to incur to complete an acquisition deal. The advantages of uniformity in M&A are overstated if one considers that these deals are promoted by large investors, who are sufficiently sophisticated and well-advised to assess, from a structural and legal standpoint, the strengths and weaknesses of their target.[196]. Also, the number of M&A transactions is generally low if compared to other markets where uniformity comes at a premium (consumer markets, for instance). Standardization and uniformity are crucial when the number of transactions that market players complete every day is high or when the players lack the time, skills or experience to evaluate all the aspects of the transaction. Corporate control transactions are planned long before they are eventually announced and at that stage acquirers know (or at least should know) all about the ownership structure of their targets, including the applicable regime for defenses. In other words, the intricacies in connection with ascertaining the applicable regime are just one of the many issues that an acquirer must solve before stepping into an acquisition; a uniform regime would not generate a significant cost reduction in connection with acquisition planning.[197]

[195] *See* Article 10 Takeover Bids Directive (requiring companies to disclose information about their owners, contractual barriers to takeovers, shareholder agreements, and so on).

[196] *Cf.* Gatti, *supra* note 192, at 562-63.

[197] Enriques & Gatti, *supra* note 194, at 964.

Another objection to our proposed policy framework is that it can facilitate the proliferation of conflicted, self-serving choices by companies.[198] Undoubtedly, any increase in contractual freedom in corporate law implies a higher risk of abuse. But conflicted decisions can already occur in any other decision (business, financial, governance or otherwise) a company makes. Consider corporate transactions such as mergers, spin-offs or sales of assets; consider major governance choices such as the decision to reincorporate in another jurisdiction, the decision to engage in a dual class recapitalization (or in a financing via equity issuance), or the decision to file for bankruptcy or any insolvency-related proceeding; consider, of course, related party transactions themselves. Clearly, there can hardly be any ex-ante guarantee that, in all such cases, the ultimate decision will not favor a conflicted shareholder or entrench the directors to the detriment of (minority) shareholders. However, seldom does that risk justify a ban of the relevant corporate action. We can see no reasons why defenses

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[198] *See e.g.*, in response to the optional approach advocated by Enriques, Gilson & Pacces, *supra* note 34, Hopt, *supra* note 183, at 164 (arguing that leaving room for choices made at the individual company level is "questionable because it makes shareholder and minority shareholder protection fully subject to the majority's power"). *See also* Lucian A. Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1835-46 & 1858 (1989) ("[in] companies with a dominant shareholder . . . the evident value-decreasing nature of an amendment might well not prevent it from being adopted if the amendment serves the interests of the controlling shareholder") *and* Lucian A. Bebchuk & Allan Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168, 1171-72 (1999): "[b]ecause of the value that managers might place on their independence, managers might prefer rules that excessively restrict takeovers, notwithstanding that such rules might somewhat restrict share value" (commenting on the usual impasse that can occur between pro-takeover shareholders, on the one hand, and takeover-wary directors, on the other, when it comes to amend a company's charter in Delaware, which requires approval by both shareholders and directors (*cf.* Section 242(b)(1)-(2) of the DGCL): generally, charter amendments with a bearing on corporate control ultimately tend to fail to pass given the high level of polarization between the two constituencies). In general, this line of thought shows how a constituency's own agenda (whether the constituency is the board or a dominant shareholder is irrelevant) can alter the decision making process. For all the reasons highlighted further in the text, and most notably that there is a good margin to improve each jurisdiction's procedures to implement such amendments, we do not believe that the remarks by the authors mentioned above represent significant obstacles to our suggested policy.

against CAs, an inherently dangerous practice from the viewpoint of shareholders, should require such a ban.[199]

Therefore, rather than thwarting the *spectrum of possible substantive choices* a company can make, policymakers should focus on *adequate procedures*[200] to ensure that a company's choice represents in a "sincere" manner the best interests of its shareholders. By adequate procedures we mean that policymakers should carefully:

(a) select the default regime, both for the MBR and for defenses: our inclination, as each of us separately argued in previous work,[201] is for (minority) shareholder-friendly defaults (for example, setting forth the MBR and the BNR as defaults), which shareholders can opt out of if they so desire. With specific regard to CAs, we would argue that in Europe, where CAs are currently unconstrained, the default should contain no newly-enacted anti-CA provisions. It will be for the

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[199] *Cf.* Marcel Kahan & Edward B. Rock, *Corporate Constitutionalism: Antitakeover Charter Provisions as Precommitment*, 152 U. PA. L. REV. 473, 491 ("Investors need not buy shares of a company in an IPO or secondary market if they do not like their charter. . . . [D]issatisfied shareholders . . . individually . . .. can sell their shares; and collectively such selling, by depressing the share price, can exert pressure for change. As a result, exit imposes . . . significant constraints on managers").

[200] As one of us stressed elsewhere (Gatti, *supra* note 86, at 36-52), the rules of the game in a tender offer are not uniquely determined by the plain and simple takeover regime applicable in the given jurisdiction, because factors external to the takeover regime itself (such as shareholders' ability to call special meetings or act by written consent, the presence of supermajority provisions, biased proxy rules, ineffective rules policing shareholders' conflict of interest, staggered boards and director removability, which are labeled as "corporate law collateral factors") may act as barriers to reversing the regime initially selected by the legislature: as a consequence, the *combination* of the takeover regime and such external factors are key in determining the final outcome of a takeover attempt. If companies had only to decide on the rules of the game relating to takeovers and neglect such other factors, the benefits of letting companies determine what takeover rules they are subject to would be partial at best, if not minimal (*id.* at 73). Hence, the suggestion that legislatures should promulgate tailored rules (applicable in the takeover context only and explicitly pre-empting corporate law principles or rules of general applicability) for such matters as shareholders' conflict of interest, proxy rules, availability of poison pills, and so forth (*id*. at 74).

[201] *See* Gatti, *supra* note 192, at 570-71 (arguing for the BNR as the default regime); Enriques, Gilson & Pacces, *supra* note 34, at 42 (arguing for the BNR and the MBR as the default regimes).

companies to go out and "sell" their new idiosyncratic regime to their shareholders (via opt-ins or opt-outs, as the case may be);[202]

(b) craft tailored[203] rules and procedures for the adoption and repeal of the regime the company chooses:[204] in particular, which corporate bodies are involved, who has the initiative, whether directors need a say,[205] what the necessary majorities are,[206] and how to improve the proxy machinery to ensure effective participation by shareholders;[207]

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[202] One exception to this framework could be for legislatures to consider introducing SARs as default regimes.

[203] *See supra* note 200.

[204] *See generally* Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L.J. 2032 (2012).

[205] If directors are given a say, impasses might easily ensue. The American experience is a case in point: in order to amend the charter both directors and shareholder approvals are necessary (*see supra* note 198). That, in turn, means that directors have a veto power over such amendments. As Bebchuk & Hamdani put it, "for any level of shareholder support, corporations are much more likely to adopt amendments management favors than amendments management disfavors" (Lucian A. Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 492 (2002)). Note that the Shareholder Rights Directive prevents member states (and individual companies) from requiring director approval of charter amendments, given that shareholders representing a fraction of the company's capital no higher than 5 percent have a right to table charter amendment proposals. *See supra* text accompanying notes 135-136.

[206] For a critique to imposing supermajorities in the takeover context, *see* Gatti, *supra* note 86, at 46-49 (supermajorities unduly favor one side of the contest, by making it more difficult for the other side to pass a resolution that is pivotal for such other party's desired takeover outcome).

[207] One might counter that our proposal can only work so long as a given jurisdiction's proxy machinery is well developed. Otherwise, the risk exists that well organized shareholders can game the system and succeed in passing the arrangements that are most advantageous to them but not to the generality of shareholders. In our view, the right policy response to that problem, rather than limiting shareholders' spectrum of choices, would be to take steps to actually improve the proxy machinery with rules that truly facilitate shareholders' participation. (Incidentally, the Shareholder Rights Directive has already taken steps in this direction. *See e.g.* Caspar Rose, *The new European shareholder rights directive: removing barriers and creating opportunities for more shareholder activism and democracy*, J. MGMT & GOVERNANCE 269, 275-78 (2012). Further, proxy solicitation is now less relevant than in the past, in the presence of rules (like those mandating voting by institutional investors) and best practices (including so-called "Stewardship Codes") leading to historically high turnout at shareholder meetings across jurisdictions. *See e.g.* INSTITUTIONAL SHAREHOLDER SERVICES, 2013 VOTING RESULTS REPORT: EUROPE 6 (2013).

(c) for companies that have adopted a takeover-proof regime, consider re-openings, whether on a mandatory basis or as part of a menu rule,[208] i.e. shareholder re-authorizations of such regime after a given time lag: as John Coates observed in the context of dual class share structures and the original proposal for a break-through rule, a re-opening of a takeover-proof structure "would insure that control of every listed company would be put up for auction every so often, facilitating the integration of the EU's internal market, but would not immediately and permanently displace existing [dual class] structures;"[209]; and

(d) provide for mechanisms to ensure that conflicted actors (whether directors or shareholders) do not taint the outcome of the decision-making process.

With respect to (d), as one of us noted elsewhere, if a jurisdiction contemplates some sort of shareholder voting in the context of an acquisition (whether to approve defenses, approve the tender offer, repeal the board or, as we are suggesting here, select the rules of the game), the rules governing conflict of interest by shareholders are as important as the (default) takeover regime.[210] To ensure that shareholders can truly express their preferences, the conflict of interest of one or more shareholders should not affect the shareholder resolution choosing the actual takeover regime for the company. In a system in which the outcome of the vote can easily be altered by "insincere voting,"[211] astute coalitions of shareholders could exploit the optional regime at the expense of the remaining shareholders. National policymakers should look into their corporate voting systems to assess whether their current regimes adequately police conflicted voting.

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[208] Enriques, Gilson & Pacces, *supra* note 34, at 45-46.

[209] Coates, *supra* note 82, at 706.

[210] Gatti, *supra* note 86, at 50-52.

[211] Zohar Goshen, *Voting (insincerely) in Corporate Law*, 2 THEORETICAL INQUIRIES L. 815, 816 (2001).

Generally speaking, to tackle conflicted voting in acquisitions one can think of two non-mutually exclusive approaches: first, allowing everyone to vote and intervening ex post to sanction situations in which a resolution was adopted with the pivotal vote of a conflicted shareholder based upon an open-ended definition of conflict of interests; second, requiring that the relevant resolution be adopted by a majority of the disinterested shareholders, i.e. not counting specific categories of shareholders who are presumed to be conflicted (e.g., the offeror, the largest incumbent blockholder, directors, employees and so forth).[212] The former, an ex post standard-based command,[213] has the advantage that, when enforced and adjudicated, bar any error by the competent adjudicator, only conflicted conducts will be detected and sanctioned. Yet, a standard approach has two important drawbacks: uncertainty (and ensuing costs of obtaining legal advice),[214] because who may or may not vote is not specified ex ante, and possibly insufficient or misguided enforcement, because the judiciary may be reluctant to second-guess the resolution, especially in less than well clear-cut situations, and because judicial error is easier when courts' discretion is wide. The ex ante rule

[212] There are various examples of this type of approach in the context of takeover regulation around the world: (i) virtually all so-called Control Share Acquisitions Statutes (whereby a shareholder approval is a prerequisite for launching a hostile tender offer or passing certain significant ownership thresholds) expressly exclude all "interested shares" for computation purposes (*see e.g.*, among several, Section 23-1-42-3 of the Indiana Business Corporation Law that excludes "[a]n acquiring person or member of a group with respect to a control share acquisition[,] … [a]ny officer of the issuing public corporation[, and] … [a]ny employee of the issuing public corporation who is also a director of the corporation"); and (ii) the regimes of partial bids in the UK (*cf.* Rule 36.5 of the Takeover Code: "Any offer which could result in the offeror and persons acting in concert with it being interested in shares carrying 30% or more of the voting rights of a company must be conditional, not only on the specified number of acceptances being received, but also on approval of the offer, normally signified by means of a separate box on the form of acceptance, being given in respect of over 50% of the voting rights held by shareholders *who are independent of the offeror and persons acting in concert with it*;" emphasis added) and in Italy (*cf.* Article 107 Consolidated Act on Financial Intermediation), which excludes shares held by the offeror, the company's largest shareholder if its stake is greater than 10% and any person acting in concert with any of them.

[213] According to Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 560 (1992), in interpreting standards, "efforts to give content to the law are undertaken … after individuals act."

[214] *Id*. at 569.

approach embedded in majority of the minority provisions has the advantage of being clear and, if artfully drafted, certain in its application; yet it can be over- or under-inclusive depending on how strict the rules disqualifying certain shareholders are. It is beyond the purpose and scope of this paper to suggest a single, optimal solution for each and every jurisdiction: we can only guess that if an existing standard-based system for conflicted voting by shareholders is believed to work well in a given Member State, legislative action would be less pressing; conversely, if a system to police conflicted voting is considered ineffective, legislatures should consider enacting takeover-specific "majority of the minority" or "disinterested shares" rules.

Indeed, all the rules aimed to ensure that adequate procedures are in place should not necessarily be of general application for all company law purposes, but rather tailored for CAs and tender offers.[215] That will help against any overreaching effects in other areas of company law. And while we acknowledge that no perfect policy solution exists even for the issues we have highlighted in items (a) through (d) above, it is our view that legislatures and the judiciary are better apt at establishing and enforcing these procedural rules than at making substantive choices applying across the board to the generality of companies and of M&A deals, which is what currently happens with rigid takeover regimes. Albeit the latter appear to be inherently simpler to draft, their long-term effects could be far worse: we have shown at length how over- and under-inclusive such regimes and possible amendments thereof are bound to be.[216]

VII. CONCLUSION

EU corporate and M&A laws fail to address subtle grabs of de facto control via creeping acquisitions both at the European level and in individual member states. With the exception of jurisdictions such as the Netherlands that more generally offer a good

[215] *See supra* note 200.
[216] *See supra* Parts IV and V.

degree of freedom for companies to defend against unsolicited acquisitions,[217] European public companies can easily become the target of a creeping acquisition. Unlike substantial investments by hedge fund activists (their not so distant cousins in the "market for corporate influence"), creeping acquisitions can lead to a permanent loss of a company's contestability status and therefore of any prospect for its shareholders to obtain a substantial control premium in the future. This in turn can generate negative effects on two levels: excess in search and investment by hostile acquirers and lower market valuation (and hence a higher cost of capital) for target companies.[218]

This paper does not call for a legislative overhaul of current regimes: one-size-fits-all solutions are ill-suited in M&A law. With their variable ownership structures, business strategies, and industry features, companies can be very differently situated in the market for corporate control. Rather, this paper suggests a lift on existing limitations to a company's freedom to determine its preferred level of openness to creeping acquisitions: European legislation should grant companies an optional regime whereby they can select effective arrangements to thwart or limit such acquisitions.

We address the concerns that are often raised with regard to takeover defenses by emphasizing the importance for jurisdictions to set up adequate procedures that companies must abide to when selecting the preferred regime. Ultimately, defensive measures *per se* are not foreign to EU M&A law, even in jurisdictions that have implemented the board neutrality rule, in that target companies can adopt such measures so long as they obtain shareholders' approval.[219] Shareholders should be able to devise measures that can block creeping acquisitions (and, incidentally, takeovers more generally) in an effective way and without unnecessary costs. Once a jurisdiction empowers shareholders to authorize defensive actions, it should better provide them

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[217] *See supra* note 17.
[218] *See generally* Haddock, Macey & McChesney, *supra* note 180, at 702-03 & 708.
[219] *See supra* note 127.

with good arrows rather than bad ones; there is no reason for permitting only a limited set of defenses (such as potentially value-wasting transactional defenses) and excluding those, such as poison pills and similar structural defenses, that are both more effective in fending off unwanted acquirers and neutral to companies' operations.[220]

[220] *See also* Gatti, *supra* note 86, at 71 n.152.

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