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Equity markets, market efficiency and contestability of control in a trans-Atlantic perspective. The regulatory conundrum of the ownership structure in an internationally integrated financial market in the wake of directive 2004/25/EC on takeover bids. (**)

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1.- Equity markets display an important function in fostering allocative efficiency. Indeed, they appear not only to lower entry barriers into the market by providing a wider access to capital (especially important for start up technological companies or other emerging firms), thereby promoting a more decentralised economy (than the one of bank-centred systems) and a more rapid pace of economic growth and innovation[2], but also to: a) provide a tool for *the external control* of the "agency costs" implied in the shareholders/corporate managers relationship, through the exposure of the ownership of the companies to changes driven by the market whose associated ordinary effect is thought to be the displacement of existing non performing management; and b) prompt, by means of market operations directed at fostering the company's external growth, industrial reorganization and consolidation, especially on a wider international scale (alongside with the opening of more integrated global markets). In so doing securities markets basically allow companies to benefit from their major structural advantages in respect to other organizational forms which do not admit ownership transmission (as the state enterprise) or neutralise the control effects of ownership on management (as cooperatives and not-for-profit associations). This proved essential to respond to the challenges posed by a market economy environment characterised by imperfect competition (and therefore by a distinct tendency towards oligopolistic concentration) and was one of the reason for the rise and success of the public company model in modern free market economy. Takeovers – i.e. the friendly or hostile public offers to purchase shares, ordinarily in an amount sufficient to control the company – are therefore, in principle, not just a technique for the company's change of control but an instrument of allocative efficiency. To be sure, they are not market techniques without substitutes. The disciplinary effect on the management exerted by the threat of a takeover can be obtained, indeed, also through other market practices like the solicitation of proxies and the public offer to purchase votes (instead of shares), if and where, departing from the traditional veto of such a practice in the, albeit different, political context and from a principle of necessary correlation between risk and

[2] J.C.COFFEE JR., J.SELIGMAN, H.A.SALE, *Securities Regulation, Cases and Materials*, Foundation Press, New York, Tenth ed., 2007, p.7

control, this practice is allowed ([3]). The industrial consolidation can be attained also, albeit with different ownership outcomes, through other market transactions like mergers or, in the case of public enterprises, through legal intervention. Stocks acquisition is however generally easier and more flexible and usually does not depend on anything else than market forces alone. This is particularly true for private companies, where free bargaining controls and both shareholders, with the articles of association, and the bidder, with the offer proposal, can therefore define the conditions at which the change of control can take place as they deem fit. On the contrary, the way market forces are left to guide the process of acquisition in the case of listed public companies varies.

2.- In the U.S. federal legislation on takeovers – enacted with the 1968 Williams Act and amended in 1970 – refrains from intervening in the process other than by imposing to the bidder a few mandatory rules of conduct intended to enhance shareholders' value such as: a) the disclosure of a sufficient degree of information (the "early warning" Schedule 13G due under § 13d and the Schedule TO, containing the filing disclosure statement and its annexed tender offer, under § 14d), so as to avoid, as indicated in the House Report, that the shareholders of the target company be forced to make a choice on the acceptance or refusal of the offer "without the benefit of full disclosure" and without receiving "full and fair disclosure analogous to that received in proxy contests"; b) a minimum duration of the process (the 20 days set forth by SEC Rule 14e-1), designed to provide the shareholders the opportunity "to examine all relevant facts in an effort to reach a decision without being subject to unwarranted pressure" or "being forced to act hastily"; c) a pro-rata rule, whereby the bidder, even if it is left free to fix the amount of shares tendered as it deems fit, without any obligation to tender all shares carrying voting rights (as it is on the contrary the case of the mandatory tender offer provided for by European law), must prorate shares received during the offer under SEC Rule 14d-8 (which extends during the entire life of the offer a principle with § 14(d)(6) would limit to the acceptances received in the first 10 days); d) the non discrimination rule, whereby the bidder must offer to all holders (under

[3] For a recent comparative study, see *Report on the Proportionality Principle in the European Union*, external study commissioned by the EU Commission to Shearman & Sterling, ISS and ECGI, Brussels, July 2007.

Rule 14d-10) and at the same and best price (§ 14(d)7) the acquisition of the targeted amount of shares. The Williams Act, however, does not require that the acquisition of control of a listed company comes along with a compulsory tender offer (and therefore a moneyed exit solution) to all existing shareholders at the same price nor mandates the launch of a (subsequent) bid in order to align the economic treatment of dispersed shareholders with the one reserved, in an over-the-counter transaction, to the former controlling or substantial shareholder(s), if any. *In other terms, American takeovers are not determined by law but by market forces alone.* The legal permissibility of partial bids and even of "two tier bids", in which the bidder offers a "front loaded" above market tender offer price (and premium) for an amount of shares giving control and announces a plan to merge out the remaining minority shareholders at a lower price when control is obtained is, in fact, consistent with the policy goal of facilitating the (market-driven) takeover process by avoiding an excessive cost of the change of control of public listed companies. In turn the policy goal of facilitating takeovers is clearly embedded in the underlying conceptual premise – dating back to a seminal and highly influential study of Manne, but hotly debated since then – that takeovers serve as an external and efficient market response to the bad performance of management. It is assumed indeed, so the theory goes, that when there are high "agency costs", slack management performance convert into stocks' under pricing, thereby creating a market opportunity for a profitable change of control which would bring about the replacement of the slack management[4]. *Ironically, though, the Williams Act did not address directly the shareholders/managers relationship nor it defines the boundaries of the power granted to the incumbent managers to contrast or even frustrate the bid, leaving to state law and to the common law of fiduciary duties the task to define it.*

[4] Some event studies find that companies with more anti-takeover protections had a lower Tobin Q throughout the 1990s and showed poorer firm performance in terms of return on equity and sales growth (P.GOMPERS, J.ISHII, A.METRICK, *Corporate Governance and Equity Prices*, (2003) 118 *Quarterly Journal of Economics* 107, as well as managerial weakness in minimizing labour costs (M.BERTRAND, S.MULLINATHAN, *Executive Compensation and Incentives: The Impact of Takeover Legislation*, (1998) NBER Working Paper 6830).

3.- The Delaware Supreme Court, in a series of remarkable and most cited cases starting from *Unocal Corporation v. Mesa Petroleum*[5], whilst requiring some justification and proportionality of the board defensive decisions "in respect of the threat posed" by the tender offer, confirmed (and progressively broadened) the wide authority of the board to adopt post bid defensive measures without shareholders' approval. In *Paramount Communications, Inc. v. Time*[6] and even more straightforward in *Unitrin v. American General Corporation*[7] - where the Supreme Court found legally sufficient the board motivation to adopt a defensive measure without seeking the approval of the shareholders since "Unitrin's shareholders might accept American General's inadequate offer because of ignorance or mistaken belief regarding the board's assessment of the long term value of Unitrin's stock"[8] – case law evolved to the point as to recognize the board general power, under the common law of fiduciary duties, to adopt defensive measures without the need to obtain prior shareholders approval *with very little in the way of justification*[9]. In addition to that, anti-takeover state provisions – upheld by the Supreme Court in its landmark decision of 1987 in *CTS Corp. v. Dynamic Corp of America*[10] in so far as they impose additional disclosure requirements or corporate law restriction but refrain from mandating a prior notice to the target company and to state officials some time before the commencement of the offer[11] - often supplement further the weapons available to the board,

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[5] 493 A.2d 946 (Del. 1985). Earlier cases often (but not always) conformed to the plain business judgement rule.

[6] 571 A.2d 1140 (Del. 1989)

[7] 651 A.2d 1384 (Del. 1995).

[8] As the Vice Chancellor Strine of Delaware observed, however, "if stockholders are presumed competent to buy stock in the first place, why are they not presumed competent to decide when to sell in a tender offer after an adequate time for deliberation has been afforded them?" (quotation in A.FERREL, *Why Continental European Takeover Law Matters*, in *Reforming Company and Takeover Law in Europe*, eds. Ferrarini, Hopt, Winter, Wymeersch, Oxford University Press, 2004, at p. 567)

[9] Little more, thus, than a plain "just say no". This is why J.A.GRUNDFEST, *Just vote No: a Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 *Stan. L. Rev*. 857 (1993) concluded that "the takeovers wars are over. Management won".

[10] 481 US 69 As correctly pointed out by M.VENTORUZZO, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, in 41 *Tex. Int'l Law Journal* 171 (2006) this decision "denied the existence of an interstate market for corporate control protected by the Commerce Clause".

[11] The Delaware statute requiring a 20 days advance notice to the company and state officials was invalidated by the Supreme Court as impermissible burden on the interstate commerce and was declared preempted by the federal rules of 1934 Act in *Edgar v. Mite Corp.*, 457 US 624 (1982)

by, for example, a) setting forth that a person acquiring over a certain threshold of stocks can vote only with the approval of other shareholders ("control share acquisition statutes"); b) prohibiting the combination of the target company with the hostile bidder for a period from 2 to 5 years ("business combination moratorium statutes"); c) requiring supermajority approval for a merger when it fails to satisfy a fair price test ("fair price statutes"); d) expressly authorizing the board to take into consideration, when assessing the suitability of the offer, also the interests of stakeholders other than shareholders ("non shareholders constituencies statutes"). The catalogue of defensive measures available to U.S. (mostly Delaware) incorporated listed companies is extremely long: though, the most often used technique seems to be, still, the combination of a "flip in poison pill" and a "classified" or "staggered board". When a potential bidder crosses a stated ownership threshold, the other shareholders are entitled to acquire target shares at a bargain price, so that the massive and discriminatory (against the bidder) issuance of new and cheap stocks dilutes the bidder stake and makes overwhelmingly more expensive the acquisition of the control. To be sure, the pill can be made inoffensive if the board – which has the power to do so – redeems, instead of triggering, the options. To prevent therefore the rational bidder countermove of soliciting proxies to appoint, after a successful proxy solicitation, a new board, which will then redeem the pill to permit the bid to go forward, the articles of association of the companies adopting the pill usually complement it with an additional pre-bid technical barrier to the swift change of control consisting in a staggered board which makes it impossible to replace the majority of the board's members in a single run, thereby postponing for one or two years the effective acquisition of control and, at the same time, exposing the bidder to the usually prohibitively risky situation of investing a huge amount of money in a transaction which could be closed (with the effective taking of power) only after a long period of time[12].

[12] On this anti-takeover measure, which is reported to have been adopted by around 50 percent of large US firms J.N.GORDON, *An American Perspective on Anti-Takeover Laws in the EU: The German Example*, in *Reforming Company and Takeover Law in Europe,* at p. 549; ID.,*"Just Say Never? Poison Pills, Deadhand Pills and Shareholder-Adopted By-Laws: An Essay for Warren Buffet*, (1997) 19 *Cardozo Law Rev*. 511; L.A.BEBCHUK, J.C.COATES IV AND G.SUBRAMANIAN, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, (2002) 54 *Stan. L. Rev*. 887 (where an event study of the practical effect of the measure finding that in the period 1996-2000 only 21 firms were able to frustrate an hostile bid through this device out of over 40.000 acquisitions in the same period: a scarce 0,4%)

4.- Contrary to the appearance and to a quite common misconception, though, the formal existence of effective anti-takeover measures did never convert into a general and functional insulation of U.S. listed companies from the market of corporate control. As it has been convincingly put forward by Professor Gordon:

> "US corporate governance institutions have adapted *so that US managers rarely resist a premium bid* (emphasis added). Acquisition activity in the 1990s was, if anything, more intense than in the 1980s, measured both as a percent of market capitalization and in the number of transactions and much greater if measured in real dollar terms or a percent of the GDP. The degree of hostility declined across the decades, but we have come to realize that in many cases hostility is merely an artifact of when a deal becomes public. Many transactions that start off as unwelcome overtures end up as "friendly" rather than "hostile" if target management decides that resistance is unsustainable and undesirable. There are very few financial buyers pursuing highly leveraged hostile burst up, but this is more because of the dearth of target for which this 1980s deal strategy now makes economic sense. During the 1990s the hostile bidders were strategic buyers, including some of the most widely respected firms, with access to internally generated capital. This shift in the nature of the buyers helps to explain why the minuet of resistance and capitulation often played out privately. Nevertheless the threat of going hostile is still very important because many friendly deals are negotiated against the backdrop of the hostile bid possibility".

In a *quantitative* perspective – looking thus at the overall numbers of takeover transactions without distinguishing *qualitatively* in respect to the bigger or lesser sensitivity of certain industries or companies to the pressure for the isolation from the market for corporate control – it has been possible, therefore, to argue[13] that "defensive measures do not really protect US firms from hostile bid. *Generally speaking, they merely structure a process in which the target board can negotiate an higher price*

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[13] J.N.GORDON, *An American Perspective on Anti-Takeover Laws,* p. 548.

for the shareholders (emphasis added). But that fortunate outcome is the result of institutions and practices that may not be easy to reproduce elsewhere. Thus the same basic legal rules may lead to radically different outcome" in other legal systems. In fact, "the set of mitigatory institutions or adaptive institutions" which in practice often render the high powered defensive measures available unable to systematically impede the takeover market includes, i.a.: a) First, the fact that the flip in poison pills is reversible and value enhancing for the existing shareholders, except for the discriminated bidder, and for the company and is not a self-destructive and irreversible measure which reduce the value of the firm in order to "save it" as it happened with many of the "old" measures used in the U.S. in the 1970s and early 1980s (selling off the crown jewels, i.e. assets that the bidder might prize; entering into "tin parachute" agreements with management and file employees that promise large bonus conditional upon the change of control; respond with "pac-man" strategy of counter-bidding for the offeror; reshaping the capital structure through additional leverage)[14]; b) Second, the "typical U.S. practice of annual shareholders elections of board members combined with heavy institutional investor ownership in large public firms means that managers and directors are highly sensitive to public shareholder interest in considering the bid; c) Third, the use of stock options and other executive compensation devices which align managerial and shareholder interest in the takeover decision[15]. *Not surprisingly, thus, during the Nineties, European companies bought American companies at a far greater rate (almost three times, when calculated in aggregated value) than American companies bought European ones*[16]

5.- *Qualitatively*, however, it remains somehow unclear how the anti-takeover philosophy embedded in the state corporate laws and in the current judicial construction of the board's fiduciary duties is exerting, under the pressure of local politics, a role in insulating from the market of corporate control *specific relevant companies incorporated in the U.S.*, displaying a central role within the American economy: a question which appears especially relevant in a transatlantic cross-border perspective[17]. In

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[14] J.N.GORDON, *An American Perspective on Anti-Takeover Laws*, p. 551.
[15] J.N.GORDON, *An American Perspective on Anti-Takeover Laws*, p. 553.
[16] G.SUBRAMANIAN, *The Influence of Anti-Takeover Statutes on Incorporation Choice:Evidence on the "Race" Debate and Anti-Takeover-Reaching*, in 150 *U.Pa. L. Rev*. 1795 (2002), at p. 1867-68.
[17] The cross-border perspective poses, obviously, also several questions concerning the concurrent applicability of different, and sometimes inconsistent, national rules to the same tender offer: for an example, see SEC Release no. 7759 of October 22, 1999 and no. 7760 of November 10, 1999 providing a two tier exemptive structure for the bids

other terms, if we look at the control of “Corporate America”, it remains to be investigated to what extent *strategic* U.S. public listed companies are contestable by foreign bidders – to be true, not only European companies but possibly, today, even Russian or Indian or Chinese private or state-funded investment vehicles – and to what extent international law can provide a level playing field for U.S. and non-U.S. investors. In fact, a few relevant restrictions to foreign takeovers exist, despite the multilateral international provisions of GATS aimed at liberalizing market access and foreign investment[18]. In particular, the “Exon-Florio” provision[19] entitles the President to suspend or prohibit any foreign acquisition, merger or takeover of a U.S. firm that is found *to threaten the national security*. The proviso is implemented by the Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee chaired by the Secretary of Treasury in charge of reviewing proposed transactions, usually upon a voluntary prior notice. The confidential nature of the CFIUS review process makes it difficult to account for the cases. According to one source, however, CFIUS conducted so far full investigation of 25 cases. To our knowledge, of these 25 cases, thirteen transactions were withdrawn upon notice that CFIUS would conduct a full review and twelve of the remaining transactions were sent to the President with a single order prohibiting the acquisition in 1990 of Mamco Manufacturing Company (an aerospace parts manufacturer) by the China National Aero-Technology Import and Export Corporation (CATIC), owned by the Government of the People’s Republic of China[20]. Since 11 September 2001, it is reported that the CFIUS review process has intensified due to sensitive national security concerns. In the Telecommunication sector, in turn, Section 310 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996, imposes foreign ownership restrictions on U.S. broadcast, common carrier, or aeronautical radio station licensees. Finally, Section 1117 of the Federal Aviation Act requires in general that transportation funded by the U.S. government be performed by U.S. carriers while the Merchant Marine Act of 1920 (“Jones Act”) prohibits foreign-built vessels from engaging in coastal trade, dredging, towing or salvaging.

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concerning securities of a foreign issuer partly held by U.S. investors. For a brief overview, J.C.COFFEE JR., J.SELIGMAN, H.A.SALE, *Securities Regulation*, p. 840.

[18] See European Commission, *U.S. Barriers to Trade and Investment Report for 2006.*, February 2007, available at http://trade.ec.europa.eu/doclib/docs/2007/february/tradoc_133290.pdf

[19] Section 721 of the Defense Production Act of 1950 as amended by Section 5021 of the Omnibus Trade and Competitiveness Act of 1988 and by Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993, called the "Byrd Amendment,".

[20] See CRS Report for Congress, at: http://www.fas.org/sgp/crs/natsec/RL33312.pdf

6.- In Europe, the regulatory experience on takeover bids draws extensively from the original English model. In the United Kingdom, in fact, hostile takeovers became a quite common market practice in the 1950s[21], also thanks to the financial ability of bankers like Sigmund Warburg and Charles Clore. The first regulation was thus to be found in the Notes of Amalgamations of British Business of 1959 and, nine years later, in the first edition of the self-regulatory Code on Takeovers and Mergers of 1968: a remarkable collection of "soft" rules, enforced by the private Panel on Takeovers and Mergers, which set and anticipated most of the basic principles which are today embedded in the European harmonized legislation. The City Code dictated indeed specific provisions: a) on the procedure, designed first to prevent the bidder from coercing the targeted shareholders into an hasty decision on whether to accept or not the offer and, second, to favour the smooth performance of the transaction and shareholders' price maximisation, by consenting both price increase by the bidder and competing offers, if any; b) on the information to be provided during the process by the bidder and by the board of directors, so as to put the shareholders in an unbiased position for adopting a conscious decision on the acceptance or refusal of the offer; c) on minority protection, bringing about the obligation to launch a bid at comparable conditions when the acquisition over-the-counter of a controlling stake triggered a change of control (so called "mandatory offer"); d) on the neutrality of the board, which, under General Principle 7, was from the outset barred, once a bona fide offer had been made or had been announced as imminent, from taking any action which could "frustrate the bid" without the prior shareholders' approval. *The contestability of the corporate control did represent, thus, one of the takeover policy goals from the very outset of the first European model of takeovers (self)regulation*. This was not related solely to post-bid defences. The English law, in fact, addressed also, albeit partially, the issue of pre-bid anti-takeover measures. As it has been correctly pointed out[22]:

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[21] Prior to World War II it is reported that takeovers were essentially "friendly", consisting in the negotiated acquisition of the directors' personal stake followed by an offer of the buyer to all shareholders to sell also their shares at identical conditions accompanied by a recommendation of the board to accept the offer: A.FERREL, *Why Continental European Takeover Law Matters,* p. 569 (where additional references).
[22] A.FERREL, *Why Continental European Takeover Law Matters,* p. 570

> "There are a number of relevant statutory and London Stock Exchange rules that impede the adoption of certain types of defensive tactics. In addition to these provisions, there is a common law doctrine that managers may only use their corporate powers for "proper purposes". In the groundbreaking case of *Hogg v. Cramphorn* it was concluded that placing a large block of stock in a trust fund established for the benefit of corporate employees was found to constitute an improper purpose of English common law given that the purpose of the managers in placing the shares was to block potential bidders".

7.- Building on this model and at the end of a long and extremely disputed legislative history (reflecting both the very different starting point of national corporate laws regulating pre-bid and post-bid defences and, more broadly, the non converging political and historical approaches of national industries to the contest for corporate control prior to harmonization), the European Union recently reached, with directive 2004/25/EC an harmonized platform grounded on these principles. As a matter of fact[23], according to the Financial Services Action Plan adopted by the Commission in 1999 and to the position expressed by the European Council in Lisbon, the enactment of a framework directive on takeover bids was expected as an important component of the EC capital market regulation, *precisely designed to set a common European framework for cross-border takeover bids, whereby contributing to the reorganisation of European companies and to the development of a single pan-European capital market*. In the White Paper on the completion of the internal market published in 1985 the Commission first expressed its intention to draft a directive to harmonise Member States provisions on take over bids. In 1989 the Commission was finally able to publish a detailed first proposal but, since the European Council considered it overly detailed and the proposal encountered the opposition of many Member States, the

[23] Compare B.DAUNER LIEB, M.LAMANDINI, *Report to the European Parliament on the Commission's new proposal of a directive on company law concerning takeover bids, with particular reference to the recommendations of the High Level Group of Company Law Experts set up by the European Commission and to the achievement of a level playing field in the domain of takeover bids*, (Study no. IV/2002/06/01), Official Expert Report delivered to the European Parliament on 9 December 2002 in the stage of parliamentary discussion of the directive proposal which was then to become directive 2004/25/EC.

Commission preferred to drop it and to publish a revised version in 1996 in the form of a framework directive which set out general principles but at the same time left wider scope to the legislation of Member States. The proposal was recommended by the Economic and Social Committee and by the European Parliament, which proposed however 20 amendments. In 1997 the Commission published therefore a new version which took account of the recommendations of the European Parliament. In 2000 a common position was achieved in the European Council. On second reading, however, the discussion in the Parliament revealed major differences between the European Parliament and the European Council. In particular, the European Parliament posed the question of the regulation of a squeeze out and sell out right which was not covered by the proposal and required a more detailed definition of the “equitable price” paid in the event of a mandatory bid. Furthermore the Parliament stressed the importance of adding provisions for the protection of employees affected by a takeover bid. The following conciliation procedure ended up with a compromised text which, surprisingly (but not without merit), failed to obtain the required majority for enactment in the plenary session of the European Parliament on 4 July 2001 (when, for the first time in the Parliamentary history, 273 members voted in favour and 273 members voted against the conciliation text). The Parliament, following the German position, still considered that: a) a principle whereby the board of the target company could not take defensive measures in the face of a bid without the prior approval of the shareholders’ meeting to be held once the bid has been launched, could not be accepted *until such time as a level playing field was created for European companies facing a takeover bid*; b) the protection afforded by the directive proposal to the employees was still insufficient; c) the proposal failed also to achieve a level playing field with the United States. Following such a vote of the European Parliament, the Commission set up a High Level Group of Company Law Experts with the mandate to examine the issues raised by the Parliament in relation to the ill fated directive proposal. The High Level Group rendered its advice with an influential – albeit hotly debated - Report delivered on 10 January 2002. On 2 October 2002 the Commission submitted a new directive proposal, which, on one hand, confirmed many of the provisions of the 2001 ill-fated directive proposal but, on the other hand, also endeavoured to properly address the issues raised by the European Parliament in July 2001. The parliamentary position – reflected by the report of MP Klaus H. Lehne, rapporteur at the EP Legal Affairs and Internal Market Committee[24] – was favourable in principle, although it was required that the "break through" rule of pre-bid defensive measures set out in Article 11 of the Commission's proposal (designed, along the lines of the suggestions of the High Level Group, to address the issue of the level playing field throughout the Union), be amended *in order to encompass several additional pre-bid defences, and primarily multiple voting[25] still uncovered by the proposal*. Faced with the fierce opposition of some Member States to adopt a directive with such a broadened break through provision, in May 2003 the Portuguese Presidency tabled a compromise proposal (then incorporated in a new draft of the directive proposal presented in June 2003), rendering optional the provisions of article 9 and 11 on anti-takeover defences. This proposal reached in fall 2003 the political compromise between the Parliament and the Council (with the opposition, though, of the Commission) and led to the final approval of the directive[26].

8.- Directive 2004/25/EC "lays down measures coordinating the laws, regulations, administrative provisions, codes of practices and other arrangements of the Member States, including arrangements established by organisations officially authorised to regulate the markets, relating to takeover bids for the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market in one or more Member States". Member States can however extend, if deemed appropriate, the applicability of its provisions also to non listed securities when implementing the directive and, under Article 3(2)(a) "lay down additional conditions and provisions more stringent than those of the directive for the regulation of the bids" or, under Article 4(5)(i), "include such derogations in their national rules" which, without derogating to the general principles of the directive (referred to here below), be necessary "in order to take into account of circumstances determined at national level". The directive sets out in Article 3, a series of general principles which must be complied with in the

[24] COM(2002)534 – C5-0481/2002-2000/0240(COD), 11 March 2003
[25] For a brief account, P.O.MULBERT, *Make it or Break it: The Break-Through Rule as a Break-Through for the European Takeover Directive?*, in *Reforming Company and Takeover Law in Europe*, p. 713.
[26] On the last phase of this complex legislative process, M.BECHT, *Reciprocity in Takeovers*, in *Reforming Company and Takeover Law in Europe,* p. 650

implementation of the directive and namely that: a) “all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover if a person acquires control of a company, the other holders of securities must be protected”; b) “all holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company’s places of business”; c) “the board of an offeree company must act in the interest of the company as a whole and must not deny the holders of the securities the opportunity to decide on the merits of the bid”; d) “false markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid”; e) “an offeror must announce a bid only after ensuring that he/she can fulfill in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration”; f) “the offeree company must not be hindered in the conduct of its affairs for longer than it is reasonable by a bid for its securities”.

9.- According to said general principles, the directive covers a wide range of issues.

a) It dictates, under Article 4, a principle for the allocation of the supervisory functions in respect to cross-border takeovers which, on one hand, where the target company has its registered office in a Member State other than the one of listing and trading, gives some leave way to European regulatory and supervisory arbitrage and, on the other hand, differentiate between matters relating to “market rules” or “securities law provisions” (those on the consideration to be offered, the bid procedure and the information to be provided) – which are governed by the “rules of the Member State of the competent authority” and matters “relating to the information to be provided to employees of the offeree company and in matters relating to company law” – herein included, however, “the conditions under which the board of the offeree company may undertake any action which might result in the frustration of the bid” – governed by the laws of the Member State in which the offeree company has its registered office[27].

b) It sets out in Article 5, for the protection of the minority shareholders, a mandatory bid at equitable price, it being the highest price offered by the bidder during the last six to twelve months before the bid.

c) It details, under Article 6, the basic information to be provided for by the bidder in the offer document (a provision supplemented by additional disclosure duties under Article 8, in order to "prevent the publication or dissemination of false information").

d) It defines, in Article 7, the duration of the offer from a minimum of two weeks to a maximum of 10 weeks (Member States are however allowed to extend it "on condition that the offeror gives at least two weeks' notice of his/her intention of closing the bid" or "in order to allow the offeree company to call a general meeting of shareholders to consider the bid").

e) It posits in Article 9 a "non frustration rule", whereby the "board of the offeree company (such being, in a two-tier board system, "both the management and the supervisory board": Article 9-6) shall obtain the prior authorisation of the general meeting of shareholders given for this purpose before taking any action, other than seeking alternative bids, which may result in the frustration of the bid and in particular before issuing any shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company". The constraints on the board's discretion operate "from the time the board receives the information" referred to in Article 6 (unless Member States anticipate it at an earlier state, "for example as soon as the board of the offeree company becomes aware that the bid is imminent") "and until the result of the bid is made public or the bid lapses" and extends to all decisions, even if already taken but not yet partly or fully implemented, "which does not form part of the normal course of the company's business and the implementation of which may result in the frustration of the bid".

f) It requires, again in Article 9, that the board "draw up and publish a document setting out its opinion of the bid and the reasons on which it is based". Having clear the potential re-allocative effects often brought about by a takeover (relocation and economy of scale effects when the takeover

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[27] For a discussion of this relevant provision, see M.BENEDETTELLI, *Offerte pubbliche di acquisto e concorrenza tra ordinamenti nel sistema comunitario*, working paper (on file with the Author), forthcoming in *Banca, borsa e tit. cred*., 2007, I.

is industrially motivated; “burst up” effects, when the takeover is financially motivated), the directive mandates to the board to expressly include in such a document “its views on the effects of implementation of the bid on all the company’s interests and specifically employment, and on the offeror’s strategic plans for the offeree company and their likely repercussions on employment and on the locations of the company’s places of business”. Particular emphasis is given to the employees perspective, by making the same addressee of the document in addition to the shareholders and by providing that “when the board of the offeree company receives in good time a separate opinion from the representatives of its employees on the effects of the bid on employment, the opinion shall be appended to the document”.

g) It sets out, under Article 10, a new, specific transparency provision concerning pre-bid defensive measures[28], consisting of a duty to publish information and present an explanatory report to the annual general meeting concerning the structures and measures that could hinder the acquisition and exercise of control over the company, such as “the structure of the capital”, “any restriction on the transfer of securities”, “significant direct and indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings)”, “the holders of any securities with special control rights and a description of those rights”, “any restrictions on voting rights”, “any agreement between the shareholders which may result in restriction on the transfer of securities and/or voting rights”, “the rules governing the appointment and replacement of the board members”, “the powers of board members and in particular the power to issue or buy back shares”, “any significant agreement to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid, and the effects thereof”, as well as “golden parachutes” between the “company and its board members or employees providing for compensation if they resign or are made redundant without valid reasons or if their employment ceases because of a takeover bid”.

[28] This obligation clearly relies on an efficient market hypothesis and therefore on the assumption that the market shall evaluate these structures, better pricing the shares of the companies whose ownership structure is open and contestable. This provision mandates disclosure but not displacement of pre bid technical barriers. Due to market imperfections, it seems hard to believe that transparency alone could bring about the necessary level playing field, at least at the present degree of development of securities markets in Europe.

h) It provides, under Article 11, a break through rule aimed at making unenforceable during the bid and at dismantling, if the bid is successful, at least some of the most common pre bid defensive measures that can be regarded as hindering bids such as “any restrictions on the transfer of securities or on voting rights (herein included multiple vote) provided for in the articles of association or in contractual agreements” and “extraordinary rights of shareholders concerning the appointment or removal board members”.

i) It provides, under Article 13, a referral to Member State legislation on the rules concerning, i.a., “the revision of bids”, “competing bids”, “the irrevocability of bids and conditions permitted”;

l) It safeguards in Article 14 the information and consultation procedures with the representatives of the employees, especially relevant where co-determination is nationally recognized;

m) It introduces, under Article 15, the squeeze out procedure requested by the European Parliament which enables a shareholder who holds not less than 90% of voting securities following a takeover bid to require the remaining minority shareholders to sell her or him their securities at a fair price;

n) It introduces, under Article 16, a sell out right for the benefit of the minority shareholders upon the same terms and conditions provided for in the squeeze out procedure;

o) It incorporates, under Article 18, a new provision on committee procedure which somehow extends to the domain of company law the Lamfalussy procedures set out for financial markets and which therefore raised some political concerns within the parliamentary circles (concerns then addressed by the sunset provision of Article 18(3), whereby “four years after the entry into force of the directive, the application of those of its provisions that require the adoption of technical rules and decisions according to the comitology procedure shall be suspended” and shall be reviewed by Parliament and Council).

p) It sets forth in Article 19 a contact committee “to facilitate the harmonised application of the directive through regular meetings dealing with practical problems arising in connection with its application” (it being however specified that “it shall not be the function of the contact committee to appraise the merits of decisions taken by the supervisory authorities in individual cases”) and “to advise the Commission, if necessary, on additions and amendments to the directive”.

q) Finally, it provides, under Article 20, a revision clause aimed at achieving, at a later stage, a more level playing field in takeover bids.

10.- *It is apparent from the foregoing that the "most innovative core" of the directive relies on the provisions concerning the contestability of control*. Indeed, most of the harmonized rules on disclosure and procedure – as well as the one on mandatory bids – essentially ratify a convergence, inspired by the original U.K. model, which, at the date of enactment of the directive, had already taken place in (at least) the principal Member States. Not surprisingly, these well settled provisions received quite general acceptance, despite the inevitable existence of inside inconsistencies, as a result of the multiplicity of policy goals traditionally pursued by the takeover (British-style) regulation, for example between the provision of a mandatory bid at the "highest price" and the (coexistent) purpose of fostering the market for corporate control[29]. Despite the fact that the innovative conceptual core of the directive relies in the provisions of articles 9-11 aimed, in their true substance, at fostering the contestability of control of European listed companies, *it would be wrong to read such a directive as the final recognition of a general European ban of national, public or private, defensive measures* capable of insulating the ownership of listed companies from the market for corporate control. On one hand, indeed, the harmonizing rules directed at setting a level playing field in respect to private-law pre-bid and post-bid defences are made only optional by Article 12. They do represent, thus, a European benchmark for policymakers, but not yet a compulsory rule mandated throughout Europe. In practice, thus, as the directive's legislative history and its subsequent national implementation show, the "sunlight" on national regulatory choices brought about by the political debate accompanying the directive proposal served to highlight the existing uneven openness to the contest for corporate control of national champions and the political inability to reach a European convergence on the level playing field. *This, ironically, prompted - instead of the removal of existing barriers - a nationalistic*

[29] Such a price, in fact, whereas it affords the best protection to the minority shareholders, might render the launch of a bid, in certain circumstances, overly costly (especially when prices are decreasing), thereby impairing the contestability of control. For a critical re-assessment of the mandatory bid, in general, L.ENRIQUES, *The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization or Rent –Seeking?,* in *Reforming Company and Takeover Law in Europe,* p. 767-795.

insurgence of new ones (at least in the short term). On the other hand, public-law restrictions to the contestability of control fall outside the scope of the directive and are covered straight by the Treaty, as interpreted by a rising flow of path-breaking ECJ decisions. Both issues deserve closer scrutiny.

11.- As regards private-law pre-bid and post-bid defences, it seems correct to state that, from the outset, the implied political foundation of a takeover directive was indeed to be found in the need to create a level playing field within the European internal market which could facilitate and accelerate the European integration process and could make it as easy for a British or Italian company, for example, to acquire, through a successful takeover bid, a French or German company as it would have been for a French or German company to acquire the controlling interest in a British or Italian company. *In other words, takeover bids had to be possible freely within the European internal market*. The underlying rationale for that was twofold. On one hand, it was necessary to duly implement Article 43 of the Treaty which sets out the principle of freedom of establishment. Such principle refers indeed not only to the incorporation but also to the *management of companies*. Accordingly, Article 44 g) – which constitutes the legal basis of the directive – requires the Community to issue directives under the co-determination procedure set out under Article 251 to coordinate certain safeguards which, for the protection of the interests of members and others, Member States require of companies governed by the law of a Member State with a view to making such safeguards equivalent throughout the Community. This means - as the directive itself acknowledges in the recitals – that a Community action is needed to "prevent patterns of corporate restructuring within the Community" (namely the consolidation of the European industry, also through cross border take over bids) "from being distorted by arbitrary differences in governance and management culture". Since the freedom of establishment is also to be recognised in the acquisition of the control of a company established in a different Member State, it could be effectively implemented only through the introduction of a level playing field throughout Europe concerning takeover bids. On the other hand, if we assume (as it is the case of the current European approach, *in response to a trend toward oligopolistic consolidation which characterizes since long the* *global markets*) that, as a matter of policy, takeovers are to be *generally*[30] "presumed" economically beneficial for the shareholders and the overall economy, both as an instrument of industrial consolidation and, especially where the ownership is widely dispersed among shareholders, of external monitoring and displacement of slack management, they should be regulated in order to favour the contestability of control and, by doing so, to foster the on going process of trans-national growth of the European companies to an optimal scale in order to duly protect – as it is required by Article 44 g) of the Treaty – the interests of members. To this purpose, the right to take decisions which might hinder the success of the bid and thus the change of control should be vested into the shareholders of the target company and not into the management of the same. Managers could easily act, in this respect, in conflict of interest. In other terms contestability of control requires shareholders' empowerment as a reaction to any possible form of managerial entrenchment ([31]). *This is to say that the major justification for a European action towards the harmonised removal of pre-bid and post-bid barriers to takeover rests at the interplay of internal market integration (herein included an integrated and well protected financial market) and the correlated, perceived, need to favour, with the takeovers regulation, as much as possible the emergence and growth of trans-European and even pan-European listed company as an engine of the development and restructuring of the European industry in the context of an international global economy*[32].

[30] This is not to say, thus, that in some (or even many) cases takeovers may adversely affect shareholders, suppliers, employees and the overall economy. To be true, even the idea itself underlying the directive, namely that takeovers are desirable from an overall economic point of view and that European legislation should facilitate takeovers, could politically be disputed in its very foundation. But since the directive is clearly (and probably realistically) based on this idea, grounded in turn in the actual features of real, global markets, it is certainly outside the scope of this work to address the question of its political merit.

[31] This is not to say that a parallel shareholders' empowerment is recognised on the part of the bidder. And this is so despite – as it is commonly recognized and also the High Level Group noted – takeover bids are not always beneficial for the bidder and its shareholders. Bids may sometimes be wealth destroying for the bidder's shareholders. This is a matter of the corporate governance of the bidder which – following the advice rendered by the High Level Group – has been considered outside the scope of the directive. A similar approach was sponsored by the British Company Law Review Steering Group which, in its final report, did not find a clear case for the introduction of such a rule, although it recommended to keep the issue under review.

[32] Clearly, board neutrality has very different implications in systems with concentrated ownership structures, where the controlling shareholder(s) not only would normally

12.- Initially, both the Commission and the Council denied the absence of a level playing field, arguing that the different anti takeover measures existing in the economic and legal systems in each Member State neutralised each other. Consequently, all companies within the European Union were said to have substantially the same possibilities of defending themselves against hostile takeover bids regardless of the Member State in which they were incorporated. This position soon proved flawed, when it resulted that anti-takeover technical barriers embedded in national corporate laws do not exist identically in all Member States. Whereas, for example, multiple voting shares had been abolished in Italy, Austria, Spain, and Germany, they were still common in France, Sweden and in the other Scandinavian countries. Pyramids on the other hand were much more common in continental Europe than in Northern Europe. Voting caps in turn were admissible for instance in Austria, the Netherlands, France, Spain, and Italy (prior to the company law reform of 2003) whereas they were forbidden in Belgium and Germany. Non-voting shares and voting rights agreements were admissible and common almost everywhere in Europe but shareholders' agreements were perhaps more common in Continental Europe than in the United Kingdom. Although no comprehensive study had yet been made to review all these different anti takeover pre bid techniques in all different Member States[33], it emerged quite soon that, although each Member State offered one or more technical pre bid defences, companies incorporated in some Member States had a far greater range of possibilities to use provisions of their articles of association or other legal means to protect themselves against hostile takeovers than companies incorporated in other Member States. Despite these findings, as anticipated, none of the previous directives had ever set out provisions specifically aimed at dismantling the pre bid technical barriers erected or allowed by national company laws of the different Member States to discourage takeover bids. And it was so, although the Commission was aware of the problem at least since 1990, in the wake of

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appoint the majority of the board but also approve virtually all defensive measures: M.VENTORUZZO, *Europe's Thirteenth Directive and U.S. Takeover Regulation,* at p. 214.

[33] See now *Report on the Proportionality Principle in the European Union,* external study commissioned by the EU Commission to Shearman & Sterling, ISS and ECGI, Brussels, July 2007.

the publication of the Booz Allen report ([34]) and of the Coopers & Lybrand study ([35]), which devoted great attention to this specific issue. Actually, the Commission initially reacted to those reports putting forward a comprehensive set of amendments' proposals to the Second directive on company law, to the takeover directive proposal (this latter however solely in order to limit the use of resolutions authorising the board to buy back own shares passed prior to the bid) and particularly to the draft Fifth directive on company law which have become known as the "Bangemann Proposals". Unfortunately, with the sole exception of the amendments to the Second directive (approved by the Council in 1985), these proposals were unsuccessful, as the Fifth directive proposals remained blocked.

13.- Later, with the ill fated 2001 takeover proposal the Commission preferred to focus only on the post bid technical barriers, hereby adopting the "passivity rule" set out now in Article 9 of the directive, and to set aside the question of the harmonisation of the great many company law features which could, and in fact (with different patterns in all Member States) did and do, function as pre-bid technical barriers to takeovers. As scholars correctly noted, *this restrictive approach to the level playing field question somehow insisted, theoretically, on a slippery distinction between core company law and securities law*. In other words, it was adopted on the implied assumption that tackling pre bid measures would have entailed the introduction of major changes in European company law and would have been outside the scope of the take over directive, perceived as a securities' piece of legislation. It was argued on the contrary that if the rationale of the neutrality rule set out in Article 9 of the directive proposal was and is to be found in the facilitation of the contest for the corporate control, the difference between pre bid and post bid measures necessarily blurs. Focusing only on post bid technical barriers would leave in fact companies free to adopt pre bid governance devices that effectively block a hostile takeover from ever being made and thereby insulate them from the market

[34] BOOZ ALLEN ACQUISITION SERVICES, EXECUTIVE SUMMARY, *Study on Obstacles to Takeover Bids in the European Community*, Brussels, December 1989, *passim.*
[35] *Barriers to Takeovers in the European Community*, Report commissioned by the British Department of Trade and Industry, 1989, *passim*.

for corporate control. It has been correctly added to it ([36]) that the pre offer barriers – which are part of the formal structure of the corporate governance environment – do also facilitate the erection of *structural barriers, which by contrast reflect the effect of existing conditions in the economic environment*, and include such circumstances as concentration of ownership in families, the influence of large universal banks and the reliance on debt as opposed to equity financing. Technical pre bid barriers therefore serve under several respect to insulate pre-existing outcomes in the economic environment when change would otherwise shift the efficient boundary of the firm. Furthermore, takeover regulation in Europe is not only a component of securities regulation but also (and perhaps even more so) an important creature of company law and corporate governance. The provisions on transparency and disclosure in the takeover process are certainly crucial in so much as they play a major role in redressing market imperfections providing the investors with a sufficient flow of information, but at the same time it cannot be neglected that a very significant focus of takeover regulation rests on the protection of minority shareholders in the change of control and in their fair treatment. This is why, although this regulation is clearly at the interstices of company and securities law and covers both aspects, the directive is a piece of legislation expressly classified as on company law and it has its legal basis in the second paragraph of Article 44 g) of the Treaty. It was and would be therefore hard to accept that corporate matters should remain outside the scope of the same insofar as they affect the takeover activity, rendering the launch of an unfriendly takeover virtually impossible ([37]). Finally, it would seem that, despite the different attitude shown by the Bangemann proposal some years ago, there would be little merit indeed in providing company law rules directed to enhance the contestability of corporate control of listed companies with the Fifth (or any other) directive on company law devoted to all joint stock companies irrespective of the listing of their shares. Doing so, the legislation would mistakenly equate and force into a single statutory

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[36] R.GILSON, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment*, in *European Takeovers Law and Practice*, eds. Hopt and Wymeersch, Butterworths, London, 1992, and in 61 *Fordham Law Review* 161 (1992)

[37] In the British experience, the intersection between company law and securities law was already very clearly stated by the Jenkins Committee which found in its 1962 Report that "company law should avoid, as far as possible, placing obstacles in the way of honest and fairly conducted takeover transactions": JENKINS COMMITTEE, *1962 Report*, Cmnd 1749, paragraph 265.

provision patterns of ownership change which are inherently different for close companies and public listed companies. A clear example is given by the most debated "one share one vote" rule: such a mandatory rule, if ever appropriate for listed companies[38], would certainly be inappropriate for closed companies.

14.- Based on the above, the distinction between pre bid and post bid regimes quickly appeared to be also politically untenable. Understandably enough, those Member States who would have to change their legislation in order to comply (as it was the case for instance of Germany), with the passivity rule set out by the directive proposal and did not offer to their national companies an array of pre bid company law defences comparable to that of other Member States saw an effective level playing field in the domain of the pre bid techniques as a necessary prerequisite for their approval of the directive[39]. All these reasons led to the introduction in the final text of the directive not only of Article 9, addressing the post bid defence with the passivity rule, but also of Article 11, addressing post bid defences with the so called "break through rule". Such a break through rule is in fact an ingenious attempt to create a sufficient level playing field in respect of pre bid techniques *albeit leaving these mechanisms and structures in place unless and until a general takeover bid is made and has proved successful*. Doing so, in the opinion of the High Level Group which recommended its adoption to the Commission, said rule "would strike an appropriate balance between, on the one hand, the need, at least for the time being, to allow differences in the capital and control structures of companies in view of the current differences between Member States and, on the other hand, the need to allow and stimulate successful takeover bids to take place in order to create an integrated securities market in Europe"([40]).

[38] See the *Report on the Proportionality Principle in the European Union*, external study commissioned by the EU Commission to Shearman & Sterling, ISS and ECGI, Brussels, July 2007, *passim* and the recent decision of Commissioner McCreevy to suspend any action in this respect.

[39] J.N.GORDON, *An American Perspective on Anti-Takeover Laws*, p. 545-547 (where the conclusion, at 546, that "what best protects against the potential for economic nationalism is the mutual vulnerability to takeover bids by both of the firms in question")

[40] HIGH LEVEL GROUP OF COMPANY LAW EXPERTS, *Report on Issues Related to Takeover Bids*, Brussels, 10 January 2002, p. 29-30.

15.- The “break through rule” was not unknown in the European Union before the High Level Group recommendation. It was put forward for the first time in 1992 by the French COB when, according to Article 177 of the Law of 24 July 1966 ([41]) BSN Danone amended its articles of association to set out a voting cap. In that occasion, COB obtained that the articles of association of the company had to also provide that the cap would have automatically become ineffective if a bid were successful in obtaining shares representing 2/3 of the voting rights ([42]). A statutory provision of the break through rule was then to be found in Italy under Article 3 of Law no. 474 of 30 July 1994 on privatisation and was then reflected in Article 212 of the Italian Decree no. 58 of 1998. It should be noted in this respect that, the former version of the rule published in 1994 made the break through conditional upon the attainment by the bidder of the majority of the voting rights, whereas the latter provision of 1998 dropped, at least in the wording of the provision, such requirement ([43]). Despite these differences in the details of the French and Italian models, a common feature of both national experiences was to be found in that the rule addressed only voting caps. It left untouched, instead, all of the statutory or by-laws provisions concerning the appointment and removal of the board of directors, which in different ways could delay or hinder a swift substitution of the board on the part of the successful bidder (e.g. double voting in France, special rights to nominate board members, staggered board, fixed term appointment, supermajorities, long lasting office tenure as a requirement for appointment to the board and alike). Albeit limited in scope, this rule facilitated however the success of hostile bids by making the acquisition of a (qualified) majority stake sufficient to automatically

[41] “Les statuts peuvent limiter le nombre des voix dont chaque actionnaire dispose dans les assemblées, sous la condition que cette limitation sera imposée à toutes les actions, sans distinction de catégorie, autre que les actions à dividende sans droit de vote”.

[42] “Les limitations prévues ci-dessus deviennent caduques, sans qu’il y ait lieu à une nouvelle décision de l’assemblée générale extraordinaire des actionnaires, dès lors qu’une personne physique ou morale, seule ou de concert avec une ou plusieurs personnes physiques ou morales, vient à détenir au moins les deux tiers du nombre total des actions de la société, à la suite d’une procédure publique visant la totalité des actions de la société. Le conseil d’administration constate la caducité et procède aux formalités corrélatives de modification des statuts”. This clause is reportedly customary.

[43] “La clausola che prevede un limite di possesso decade comunque allorché il limite sia superato per effetto di un’offerta pubblica di acquisto promossa ai sensi degli articoli 106 e 107 del testo unico”. Whether this provision applies also where the bidder does not achieve the absolute majority threshold is however still debated.

empower the bidder to exert control over the company without the need of a formal resolution of the shareholders' meeting to remove the cap ([44]). A similar effect, in respect to shareholders' agreement carrying transfer or voting restrictions, was to be found in Article 123 of the Italian Decree no. 58 of 1998, consenting to each party of the agreement to terminate it at no cost upon the occurrence of a bid (a provision subsequently mimicked, albeit in slightly different form, by Spanish law 17 July 2003, no. 26/2003 and in particular by its "disposicion transitoria tercera") The High Level Group proposal widened, however, the scope of these remedies, transforming the same into a general device designed to operate in respect to a greater variety of pre bid technical barriers. The implied rationale of the break through rule advocated by the High Level Group was that shareholders are free to define as they deem fit all sorts of voting arrangements and other restrictions on the transferability of control in the articles of association (also delivering the control to one or a few shareholders regardless of the proportion between risk and control) but, at the occurrence of a takeover, confirmation of their initial agreement must be sought after. To the extent they tender the vast majority of their shares to the bidder, the shareholders reverse their initial agreement on the pre bid technical barriers against takeover and the bidder should therefore, upon reaching the threshold, be able to break through said provisions in the articles of association. It is clear that there is here a significant deviation from the general rules of privity of contract and "pacta sunt servanda": a deviation which was advocated by the High Level Group and was then accepted by the directive on the implied assumption that *there is a major public interest in fostering the cross border consolidation of the European industry and the contestability of control of listed companies*.

16.- As anticipated, though, the adopted version of the break through rule - which can be read in Article 11 and, as noted above, was broadened

[44] Lacking such a rule, the sole alternative for the bidder would be either to make a bid contingent upon the removal by the shareholders' meeting of the cap or to organize a concerted action, whereby several bidders acting jointly would severally acquire shareholdings which, for each of them, do not exceed the cap but jointly provide the majority of votes. In the highly controversial arena of a bid, the latter practice would be however very likely to be litigated by referring to the by-laws voting caps the notion of concerted action already traditional in most of the national regulation on takeovers. The conditional offer would not prevent, moreover, incumbent minority controllers from dominating the shareholders' meeting called to approve a frustrating action.

in scope in the wake of the parliamentary debate – encompasses only some of most common pre-bid technical barriers to takeover (herein included multiple vote shares[45]), refraining from providing a general rule designed to "break through" any type of such barriers[46]. Moreover, it does not affect companies' models other than public listed companies (such as the partnership limited by shares and cooperatives: Article 11-7) nor dictates alternative remedies to neutralise additional pre-bid barriers to takeovers like pyramids and relevant agreements conditional upon the change of control for which the break through rule is not well-suited[47] but which

[45] For the rationale of such inclusion and for a detailed discussion of the ways to compensate the affected shareholders (an equitable compensation now mandated by Article 11(5)), B.DAUNER LIEB, M.LAMANDINI, *Report to the European Parliament on the Commission's new proposal of a directive on company law concerning takeover bids,* at § 5.1 and 5.2.

[46] See B.DAUNER LIEB, M.LAMANDINI, *Report to the European Parliament on the Commission's new proposal of a directive on company law concerning takeover bids,* at § 5.5 ("From the wording of Article 11 it results that the break through rule adopted by the Commission is very narrow in scope and covers only a few pre-bid defensive measures. We disagree with this. Concurring with the opinion of the High Level Group, we do believe indeed that Article 11 should cover any type of arrangements the effect of which is the same as the effect of those statutory or contractual arrangements which are expressly mentioned in Article 11. A limitation to only a few of such technicalities, setting aside other equivalent technicalities, would appear indeed fully inconsistent. One very good example was already given by the High Level Group and refers to the situation in which a company has issued voting shares to a trust or administration office which in turn has issued listed non voting depository receipts in respect of those shares. As suggested by the High Level Group, the un-enforcement rule should be tailored here to make the depository receipts freely exchangeable into the underlying shares in the event of a general takeover bid. Similarly, when the shareholders' agreement is a voting trust, it should be clear that the un-enforcement of the restrictions on voting rights confer the right to vote as they deem appropriate in the meeting convened to pass resolutions concerning the adoption of post bid techniques directly to the beneficial owners and not to the trustee. It might also be advisable to carefully examine whether this rule should also apply to the constituent documents at creating foundations, making unenforceable the obligation sometimes herein set out to maintain control at all times. On the other hand, this would also suggest to specify that the break through rule shall cover all those statutory or by-laws provisions concerning the appointment and removal of the board of directors, which in different ways could delay or hinder a swift substitution of the board by the bidder (i.g. staggered board, fixed term appointment, supermajorities, long lasting office tenure as requirement for the appointment of the board). At the first shareholders' meeting the successful bidder should be able to immediately nominate the new management.)

[47] B.DAUNER LIEB, M.LAMANDINI, *Report to the European Parliament on the Commission's new proposal of a directive on company law concerning takeover bids,* at § 5.6 (where the recommendation "to prohibit in the future the listing of any company whose main asset is the shareholding in another listed company, according to a practice already followed for instance by the Italian listing rules and now also recommended by the High Level Group, unless the economic value of such admission is clearly demonstrated"

would have deserved, however, a similar pro-competitive regulation. The most critical (and disturbing) point is however that the adoption of the "break through" rule was possible only at the price of waiving the mandatory nature of the harmonised provisions of Article 9 and 11. At the price of making, thus, the level playing field only optional. Article 12 of the directive – ironically adopting in Europe, due to nationalistic political constraints, a regulatory choice advocated for U.S. federal securities laws by Bebchuk and Ferrel[48] - sets out indeed that:

> "Member States may reserve the right not to require companies which have their registered offices within their territories to apply Article 9(2) and (3) and 11".

It was therefore permitted to Member States to opt out these core provisions of the directive when implementing the same. Having waived the mandatory nature of such provisions, *the European aspiration to foster the contestability of control represents no more than a simple benchmark recommended to Member States*. This is somehow confirmed by the fact that, where Member States opt out, they must nevertheless "grant companies which have their registered office within their territories the option of applying Article 9(2) and (3) and/or Article 11". This pro-contestability aspiration is particularly timid, though. Suffice to say that the company's decision to adopt Article 9 and 11 requires an opting in resolution to be taken by the shareholders' meeting with the highest majorities required for the amendment to the articles of association and it is made "reversible". In an attempt to discourage, as much as possible, a race to the bottom in the implementation of the directive – and namely the

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and "to introduce, for those pyramids already listed, a duty to list in a specific segment of the regulated market as well as an obligation to delist when the existing operating company is transformed in a simple pyramid vehicle") and at § 5.7. (where the recommendation that agreements conditional upon the change of control such as golden parachutes, loan and credit agreements, call option rights to buy assets of the company should be subject to a provisions inspired by Article 556 of the Belgian Company Code, according to which the shareholders' meeting must formally approve any transaction whereby the company grants a right to a third party contingent upon the launching of a public offer for its shares or upon the change of control of the same").

[48] L.A.BEBCHUK, A.FERREL, *A new Approach to Takeover Law and Regulatory Competition*, 87 *Va. L. Rev.* 111 (2001) and, in response mainly to J.R.MACEY, *Displacing Delaware: Can the Feds Do a Better Job Than the States in Regulating Takeovers?*, 57 *Bus. Law.* 1025 (2002), L.A.BEBCHUK, A. FERREL, *On Takeover Law and Regulatory Competition*, 57 *Bus. Law*. 1047 (2002)

adoption by all Member States of opting out provisions in order to avoid the risk of national vulnerability to foreign takeover bids in a European setting not characterised by the parity of army - Article 12(3) sets forth a reciprocity clause, whereby also companies subject to Article 9 and 11 (either according to the Member State opting in choice or due to the shareholders' meeting resolution) may, "under the conditions determined by national law", be exempted from applying the legal provisions displacing pre-bid and post-bid barriers "if they become the subject of an offer by a company which does not apply the same Articles or controlled, directly or indirectly, by the latter[49].

17.- *As it was certainly likely and expected, the implementation of the directive marked a general failure in the attainment of a pan-European level playing field for cross-border takeover bids in Europe*. Liberalism failed. Indeed, as of February 2007, the Commission reported in its "Report on the Implementation of the Directive on Takeover Bids[50]"that, in the fourteenth Member States were the directive had been implemented by its deadline, the passivity rule of Article 9 was implemented in all cases but for Denmark, Germany[51], Luxembourg. All the opting in States, however, had already a similar obligation in place before transposition (except for Malta and its 13 listed companies) and, due to the application of the reciprocity clause of Article 12 by many of the opting in Member States,

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[49] On the likely difficulties in the application of such a reciprocity principle M.BECHT, *Reciprocity in Takeovers*, p. 653 (available also at http://ssrn.com/abstract=46003); M.GATTI, *Optionality Arrangements and Reciprocity in the European Takeover Directive,* 6 *Eur. Bus. Org. L. Rev*. 553 (2005)

[50] SEC(2007) 268 of 21st February 2007

[51] Germany confirmed indeed the pre-existing regime of § 33 of WpUG. Under § 33a and 33b of the WpUG, as introduced by the UberRUmsG of 14 July 2006 neutrality and break through rule can apply, though, if expressly opted in by the company's articles of association, expressly derogating to the provisions of § 33 and making express reference to § 33b. Note however that, as correctly pointed out by J.W.CIOFFI, *Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and in the European Union,* 24 *Law & Pol'y* 355 (2002), at p. 388 contrary to a quite common misconception, "the irony of the battle over the Takeover Directive was that Germany did not switch its position on the Takeover Directive because it was hostile to economic modernization and liberalization. Rather, it was because domestic reforms had already liberalized the legal structure of corporate governance to a significant degree and other member states had not undertaken similar steps. The European Commission refused to acknowledge or address this issue that was of paramount importance to domestic political and economic actors"

many of them, whilst accepting in principle the pssivity rule subject it now to reciprocity (France, Greece, Hungary, Portugal, Slovenia and no Italy). The Commission correctly pointed out, thus, that "these Member States have increased the management's power to take frustrating measures without the approval of shareholders": *a situation which "likely holds back the emergence of an open takeover market rather than promote it"*. As regards the "break through rule" of Article 11, the general outlook is even bleaker. The Commission finds that "the vast majority of Member States have not imposed (or are unlikely to impose) the breakthrough rule, but have made it optional for companies[52]. Break through is expected to be imposed only in the Baltic states". Following the opt out decisions of the Member States, very few companies are expected to apply Article 11 on a voluntary basis. Finally "the majority of Member States have allowed companies to reciprocate against a bidder not subject to Articles 9 and 11[53]".

18.- On the question of trans-Atlantic and, more in general, non pan-European cross border takeovers, the directive chose not to specifically address the issue of an international level playing field and of the treatment to be reserved to a non European bidder. The preparatory works focussed, in this respect, solely on the trans-Atlantic relations considering that U.S. state legislation (as showed above) provides for a wide range of anti takeover devices. The High Level Group, however, suggested not to take any specific action, reasoning that current patterns of European flows of investment towards the United States show "that defensive mechanism and state defensive laws have not blocked European companies taking over American companies" ([54]). Only "if political concerns remain", the Group

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[52] See, for instance, the Takeovers Directive (Interim Implementation) Regulation 2006, effective as of 20 May 2006 (on the assumption that "market pressure in the UK means that very few such measures in fact exist": J.BIRDS, *Report from the United Kingdom,* in *ECL,* 2006, p. 209) and French law no. 2006-387 of 31 March 2006 (on the perceived reinforcement of the already existing isolation of French champions from the market for corporate control – ironically also through the use of Dutch *Stichting* -.brought about by the new law, F.CARLE, *Are French Listed Companies Takeover Proof*?, in *ECL,* 2007, p. 154 and the Marini Report to the Senate on "Offres Publiques d'Acquisitions", no. 268).
[53] See for instance the Italian provision of new Article 104-ter, which applies reciprocity also when only one of the concerted parties is not subject to Article 9 and/or 11.
[54] HIGH LEVEL GROUP OF COMPANY LAW EXPERTS, *Report on Issues Related to Takeover Bids*, p. 41.

recommended to provide that the benefit of the break through rule “can be enjoyed by listed European companies making general takeover bids for other listed European companies, to the extent that this would not violate international agreements and could be practically enforced”: a sort of anticipation of the reciprocity clause then set out in Articles 12. Not surprisingly, in the silence of the directive, the final outcome of the process of national implementation was basically to subject non-European bidders to the reciprocity clause, at least in any Member State adopting such a reciprocity clause (where this is not the case, national or international multilateral and bilateral general rules on foreign investment control the matter). How to assess, however, whether a U.S. or Russian or Chinese bidder is or is not contestable, remains practically obscure, *prompting both very significant administrative*[55] *and judicial discretion at the national level (and ex-ante uncertainty) and a strong risk of nationalistic capture.* As we already noted, in fact, the takeover regimes in the United States and the European Union are, for instance, hardly comparable and in the U.S. anti-takeover measures are generally said to be used by the management to get a better price for the shareholders rather than to frustrate the bid and insulate the company from the market of corporate control. It could be very difficult, therefore, to assess whether the Delaware regime as applied to the specific articles of association of the offeror does or does not meet the reciprocity requirement. On the other hand, the silence of the directive confirms that Member States are free to set out, if deemed suitable in their national interest, veto power or other equivalent measures with respect to takeovers launched by a bidder whose ultimate controlling entity is incorporated outside the European Union, provided however that they abide by their international obligations and by the basic freedom of free circulation of capital enshrined in the Treaty and in its implementing directives and currently considered by the Commission applicable, subject to certain limitations, also to third non EU parties. A similar provision is for example since long present in the Italian antitrust law (law 10 October 1990, no. 287), under Article 25 (2): the Prime Minister, upon resolution of the Council of Ministers and if essential interests of the national economy

[55] See, for instance, the Italian provision of new Article 104-ter, which requires the Italian supervisory authority CO.N.SO.B. “to determine with a substantiated decision, upon request of the offeror or of the target company and within 60 days from such a request, if the provisions applicable to the bidder are equivalent to those applied to the target company”.

are concerned, is empowered indeed to enjoin the acquisition of control of an Italian company from a prospective acquirer incorporated in a State applying discriminatory provisions for similar acquisitions by Italian companies. In France, under Decree 2005-1739 of 30 December 2005 the prior authorisation of the French Ministry of Economy is required for acquisitions in 11 economic sectors that are considered particularly sensitive for French national interests, herein included the preservation of industrial capacities on the French territory (R&D, know-how and other IP assets, production capacity). If necessary, French authorities may condition their authorization to specific commitments from the foreign investors. Moreover, under the OECD Code of Liberalization of Capital Movements, France reserved the right to restrict foreign investment in air transport, maritime transport, insurance and in the national security-related sectors. Similar, albeit less extensive, limitations to foreign direct investment in strategic industries exist in Germany[56], United Kingdom[57] and basically in all Member States.

19.- Despite these exceptional restriction set out by the law in the national public interest, ironically, whilst it was being consummated the political failure of the European attempt to dismantle *private-law* pre-bid barriers to takeovers, the Commission was successful – partly using its powers based upon free circulation of capital and freedom to establish and partly using the new and effective weapon enshrined in Article 21(4) of the new Merger Regulation no. 139/2004 - in addressing many of the hidden administrative barriers lifted by Member States to the cross border market for corporate control. This occurred, for instance, with respect to the traditionally fortified "national bastions" in the historically strategic banking, highway and energy sectors. In the banking field[58], the perceived

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[56] § 2 (6) and (7) of the German Foreign Trade Law gives the government the power to restrict foreign direct investment for reasons of national security, public order, foregn policy and balance of trade considerations.

[57] Industry Act of 1975 authorises the government to enjoin the takeover of an "important" manufacturing concern by non resident if against the national interest: the provision has never been used, though.

[58] See *Cross border consolidation in the EU financial sector*, Commission staff working document, SEC(2005) 1398, Brussels, 26 October 2005, acknowledging at p. 23 that "anecdotal evidence seems to show that the financial sector is often considered as a strategic one and therefore interference with business decisions is more likely". See also COMP/M.1616 in the case BSCH/Champalimaud. This protectionist attitude in the field is

opportunistic use of denials or delays in the prudential authorisation for bank acquisitions by the former Governor of the Bank of Italy (lately in the Antonveneta and BNL cases, where, ironically, the criminal proceedings based on the harmonized market abuse regime brought about an Eliot Spitzer effect “the Italian way”, sweeping away “backroom” defences and ultimately favoring cross border takeovers) prompted the adoption of the recently approved Directive amending directives 92/49/EC, 2002/83/EC 2004/39/EC 2005/68/EC and 2006/48/EC [59]. In the highway sector, the failed cross border merger between Autostrade and Abertis, abandoned by the parties in 2006 due to the refusal of Italian authorities to transfer highway concessions, prompted a double reaction of the Commission (both based on free circulation of capital and article 21 of the merger regulation) which led to the adoption of a new Italian ministerial “directive” preventing any opportunistic use of administrative discretion for national protectionism. Similar was the outcome in the energy sector in the wake of the three “Endesa” cases[60], with the final adoption of a new directive in the field.

20.- The same can be said in respect of “golden shares”. Indeed, although the takeover directive is explicitly excluding from the “break through rule” “golden shares”, on the assumption that they must be considered by the Commission on a case by case basis, the European Court of Justice, beginning with its path-breaking judgments of 23 January 2000, in the case C-58/98, *Commission v. Republic of Italy*, and, two years later, 4 June 2002 in the cases C-367/98 *Commission v. Portugal*, C-483/99 *Commission v. France* and C-503/99 *Commission v. Belgium*, inaugurated

very old: a former Italian Prime Minister, Francesco Nitti, could write in *Il capitale straniero in Italia*, Bari, Giuseppe La Terza, 1915, at p. 57 “è doveroso ammettere che le banche le quali accettano depositi e perciò stesso dispongono del risparmio nazionale non possano essere amministrate da cittadini stranieri. So che questa disposizione alcuni ritengono inefficace, altri dannoso: ma niuno in buona fede può negarne l’utilità. Tutte le riforme legislative non sono in sé stesse buone o cattive; ma vanno sempre riferite a momenti storici e a condizioni attuali. Se in passato ogni limitazione all’opera e al capitale degli stranieri riusciva dannosa, le condizioni sono del tutto mutate. Del resto lo Stato non può lasciare senza difesa alcuna il risparmio popolare”.

[59] See also the Communication from the Commission on “*Intra-EU investment in the financial services’ sector*”, 21 October 2005.

[60] See cases COMP/M.4110, COMP/M.4197 and COMP/M.4672

a substantial flow of cases (some of which still pending)[61] dismantling such restriction based on Article 56 of the Treaty, unless it could be showed that: i) they are justified by one of the reasons listed in Article 58 or by compelling reasons of general interest within the meaning of the "Cassis de Dijon" case law; ii) are suitable for the achievement of the intended purpose, iii) necessary and proportionate. The catalogue of "golden shares" found inconsistent with the Treaty is quite long and there is an apparent tendency towards the broadening of the scope of Article 56 of the Treaty. In the words of Advocate General Poiares Maduro of 7 September 2006 in the joint-cases C463/04 and C-464/04 (discussing a situation where "as a result of the combined effect of the right of direct appointment of up to a quarter of the members of the board of directors set out in the articles of association based on a special provision reserved to State or other public entities and the right to participate in the election of directors by voting on the basis of lists, the Comune di Milano can control an absolute majority of appointments to the board of directors, despite its minority shareholding")

> "18.(There are) three underlying issues. The first is whether it is of importance that the powers of appointment at issue are, at least in part, based on a provision of private law. The second is whether Article 56 EC applies *ratione personae* to public bodies when they are not exercising their public authority. The third issue involves the question which rights, when held by a public body in the role of shareholder in a company, are 'liable to dissuade investors in other Member States from investing in the capital of [that company]'. I shall discuss each issue in turn. 19. In my opinion, the fact that the powers of appointment of the Comune di Milano are based on a provision of private law does not preclude the application of Article 56 EC. In that regard, it is worth noting that, for the purpose of determining whether the free movement of capital is restricted where the State enjoys special powers in an undertaking, it is immaterial how those powers are granted or what legal form they take. The fact that a Member State acts within the framework of its domestic company law does not mean that its special powers cannot constitute a restriction within the meaning of Article 56 EC. Otherwise, Member States would easily be able to avoid the application of Article 56 EC, by using their position as incumbent shareholders to achieve within the framework of their civil laws what they would otherwise have achieved by using their regulatory powers. 20. The

[61] ECJ, 13 May 2003, case C463/00, *Commission v. Spain*; ECJ, 13 May 2003, case C98/01, *Commission v. United Kingdom*; ECJ 2 June 2005, case C174/04, *Commission v. Republic of Italy*; ECJ, 28 September 2006, joint cases C282/04 and 283/04, *Commission v. The Netherlands*, Opinion AG Poiares Maduro, 7 September 2006, in the joint cases C463/04 and 464/04, *Federconsumatori v. AEM*; opinion AG Ruiz Jarabo 13 February 2007 in the case C112/05, *Commission v. Federal Republic of Germany*.

present case exemplifies this. The file shows that the Comune di Milano initially proposed that the articles of association should give it a special power to appoint one quarter of the members of the board of directors directly, pursuant to Article 2(d) of Law No 474/1994. Originally, that provision offered a legal basis for conferring on public bodies the special power to appoint a minimum of one or more directors. Article 2 of Law No 474/1994, in its original version, was discussed in Case C-58/99 *Commission* v *Italy*. The Court ruled that, by adopting that provision, Italy had contravened Article 56 EC. Subsequently, the law was amended, in particular as regards the special powers provided for by Article 2. Nevertheless, in its Decision 5/04 of 8 March 2004 the Comune di Milano introduced what is, in effect, the same power of appointment, albeit on the basis of Article 2449 of the Italian Civil Code. Irrespective of what the motives of the Comune di Milano may have been for altering its choice of legal basis, it is clear that it would not be difficult for Member States to avoid the restrictions imposed by Article 56 EC if that provision were deemed not to apply to situations governed by private law. 21. The second issue is whether Article 56 EC applies *ratione personae* to a public body, where its actions, regardless of their legal form, are private in nature and thus are not carried out in the exercise of the public authority of the State. To put the issue more generally: are Member States under a duty to respect the Treaty provisions on the free movement of goods, persons, services and capital when they are not exercising their public authority? 22. In my opinion, they are. Member States are subject to the rules on free movement, which clearly apply to them, not in their capacity as public authority but in their capacity as signatories to the Treaty. As a result, the provisions on free movement impose obligations on the national authorities of the Member States, irrespective of whether those authorities act in their capacity as a public authority or as a private entity. Indeed, any entity through which the State acts comes within the scope *ratione personae* of the provisions on free movement. In principle, therefore, a public body such as the Comune di Milano cannot rely on the argument that its actions are essentially private in nature to avoid the application of the Treaty provisions on free movement. 23. None the less, the question whether a public body is in the same position and acts in the same way as a private shareholder is of relevance for the delineation of the scope *ratione materiae* of Article 56 EC. It is a factor in determining which rights, when held by a public body in the role of shareholder in a company, are liable to dissuade investments from other Member States. 24. As with the other freedoms, the purpose of the principle of the free movement of capital is to promote the opening up of national markets through the opportunity afforded to investors and undertakings seeking capital to benefit fully from the Community's internal market. In order to achieve that objective, Member States are required to take into account the effects of their actions as regards investors established in other Member States who wish to exercise their right to the free movement of capital. In that context, Article 56 EC prohibits not only discrimination on grounds of nationality, but also discrimination which, in respect of the exercise of a transnational activity, imposes additional costs or hinders access to

> the national market for investors established in other Member States either because it has the effect of protecting the position of certain economic operators already established in the market or because it makes intra-Community trade more difficult than internal trade. Any national measure that results in treating transnational situations less favourably than purely national situations constitutes a restriction on free movement. Subject to that reservation, Member States remain free to regulate economic activity in their territories and to participate in the national market. 25. The mere fact that a public body owns shares in a company does not reduce the attractiveness of cross-border investments in that company, as long as investors in other Member States can be sure that the public body concerned will, with a view to maximising its return on investment, respect the normal rules of operation of the market. However, as public bodies are subject to local or national mechanisms of political accountability, they are naturally inclined to adjust their conduct in light of the interests of those who are represented within the framework of those mechanisms. Therefore, when a public body holds shares which give it a privileged position in relation to other shareholders as regards its powers of control in the company concerned, there is a real risk that those powers will be used to grant selective and potentially discriminatory access to the national market. This explains, in my view, the case-law concerning golden shares and the limits imposed on the State when it acts as a participant in the market. 26. In my opinion, this case-law imposes a requirement of consistency upon Member States. The Treaty entitles the Member States to maintain public ownership of certain companies. However, once a Member State decides to open up a particular sector of the market, it must act in a manner which is consistent with that decision and fully respect the principles of openness and non-discrimination enshrined in the rules governing the Community's internal market. In other words, States are not entitled selectively to curtail the access of market operators to that sector of the market. In the case of the privatisation of former State-owned companies, this requirement is particularly important. If the State were entitled to maintain special forms of market control over privatised companies, it could easily frustrate the application of the rules on free movement by granting only selective and potentially discriminatory access to substantial parts of the national market. Such forms of control are accordingly liable to dissuade investments from other Member States. 27. When the State privatises a company, therefore, the rules on the free movement of capital require that the company's economic independence be protected, unless there is a need to safeguard fundamental public interests recognised by Community law. In this way, any State control, outside the normal market mechanisms, of a privatised company must be linked to carrying out the activities of general economic interest associated with that company

Despite the breath of these conclusions, it seems however that, still, the scope of application of the European case law on golden shares cannot be extended to private-law anti-takeover measures so long as they are not enjoyed by the State or other public entities. Indeed, such pre bid anti takeover measures, as long as put into place by private parties, are not properly based on legal provisions adopted by Member States, but are adopted, under a freedom of contract paradigm, by the articles of association of the company concerned or through shareholders' agreement. They are therefore attributable to the State only in an extremely indirect manner. The role of the State in the creation of such obstacles is limited to refraining from prohibiting the creation of such takeover obstacles by freely concluded contracts and in principle restrictive effects arising from the absence of national provisions seem to be irrelevant. It seems therefore difficult, according to the current interpretation of Article 56 of the Treaty, to derive from the freedom of movement of capital an obligation of the State to prevent takeover obstacles created by private parties, even if this contradicts a general level playing field between private and public obstacles to the contestability of control. But the point is that, whilst it is generally recognised that protective duties can follow for the Member States from the basic freedoms of the Treaty, and that Member States can also be obliged under certain conditions to enforce these freedoms against any third party interference, it will always be necessary in such cases to reasonably balance the freedom of the individual and the intended restriction of the basic freedoms. The Member State shall therefore act to enforce the basic freedoms only in cases of especially serious violations by a private party and certainly is not obliged to do so in where a European directive itself, through the opting out rule in Article 12, does not out-law such private arrangements.

21.- It remains to be questioned, in the light of the above, if the nationality of the owners does really matter in protecting the interests of the national economy, as the protectionist attitudes indicated above (and often voiced in the political debate) would suggest. To the best of my knowledge, there are no studies, so far, quantitatively measuring the impact of the nationality of the (final) owners on the company's performance and its alignment with the national interests of the maximization of domestic wealth, production and labour creation. The impression is, however, that national (final) ownership essentially meets the needs of the national politics (and, due to the close interplay between politics and economy in the modern society, of national oligarchies controlling both fields) *to exert some kind of control, albeit in an opaque and indirect way, on strategic industries (following a "twist the arms" approach in respect to nationals controlling such industries which, clearly enough, cannot be extended to foreigners). There is no particular reason to believe, however, that such an informal and not transparent influence actually serve the needs of the national community as a whole more than the private needs of the (national) "oligarchs"*. Not surprisingly, most of those controlling listed companies do so through foreign holding companies which benefit from the existing fiscal regulatory competition and, by doing so, do transfer part of the national wealth abroad, despite their citizenship. Increased pan European corporate mobility, in turn, makes company's nationality a reversible choice for shareholders and renders the current nationality of the company by nature subject to change, irrespective of the nationality of the controlling shareholders. It is certainly true, on the other hand, that the existing uneven structural economic development at the international and European level, coupled also with uneven ownership structures, makes the market for corporate control strongly unilateral: this is a pattern clearly showed, in recent times, by the large outflow of foreign direct investments from original Member States to new entrants in the European Union, for instance in the banking and financial industries. This trend could thus pre-empt the growth of national champions in weaker economies. National champions are not a good in itself, though. There is often the case, indeed, of foreign companies finely serving the needs of a national market more efficiently than national champions, with far less subsidisation. In turn, antitrust laws, from their side, should help in preventing that a unilateral process of industrial consolidation prompted by the flow of foreign investment may lead to a monopolistic or oligopolistic market dominance in the relevant Member State. The question seems to be, therefore, if an ownership requirement (based on nationality) cannot be more efficiently replaced by performance requirements or other conduct of business conditions set by the relevant Member State aimed at realizing straight and transparently the national interests implied in the basically exceptional cases of strategic industries, where market forces cannot be left to operate alone. This is in fact a tendency in action[62], which has also remarkable

[62] See for instance the shift from the ownership control to performance controls in the field of highways and energy in the wake of recent contested European takeover mentioned above.

precedents for instance, in the financial sector, in the U.S. Community Reinvestment Act enacted in the late seventies when interstate banking consolidation started to modify the structure of the U.S. banking industry. Such an Act required indeed banks to invest part of the deposit within the same community. It is unfortunate, thus, that international and community law provisions (partially) seem to hamper a wide recourse to such performance requirements. In fact, such national provisions must be assessed against the international obligations of the host country embedded in the GATS and TRIMs [63] (which restrict performance requirements such as technology transfer rules, manufacturing limitations, domestic sales, local content and manufacturing requirements) and, in the European Union, in the light of Article 49 (freedom to provide services)[64], Article 43 (freedom to establish)[65] and Article 56 (free circulation of capital)[66], which are currently interpreted by the ECJ as not to allow Member States to be too intrusive, through national regulation, into the way the enterprise is conducted and operated in the host country (once a takeover has been successfully performed). A different approach – insisting on ownership control rather than simple performance – seems to be justified, instead, in respect to foreign state-funded acquirers (as it is today the case of sovereign wealth funds). The market for corporate control makes sense indeed where market participants play the game on an equal footing, without benefiting from distorting public subsidization and are motivated by genuine economic goals. Where foreign politics leverages economic public resources to acquire relevant stakes in the national industries of other states, things are different: at a minimum this could paradoxically force (as it was feared in Italy in the wake of the EDF attempt to acquire Edison) a privatised and liberalized industry to get re-captured in a public and monopolistic setting, worst than the original, though, depending on the

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[63] P.T.MUCHLINSKI, *Multinational Enterprises and the Law*, Blackwell, Oxford, 1999, p. 257

[64] ECJ, 3 October 2006, in case C-452/04, *Fidium Finanz*, especially a § 46 ("it is settled case law that all measures which prohibit, impede or render less attractive the exercise of the freedom to provide services must be regarded as restrictions of that freedom. If the requirement of authorisation constitutes a restriction on the freedom to provide services, the requirement of a permanent establishment is the very negation of that freedom. For such a requirement to be accepted, it must be shown that it constitutes a condition which is indispensable for attaining the objective pursued")

[65] ECJ, 5 October 2006, case C-442/02, *Caixa Bank France* (on which see also the opinion of AG Tizzano of 25 March 2004).

[66] ECJ, 9 July 1997, C-222/95, *Parodi*; ECJ, 10 May 1995, C-384/93, *Alpine Invest;* more recently pending case C-270/06, *Commission v. Austria*

politics of another state. In a more pessimistic perspective, if and when quantitatively and qualitatively relevant, this rising phenomenon, if not timely tamed through ownership control rules, could lead to a new form of dangerous confrontation among States unpredictable in its final effects.