White knights and black knights

Does the search for competitive bids always benefit the shareholders of “target” companies?

Working paper[1]

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1. Defending the besieged castle

The regulation of defensive measures against hostile takeover-bids has been for long time a political obstacle on the path of the European takeover Directive, which was finally approved at the end of 2003 after a lengthy debate[2].

According to Article 9 of the Directive, which follows the City Code on takeovers and mergers of the London stock exchange and many other European legal systems[3], the board of the "target" company should remain passive in front of a takeover bid. This "passivity" or "neutrality" rule was nonetheless weakened by an "opt-out" option given to the Member States by the Directive itself [4].

More precisely, Article 9 of the Directive provided that "the board of the offeree company shall obtain the prior authorisation of the general meeting of shareholders

[2] Directive 2004/25/EC of the European Parliament and of the Council of 21st April 2004 on takeover bids. OJEU, 30.4.2004, L 142/12.

[3] City code on takeover and mergers, General principle n. 7: "At no time, after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason o believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders of the offeree company being denied the opportunity to decide on its merits."

[4] Article 12.

given for this purpose before taking any action, other than seeking alternative bids, which may result in the frustration of the bid" [5].

Therefore, defensive measures are not forbidden at all, on the contrary they are allowed if they are expressly authorised by the shareholders. Put in another way, general meeting of listed companies is competent to authorise measures which can obstacle the choice of shareholders on whether to tender or not, that is on decisions which could indirectly influence the ownership of the company. The board of the target company can nevertheless seek a competing bid without being authorised by the general meeting (s.c. "white knight"), even if the competing bid may in practice frustrate the first takeover bid.

In this paper I will discuss the rationale supporting the exception according to which seeking competitive bids does not need to be authorised by the general meeting. If we admit that during a takeover contest the board of the target company should pursue only, or at least mainly, shareholder's interests, the "white knight" exception is generally to be praised, because in this way the board puts the shares up for auction, enhancing shareholders wealth[6].

I will nonetheless argue that this exception could be in few situations unfair for shareholders' interests and inefficient.

After the launch of a takeover bid, shareholders face collective action problems, which compels them to tender even though this is not in their collective best interest (s.c. pressure to tender). As we will see later on and is widely accepted among legal and economics scholars, almost every takeover bid could place collective action problems to shareholders. Competing bids could be coercive as well, so that they could "force" shareholder to tender although the bid launched at first is to be considered as more convenient.

This argument calls to account the aforementioned "white knight exception". We should therefore ask ourselves whether a board seeking a coercive competing-bid really enhance shareholders wealth. I will argue that it is not the case and that, therefore, if the competing bid sought by the target board is coercive, the "white knight exception" is neither efficient nor fair. Hence, the law should provide for a set of rules which level the playing field of all offers, hindering coercive competing bids.

The work will proceed as follows. In the second section I will briefly summarise the issue of collective action problems related to takeover bids. In the third section I will

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[5] Article 9 (2).

[6] I should mention that the question of the interests to be pursued by the board during a takeover bid is highly debated among legal scholars. The question seems to me to be twofold. On the one hand, we should ask whether the board shall pursue only shareholder's interests, or if it ought to consider other constituencies (as creditors or employee) or the interests of non voting shareholders, which are usually not targeted by a takeover bid aimed at gaining the control of the company. On the other hand, even if we follow the first theory, we should ask how the shareholders' interest to sell the shares at the best price in a takeover contest is to be compared with their interest to earn dividends on the long term run.

describe the arguments supporting the case for seeking a competitive bid by the incumbent board without being authorised by the general meeting. In the forth section I will discuss some examples of coercive competing takeover bids; I will argue that if the competitive bid raises collective action problems it is neither efficient nor coherent with the *ratio legis* of the Directive admitting the incumbent board to seek it without being authorised by the general meeting.

2. The shareholder in his labyrinth

2.1. The general issue

As I have pointed out in the former section, and as is widely acknowledged among legal ad economics scholars, the target shareholders' decision whether to tender or not to tender is affected by collective action problems. It is useful to summarise the most important results of the debate on this issue[7].

Shareholders who should decide on the merit of a takeover bid face collective action problems, as it happens in every case when more persons should take individually a decision on a certain problem without having the ability to coordinate among themselves and the utility of each person depends on the choices made by the others. In case of takeover-bids shareholders should choose whether to sell their shares to the offeror or to hold them. Thus, after a takeover bid is launched, shareholders compare the price of the bid with the expected value of minority shares if the bid succeeds. But shareholders can not know what other fellow shareholders are going to decide on the merit of the offer, and coordination among them is too costly and almost impossible. We can distinguish two cases indeed.

a) If the expected value of minority shares under the new controlling shareholders is considered by the majority of shareholders as higher than the value under the incumbent shareholders, then it is rational for shareholders to hold their shares, hoping that other shareholders will sell them (s.c. free-ride).

The success of the bid is not impeded by the fact that a minority of shareholders, or even only one of them, did not sell their shares[8]. If every shareholder behaves in this

[7] The following arguments are based on the assumption that shareholders behave rationally in order to maximise their utility. It is therefore useful to explain what I consider as a "rational" behaviour: I assume that a person acts rationally if she acts in the best way in order to reach a specific goal and her preferences are transitive.

Preferences are transitive in this case: if some good "A" is preferred to a good "B", and this latter good "B" is preferred by the same person to a good "C", then should follow that also "A" is preferred to "C". (Putting it in a formal way, we write it as follow: $A \succ B \land B \succ C \rightarrow A \succ C$.) See T.S. Ulen, "Rational choice theory in law and economics", in Elgar (eds.) *Encyclopaedia of law and economics*, http://encyclo.findlaw.com/, 790.

[8] Goshen, "Voting (insincerely) in Corporate Law", 2 Theoretical inq. L. (2001) 815.

way, however, none of them will tender their shares, hoping that fellow shareholders will sell them. If this happens a value-increasing takeover-bid is going to fail[9].

b) On the contrary, if the expected value of minority shares if the bid succeeds is lower than the price offered, shareholders are forced to sell, although under an *ex post* point of view this is not the best choice for them (s.c. pressure to tender); in this case a value-decreasing takeover bid is going to succeed[10]. This latter case deserves a deeper scrutiny.

2.2. Pressure to tender

Shareholders do not know whether other shareholders will tender their shares or not and they cannot coordinate their behaviour. If the bid succeeds shareholders risk to lose the price of the offer, bearing only under-priced minority shares; hence, the decision to tender is the dominant one. Of course, the choice made by shareholders depends on how the bid is likely to be successful: the more shareholders hold for likely that the bid succeeds, the more they are coerced to sell their shares.

a) Legal and economics theory suggests that partial and "two-tier" offers place on shareholders the biggest pressure to tender.

- *Partial bids*. After the bid succeeds, tendering shareholders will hold only an average value among the price offered and the value of the minority shares under the new management[11]. Therefore, shareholders would be better-off if they could coordinate themselves not selling their shares. Since any sort of coordination is too expensive, the optimal strategy for shareholders, under an *ex ante* point of view, is to tender[12].

- *"Two-tier" bids.* The offeror launches a first partial "front-end" offer at a high price, promising to launch a second "back-end" bid for the rest of the shares at a lower price. For shareholders this situation is similar to the one faced when a partial offer is launched, the second price being comparable with the expected value of the minority share if the partial offer succeeds[13]. Shareholders believing that the "front-end" price is

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[9] For this argument see, S.J. Grossman – O.D. Hart, "Takeover bids, the free-rider problem and the theory of the corporation", 11 Bell journal of economics (1980) 42.

[10] L.A. Bebchuk, "Toward undistorted choice and equal treatment in corporate takeovers", 98 Harv. L. Rev. (1985) 1693 and "The pressure to tender: an analysis and proposed remedy", 12 Delaware journal corp. law (1987) 926.

[11] The value depends on the amount of shares which the offeror is keen to purchase through the bid, and the number of tendered shares.

[12] If shareholders sell, they lose the difference between the offered price and the lower value of minority share they will hold after the bid succeeds.

[13] V. Brudney – M.A. Chirelstein, "Fair shares in corporate mergers and takeovers", 88 Harvard law journ. (1974) 297; G. Subramanian, "A new takeover defense mechanism: using an equal treatment agreement as an alternative to the poison pill", 23 Del. journ. corp. law. (1998) 402; P.O. Mülbert – M. Birke, "In defense of passivity – on the proper role of a target's management in response to a hostile tender offer, 1 EBOR (2000) 468.

too low will rationally tender, fearing to gain only the lower “back-end” price. The difference between the “front-end” and the “back-end” price is of great relevance on shareholder’s choices: the greater this difference is, the greater is the potential loss for non-tendering shareholders and the more shareholders are forced to tender[14].

“Two-tier” and partial bids could allocate the resources in a inefficient way. We can make the following example in order to understand this point. Assume that a potential target has 10 outstanding shares, each one worth 50€; this means that the market value of the firm is 500€. Assume that an offeror launches a “two-tier” bid shaped as follows: a first “front-end” bid for 5 shares at 60€, and a second, “back-end” bid for the remaining 5 shares at 20€ each. The offer is conditioned upon the tendering of 5 shares. Rational shareholders, fearing to get only the low “back-end” price, will tender and the bid will therefore succeed. If the value of the firm under the new majority is less then 500€, then the bid should be considered as value-decreasing, because the offeror is keen to pay only 400€ for a firm which was worth 500€, without increasing the value of the firm itself.

In order to hinder partial and “two-tier” bids the Directive introduces at a EU level the “mandatory bid rule”, providing that persons, who purchase the control of a listed company[15], should launch a takeover bid on 100% of shares carrying voting right at the higher price paid for shares over a period between 6 and 12 months before the bid. We should state, therefore, that partial bids are not forbidden at EU level, they are rather more difficult to be used for taking over a company: if a person gains the control of a listed company through the launch of a partial bid, she ought to launch a 100% bid for the outstanding shares at the same price of the first bid.

In a world with the mandatory bid rule in place the game is similar to the one described for “two-tier” offers, where the mandatory bid following a partial bid can be compared with the “back-end” bid. Therefore, the pressure to tender put on shareholders by a partial bid depends on the price of the mandatory bid: if it is lower than the price of the partial bid, shareholders could face a pressure to tender similar to the one placed by “two-tier” offers. We can argue, therefore, that the greater the difference between the price of the mandatory bid and the price paid for crossing the relevant threshold, the greater is the pressure on shareholder to tender to a partial bid.

According to the EC Directive, mandatory bids should be launched at the higher price paid by the offeror for crossing the threshold; hence the Directive eliminate the most

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We could also consider partial offers as “two-tier” offers where the “back-end” price is the price of the remaining traded shares. Therefore, the argument used for “two-tier” bids can be applied also for partial offers.

[14] Bradley/Kim, “The evolution of the tender offer as a take over devise: an analysis of ownership structure, the free rider problem, and the prisoner’s dilemma”, unpublished, (1984) 295; Oesterle, “The negotiation model of tender offer defences and the Delaware Supreme Court”, 72 Cornell L. Rev. (1986), 127.

[15] More precisely: a threshold which let presume having the control, according to the law of the Member State where the target company has her registered office. Article 4.

relevant collective action problems placed by "two-tier" bids. Member States can, nonetheless, give their supervisory authority the power to derogate to the higher price rule, allowing to launch a mandatory bid at a lower price[16]. It should happen only in extraordinary cases where the higher price paid for crossing the relevant threshold seems unsound for the mandatory bid. The Directive does not harmonise this issue, which is left to the regulation of each Member States. We could, therefore, expect having 25 different laws on exception to the best price rule across the EU[17].

b) But even 100% all-cash takeover bids can place on shareholders a pressure to tender. As we have seen before, if the bid is value-decreasing shareholder would be better-off if they could collectively decide not to tender. In this case a value-decreasing bid would be defeated[18].

Shareholders cannot coordinate themselves and they do not know whether fellow shareholder will tender or not tender. Shareholders compare the risk of holding minority undervalued shares, in case of success of the bid, with the price of the offer, hence the optimal *ex ante* strategy is to tender.

On the contrary, if the offeror has a duty to purchase all non-tendered shares at the same price of the bid after the bid succeeds or if he ought to extend the offer period after the bid succeeds[19], we could argue that the bid does not place on shareholders any pressure

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[16] Article 5 (4).

[17] L. Enriques, "The mandatory bid rule in the takeover directive: harmonization without foundation?", ECFR, 2004, 446.

[18] L.A. Bebchuk, "Efficient and inefficient sales of control", Quarterly journal of economics (1994), 957 ss. In order to establish whether a transaction is efficient, we can apply the following Bebchuk's model.

Assume that: $Wn = Mn + Bn$

Where: Wv = total value of the firm under incumbent management; Mv= stock capitalisation under incumbent management; Bv = private benefits of control under incumbent management

and that: $Wn = Mn + Bn$

Where: W_N = firm value after bid succeeds; M_N = stock capitalisation if bid succeeds; B_N = private benefits of control of the new management.

A transfer of control is efficient if: $W_V = M_V + B_V \leq W_N = M_N + B_N$.

This model relies upon some evaluations, which could be rebutted, because they are a matter of values, not only a matter of facts. For instance, we could:

a) hold that the market value is not significant for establishing the "true" value of a firm;

b) consider the private benefits of control as always negative for the firm value (on the contrary, in the Bebchuk's model the higher is B, the higher is also W);

c) consider the interests of other stakeholders, as employee or creditor, as relevant for assessing the efficiency of a transaction (see J.C. COFFEE JR, "Regulating the market for corporate control: Analitical assessment of the tender offer's role in corporate governance", 84 Col. Law. Rev. (1984) 1145 *et seq.*).

[19] Such a duty could rest either on a clause of the bid itself, or on the law, as it is the case in some EU Member States. See: London City Code on Takeovers and Mergers, Rule 31.4; German WpÜG, § 16 (2);

to tender. In these cases non tendering shareholders do not risk to hold minority undervalued shares after the bid succeeds, therefore they are free to reject the offer if they do not hold it as convenient[20].

3. Seeking a white knight

The EC Directive, as we have seen, prohibits the board to defend the company against a takeover bid without being authorised by the general meeting of shareholders ("s.c. "passivity rule"). The goal of the passivity rule is to protect shareholders' interest to decide on the merit of the offer; in order to reach this goal, general meeting is competent on measures which could indirectly influence the composition of share ownership[21].

The board can nevertheless seek a competing bid without the need to be authorised by shareholders ("white knight exception"). In order to understand the goal of this exception we can imagine a world where there is a "passivity rule" in place, but where the law does not provide for a "white knight exception". Even in this case it is possible to argue that seeking competing bids does not need to be authorised by the general meeting. We could use two different arguments[22].

a) On the one hand, we could argue that the search for competing bids should be allowed because in this way the board enhances shareholders wealth, putting their shares up for auction. The rationale underpinning this assumption is, of course, that the board has a general duty to maximise what shareholders earn selling their shares and that the "passivity rule" is a mere consequence of this general duty[23].

Austrian ÜbG, § 19 (3); Swiss ÜV-ÖK, Article 27 (2), providing that succeeding bids should be left open for two weeks after their end. Of course, in this way takeover bids are more expensive and therefore rather infrequent.

[20] R. Gilson – R. Kraakman, "Delaware's intermediate standard for defensive tactics: Is there substance to proportionality review?", 44 Bus. Lawyer (1988) 254.

[21] See H. Merkt, "Verhaltenspflichten des Vorstands der Zielgesellschaft bei feindlichen Übernahmen", 165 ZHR (2001) 249 (this work concerned a general "passivity duty" of the board in front of a takeover, but was written in a time where neither the EC nor the German law provided for a competence of the general meeting on defensive measures).

[22] Following arguments were actually used by legal scholars where the law either did not provide for any passivity rule (as it was the case in Germany until 2002), or provides for a general passivity rule without excepting the seek of competing bids from the need of being authorised by the general meeting (as is the case in Italy, according to Article 104, *Testo Unico della finanza,* 1998; see Consob DAL/99039392 may 18 1999, www.consob.it).

[23] This argument is actually twofold. This means *at least* that the board *can* put the shares on auction, without impinging the "passivity rule", but that the board does not have a duty to behave in this way. We could make a step further, arguing that the board *has to* seek competing bids. This question cannot be addressed in this paper, it is nonetheless useful to bear it in mind (see Cfr. *Revlon v. MacAndrews and Forbes Holdings, Inc.*, 506 A.2d 173 (Del. Super 1985)).

Therefore, we can argue that, if the law provides that defensive measures are allowed only if they are authorised by the general meeting, seeking a competing bid should not need such an authorisation[24]. In a world where the law prohibits defensive measures in every case, even if they are authorised by the general meeting, following this arguments we should argue that the board can search for a competing bid[25].

b) On the other hand, we could follow a slightly different argument, according to which seeking a white knight does not need being authorised by the general meeting, only because competing bids are not truly obstacles for the first bid. A competing bid embodies only a second choice for the shareholders, which does not alter the market, and therefore could not be considered as a defensive measure at all[26].

4. Black knights

In the former section I have shown the arguments according to which legal scholars can admit that the board can seek a competing bid without being authorised by the general meeting, even in a world with a "passivity rule" in place. In the next section I will point out that some defensive takeover bids could be coercive, or more coercive than the first bid. We can make following examples, which are mostly unrelated from any specific set of rules.

a) The listed company A has 10 outstanding shares. B launches a 100% cash takeover bid at a price P = 10€, promising to extend the offer period at the same price after the bid succeeds[27]. B is therefore keen to pay 100€ for the company.

The incumbent board reaches an agreement with C, according to which the latter will launch a competing bid on A shares. C launch a "two-tier" bid, where the "front-end" bid is launched for 5 shares at 12€, i.e. at a price which is higher than the price of the

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[24] K. Hopt, "Aktionärskreis und Vorstandsneutralität", ZGR (1993) 558; Id., "Verhaltenspflichten des Vorstands der Zielgesellschaft bei feindlichen Übernahmen", *FS Lutter* (2000) 1383.; F. VELLA, "La nuova passivity rule nella disciplina italiana delle offerte pubbliche d'acquisto: alla ricerca di un difficile equilibrio", BIS (2000) 169; C. Berrar – Y. Schnorbus, "Rückerwerb eigener Aktien und Übernahmerecht", ZGR (2003) 101; H. Hirte, "Verteidigung gegen Übernahmeangebote und Rechtschutz des Aktionärs gegen die Verteidigung", ZGR (2002) 639; Id., *Kölner Kommentar zum WpÜG* (2003) § 33 n 75, 962.

[25] L.A. Bebchuk, "The case for facilitating competing tender offers", 95 Harv. Law Rev. (1982) 1028; Id., "The case for facilitating competing tender offers: a reply and extension", 35 Stanford Law Rev. (1982) 23; R.J. Gilson, "Seeking competitive bids versus pure passivity in tender offer defense", 35 Stanford Law Rev. (1982), 24 ss.

[26] H. Merkt (nt. 21) 249; R. Steinmeyer – M. Häger, *WpÜG* (2002) 402.

[27] We should argue the same when the law provides for a duty to extend the offer period after the bid succeeds.

first bid, and the "back-end" price is much lower (6€). The blended price of this competing takeover bid is therefore 9€, which is lower than the price offered by the first offeror B.

In this case, target shareholders face a heavy pressure to tender. If all shareholders would tender to the first offer, they would earn the price P (10€), which is higher than the blended price of the second offer (9€); therefore, shareholders would be better-off if they could cooperate deciding not to tender. But under an *ex ante* point of view, individual shareholders cannot be sure on what other shareholders will decide on the merit of the offer and makes rationally a different choice: if the second offer fails and the first offer succeeds, shareholders can nonetheless tender to the first offer even if they tendered to the second two-tier bid; on the contrary, if the shareholder tendered to the first bid, but the second one succeeds, he can gain only the lower "back-end" price of the second bid (6€ in our example).

Hence, a rational shareholder should tender to the competing "two-tier" bid, fearing to gain only the "back-end" price of the latter offer if he tendered to the first takeover bid[28]. As I have already pointed out, the greater the difference between the "front end" and the "back-end" price, the more shareholders are coerced to tender.

b) Assume that the bidder B launches a "two-tier" takeover bid on the 10 outstanding shares of the company A shaped as follows: the "front-end" bid is launched for 5 shares at 56€ a share and the "back-end" bid for the rest of the shares will be launched at 50€. The blended price is therefore 53€.

After this bid, the board of the target company seeks a third person, C, for launching a competing tender offer, after having obtained a complete information disclosure and having made a "due diligence". The competing bid launched by C is "two-tiered" as the first bid, but is shaped in a different way: the "front-end" bid is launched for 5 shares at 60€, which is a higher price than the "front-end" price of the first bid; the "back-end" price is 40€, which is far lower than the "back-end" price of the first bid. The blended price of the second takeover-bid is therefore 50€

Although the blended price of the competing offer is lower than the blended price of the first offer, shareholders will rationally choose to tender to the competing offer. The reason is that the difference between the "front-end" price and the "back-end" price of the first offer is lower than the same difference in the second offer, hence the latter is more coercive than the former, as we have seen in the second section[29]. If the competing bid succeeds, shareholders who tendered to the first bid risk to gain only the low "back-end" price of the competing bid (i.e. 40€); hence, the dominant strategy is to sell to the

[28] I should nevertheless remember that an empirical research of SEC on the years 1981 – 1983 did not confirms this conclusions; see SEC, "The economics of partial and two-tier tender offers", Federal securities law reporter, 1984, n. 21, 926.

[29] D.A. Oesterle (nt) at p. 129, n. 49.

competing bid, even if the blended price of the first bid is higher than the blended price of the latter, and under an *ex post* point of view this is not the best possible choice for shareholders. If the competing bid succeeds, the resources allocation is inefficient, because the higher bid failed and the lower succeeded.

As we have seen in the second section, the EC Directive provides for a general mandatory bid rule, according to which if a person purchases the control of a company, she should then launch an offer for the outstanding shares. In this case, the payout of the game depends on the price which should be paid for the mandatory bid. The law could allow launching the mandatory bid at a price lower than the one paid by the bidder for crossing the control threshold[30]. This case is similar to the ones depicted before, where the first partial bid is comparable to the "front-end" bid and the mandatory bid is a "back-and" bid. Of course, the first offeror can win the takeover contest if he extends the bid to all outstanding shares or if the spread between the prices of the partial and the mandatory bid is lower then the spread of the competing "two-tiered" bid. In order to reach this goal he has to offer a higher blended price, so that we can argue that the competing bid is nonetheless an obstacle for the first bid.

c) On the contrary, in a world which provides for a mandatory bid rule at the highest price paid for crossing the control-threshold[31], the payout of the competing situations described before is different.

Assume that B launches a partial takeover bid for 6 shares at 12€. The bid is conditioned upon the fact that at least 6 shares are tendered. If this partial bid succeeds it will be followed by a mandatory bid at the same price[32]; therefore, the total price paid by B for the company A will be 120€.

After the launch of the partial bid, the board seeks a competing 100% all cash takeover bid at 11€ per share; the total price which the competitor is keen to pay is therefore 110€.

[30] Among EU-Member States. thi is the case in UK (Rule 9.4 Takeover code), Italy (Article 106 (2) Tuf), Austria (§26 *Übernahmegesetz*) and Czech Republic (Commercial code, sec. 183 (c) (4)).

[31] This is the general rule provided by the EC directive in Article 5 (1), which nevertheless allows some exceptions. The same rule (highest price paid by the bidder) is provided in Belgium (Article 14 *Arrete royal relatif aux offres publiques d'acquisition et aux modifications du contrôle des sociétés*, 1989), Germany (§§ 3 ss. *WpÜG-Angebotsverordnung*) and Hungary (§ 72 (1) (a) act CXX/2001 on capital market).

[32] It could make sense to launch a partial bid, instead of a unique 100% cash bid, because in this way the bidder could finance easily the takeover in two steps; L. Enriques (nt) 446.

The payoff of this game, and therefore the strategic choices of shareholders, depends mostly on whether the offer period of the competing bid should be extended after the bid succeeds[33].

c1) If the offer period of the competing bid does not need to be extended, if the competing bid succeeds shareholders who tendered to the first bid, or held their shares, risk to have minority shares which they can not tender to the competing bid anymore. The dominant strategy for shareholders, therefore, is to tender to the second bid, even if its total price is lower than the price of the first bid.

Putting it in a more general way, in a world with a mandatory bid rule at the same price, a 100% all cash takeover bid is more coercive then a partial bid, if the offer period of the competing bid does not need to be extended after the bid succeeds[34].

The first bidder has nevertheless the opportunity to win the takeover contest, extending his bid to all outstanding shares at 12€. Of course, this can happen only if the law applied to the takeover bid allows the bidder to change or extend his offer. If this is the case, the first bidder is damaged by the launch of a competing bid only if he is not able to finance the 100% bid at 12€.

c2) If the offer period of the competing bid should be extended after the bid succeeds the payout of the competing game seems to be different. Shareholders who tendered to the first bid can tender to the competing bid if the latter succeeds. Shareholders, therefore, can choose either bid, according to the value attached to him; the first partial bid should prevail because the total price paid for gaining the control is higher than the price offered by the competing bidder.

d) Some of the abovementioned cases are not allowed by the law of many Member States. In some of our examples, the competing bidder was able to force shareholder to tender even if the total price he is keen to pay was lower than the price of the first offer.

Consider a rule which admits competing bids only if they are launched at a price higher than the price of the first offer (in the following text: “higher price rule”). This rule changes the payoff of some of the above mentioned examples.

The case depicted in the example a) would not be allowed, because in the second “two-tier” takeover bid launched by B, the price of the “front-end” bid is lower than the price of the first 100% bid; the “higher price rule”, therefore, would hinder the “two-tier” coercive mechanism.

The case of example b), on the contrary, would be still possible, because the price of the “front-end” competing bid is higher than the price of the “front-end” bid launched by

[33] Of course, the payoff will depends also on the price offered by the first bidder and by the limits eventually put by the law to competing bids. In this stage I will nonetheless simplify the example, omitting this issue.

[34] L. Enriques (nt) 446.

the first offeror. Therefore, the “higher price rule” can not put limits to the pressure to tender in a game where both takeover-bids are “two-tiered”. In order to reach this goal, the rule should consider the whole price paid by the two offers, allowing to launch a competing bid only if the blended price of the second bid is higher than the blended price of the first bid.

In a world with a mandatory bid rule, example a) was not admitted and example b) was possible only if the considerations paid by the first offeror are lower then price paid for gaining the control threshold.

We should nevertheless consider that conflict rules applied to the takeover bid as such, as a part of the market law can often diverge from those applied for company law. The Directive harmonise the conflict rules only if the target company is both incorporated in a Member State and listed on an regulated market of a Member State[35]. In all other cases Member States are free to hold their own conflict rules for takeover law and for the defensive measures. If the company is listed on a non EU-market, national conflict rules could *renvoi* to the law of the country where the company is listed. If the latter does not provide for the “mandatory bid rule”, or for any other regulatory device aimed at limiting the coercive effect of partial and “two-tiered” bids, the competing bids sought by the board could be coercive.

The case depicted in the example c), which considers a world with a competing bid rule, is realistic even under the “higher price rule”. In the aforementioned example the value of the first partial bid launched by B was 72€ and the total price paid by the competing offeror is 110€; hence the competing bid respects the “higher price” rule.

5. Conclusions

In the former sections I have argued that even competing bids could place a pressure to tender on shareholders, who are forced to sell their shares to the lower bid. The outcome of the competing takeover game can be considered as inefficient, because the firm is not sold to the offeror who is keen to pay more for it.

The Takeover Directive, as we have seen in the first section, provides for an exception from the “passivity rule”, according to which the search of a competing bid is always allowed without the need of authorisation by the general meeting. This “white knight exception” does not distinguish coercive competing bids from non coercive ones: the Directive does not distinguish white knights from black knights.

As I have pointed out in the third section, the rationales of the “white knight exception” could be: a) that the board, seeking a competing bid, enhances shareholders wealth, and therefore the search for a white knight lies outside the *ratio* of the passivity rule itself;

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[35] On conflict rules for takeover bids see J. von Hein, “Zur Kodifikation des europäischen Übernahmekollisionsrecht” ZGR (2005) 528 *et seq*.

b) that seeking a competing bid represents only a market alternative for target shareholders and therefore it is not really a defensive measure.

If the competing bid sought by the board is coercive, on the contrary, it is neither in the best interest of shareholders, nor it represents simply a market alternative; therefore, a coercive defensive bid does not fit both the rationales underpinning the “white knight exception”.

As we have seen, the law which should be applied to a bid can hinder or mitigate the pressure to tender placed by competing bid, levelling in this way the playing field among competing offers. One could expect, therefore, that the Directive harmonise the rules applicable to competing bids: if it was the case, the “white knight” exception would be perfectly understandable and coherent with its rationale. But the Directive leaves this argument to the competence of Member States. More precisely, competing bid should be governed by the law of the State of the competent authority, which is the State where the shares of the target company are traded on a Regulated market[36]. Therefore, it is still possible that some relevant difference emerges among the regulations of Member States on competing bids and that the applicable law allows to launch coercive takeover bids.

Moreover, there is of course no harmonisation with non-EU countries, which could even not provide for a mandatory bid rule. We can argue, therefore, that a competing bid sought by the board could also be coercive and lead to inefficient results, depending on the applicable law applicable to it.

We should wonder whether the law can provide for a solution for this problem. I would like to suggest two possible alternatives.

The first one is to harmonise the law of competing bid at EU level, in a way not allowing coercive bids. Of course, this solution is useless for takeover bids involving European target companies which are not listed in a EU regulated market.

The second way to address the issue is interpret the “white knight exception” in a restrictive way, applying it only to non-coercive competing bids. It is possible to argue that a coercive competing bid sough by the board falls outside the scope of the passivity rule and should, therefore, be authorised by the general meeting. According to the “white knight exception”, the general meeting does not need to authorise the search of a competing bid because it does not obstacle free choices of shareholders on the merit of the offer, giving them only an alternative more. Seeking a competing bid, therefore, is not really a defensive measure. This is true only if the competing bid is not coercive, because if it was the case, it would not represent simply an alternative given to shareholders. If we accept this conclusion, we can also argue that the search for a coercive competing bid should be authorised by the general meeting, despite the wording of the Directive.

[36] Artiche 4 (2) c.