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Abstract

The passivity rule, the breakthrough rule and reciprocity characterize the European legislation on takeover bids and constitute its central and most critical rules. Their transposition by the Member States is based upon the mechanism of optional arrangements.

Protectionist applications could lead the Member States to opt for a minimum transposition so as which would limit – despite of the spirit of the directive – the reduction of barriers to transnational takeover bids. Nevertheless, the non binding nature of board neutrality and of the breakthrough rule is compensated by the possibility of contractual autonomy intervention: the directive allows companies to overturn the consequences of the minimal option expressed by national legislations, providing for the introduction into articles of association of clauses which set forth the strictest European rules. This is an absolute novelty: these clauses cross over the corporate organization in the strict sense, as they are capable of affecting the ownership structure and more in general the market forces which determine, at least in part, the decisions of the company and the value of its shares. This choice, if adopted by companies, should be constructed as tangible proof of a demand on the part of the market for precise positive rules. As we will try to demonstrate the provision in the articles of association of a board neutrality rule and/or of a breakthrough rule will depend on the incentives for the company to participate in the European market corporate control.

The reciprocity rule (article 12, paragraph 3) is even more innovative. This rule may be applied when expressly allowed by the Members States. In such case, the companies are authorized to disapply the board neutrality and/or the breakthrough rule (otherwise applicable legally or through their articles of association) should they be the target of a takeover bid launched by a European company not subject in its turn to the same provisions. In principle, the reciprocity rule is a step backwards on the level of the development of the market for corporate control given. However, the applicability of reciprocity is anything but discounted as it will depend upon the authorization issued by the company’s general meeting which authorization will be difficult to obtain if there is a dispersed ownership structure.

As shown in the Commission document, the introduction of the takeover bid directive coincides with a historic moment in when the market for European control, measured in terms of numbers of listed companies and of capitalization, is mostly characterized by the presence of board neutrality. If this trend is confirmed in the future, the protective force of reciprocity will be considerably diminished.
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I. **Introduction**
Art. 21 of the 2004/25/CE Directive of 21st April 2004 (1) established 20th May 2006 as the date by which all Member States were to implement the European regulations concerning public takeover bids. A little under a year from that date, on 21st February 2007, the European Commission published a working document which contained important considerations on the state of implementation of the Directive by the national legislatures (2). In particular, it concentrated on those framework rules which allow Member States wide areas of flexibility.

In reality, even though the document was drawn up some months after the latest transposition date, it can only be considered provisional and its judgements as work-in-progress. This is because, at the date of publication, only seventeen Member States had implemented the Directive or concretely set in motion the implementation process, introducing the necessary framework rules. Only six States had completely implemented the Directive by the date established: Austria, Denmark, France, Hungary, Luxemburg and the United Kingdom. The States which, at the date of the document, had not completely implemented the Directive, or which had not implemented it at all, were Cyprus, the Czech Republic, Estonia, Italy, Holland, Poland, as well as Spain and Belgium which have more recently


implemented it (3). It is interesting to note that, though Italy did not implement the Directive by the established date, it is nevertheless listed as a country where the Directive was partially already in force. It has to be said that, at the time of the Commission document, the takeover law was substantially the same as issued in 1998 (d. lgs. [legislative decree] no. 58 of 24th February 1998, so called Italian Consolidated Act). However, the positive evaluation made by the Commission is likely due to the fact that the Italian regulation was to some extent already in line with the European disposition, particularly with regard to the board neutrality principle (art. 104 Italian Consolidated Act). In this respect it is not to much to say that the Italian passivity rule could very well remain unaltered after the transposition process. This provision seems to be confirmed in light of recent developments.

As well know the thirteen Directive aims to establish a level playing field for cross border takeovers, which means operation where the target company’s head office is located in a member-State different from the bidder incorporation seat. At this stage it is early to express a final judgement on the achievement of the European goal because the transposition on internal jurisdictions is too recent or has not been complied yet.

Nevertheless some consideration can already be made. The Directive represents a hard-won achievement of a uniform framework throughout Europe and this should be considered a first element of a positive judgement. This is true above all because, as will be remembered, the thirty years preceding the approval of the Directive saw the failure of a previous proposal (4). This was due to perplexities, if not outright opposition, expressed on many sides concerning the introduction of those common rules which, more than any others, would have made concrete, and presumably more frequent, the so-called cross-border takeovers (there was particular concern about ex ante and ex post defences to a bid). However, such a positive judgement does not take into account further, more complex, matters. The wide margins of flexibility that characterize the

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Directive concern issues that undoubtedly play a decisive role in determining the structure of the European takeover regulations. It is not by chance that previous attempts to regulate these matters met with such strong opposition. To confirm or reject the initial judgement a more strict analysis is required.

The present work has two fundamental goals. We will try to assess, first of all, if the common framework given by the Directive corresponds to a substantial uniformity across Europe and it is not rendered vain by the margins of flexibility allowed by the Directive itself. Our analysis is concentrate on the Commission document which gives attention on how some national legislator have implemented the European rules. We shall also take a look at subsequent, more recent, developments by European national lawmakers (with a particular attention to Italian regulation which can be considered emblematic of the consequences of the optional arrangements). Secondly, we intend to analyse those aspects of the Directive which are especially innovative in so far as they delegate to companies’ articles of association certain important questions which go beyond mere corporate governance and affect the market mechanisms for corporate control. It is worth pointing out now that the Directive works at two distinct levels. It foresees, but does not impose, the adoption by Member States of stringent rules concerning defence and response strategies to takeovers. Where the Member States take a minimal position, not in line with the ultimate goal of creating a strong super-national and European market for corporate control, the passivity rule and the breakthrough rule may be included in companies’ articles of association. De facto, companies can overturn the consequences of the regulatory decisions of the member-State and subject themselves spontaneously to market pressures.

II. THE THREE CRITICAL RULES OF THE DIRECTIVE: BOARD NEUTRALITY, BREAKTHROUGH AND RECIPROCITY

The subject of the Commission document is about three interlinked rules which are the most important part of the Directive. Their origin can be found on the general issues of the debate – international as well as European – on takeover regulation (5).

The first rule is about measures that target's directors can adopt to repel a hostile bid. In theory, the number of takeovers which can potentially take place on a market, whether national or European, depends, other conditions being equal (in particular, the ownership structure), on the strategies available to oppose the bid. In jurisdictions where defences measures are unregulated the power to hinder the bid is vested on the target company's directors. On the contrary, Art. 9 of the Directive (often described as the passivity rule or board neutrality) neutralizes the Directors’ powers during the offering period, preventing them from frustrating the bid. This rule can be evaded, however, if any response to the bid has been approved by a shareholders’ meeting called for that purpose.

The second rule, the so-called breakthrough rule (Art. 11), is also aimed at preventing structural and ex ante barriers to hostile tender offers. It affects defensive techniques set up by the company or its shareholders when a takeover bid was only potential (the so called period of “peace”), but, like the passivity rule, its application and consequences have effect when a bid is in progress. Ex ante defences can be classified in two groups, according to the protection they offer to the incumbent controlling shareholder. The first includes measures which can reduce market liquidity, placing conditions or penalties on shareholders who are willing to accept the bid (6). According to the breakthrough rule, measures such as restrictions on the transfer of securities or restrictions on voting rights provided in the articles of association or in a shareholders’ agreements, loose their anti-takeover effects as soon as the bidder makes its offer, while they are lawful outside the offering period (if they normally are under the national law). The breakthrough rule makes easier to accept the bid since it removes any penalties imposed on shareholders by the contractual agreement entered by them (art. 11, paragraph 2). It is worth noting that the only limit to the efficacy of the breakthrough rule can be envisioned in the costs involved for the contracting parties who will suffer a loss of credibility and trust should they chose to support the raider weakening the coalition. In the second group of takeover defence can be placed measures which reinforce the bidder strength in the shareholder's meeting (for example, multiple voting rights (7)). In this respect the breakthrough rule does not permit the

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(6) G. Ferrarini (nt. 5), 753

(7) Not all the European legislations allow multiple voting shares, see the analysis of Shearman & Sterling - Institutional Shareholder Services - European Corporate Governance
incumbent controlling shareholder to take advantage from multiple-vote shares or from other voting restrictions in the general meeting called to approve the defensive measures (Art. 11, paragraph 3).

The third rule on optional arrangements (art. 12) is the most widely-discussed issue, as well as the most innovative, in the entire European regulatory framework for public takeover bids. It states how to transpose articles 9 and 11 (passivity rule and board neutrality rule) in a very complex way. Right now, it is enough to say that Member States «may reserve the right not to require companies» to adopt the passivity rule or the breakthrough rule (either or both). However, where this protectionist solution prevails, the Member States «shall nevertheless grant companies (...) the option, which shall be reversible, of applying» the passivity rule and the breakthrough rule.

We will focus on the reciprocity rule, also included in Art. 12, paragraph 3, is which allows, as explained later, the target company to waive defensive techniques rules if the rules to which the bidding company is subjected are less severe. In other words, Member States can exonerate from application of the passivity rule (Art. 9 paragraphs 2 and 3) and the breakthrough rule (Art. 11) those companies which, while theoretically subject to it, are faced with «an offer launched by a company which does not apply the same Articles as they do, or by a company controlled, directly or indirectly by the latter».

**THE TAKEOVER DIRECTIVE GOALS**

_A. Market for Corporate Control and Capital Markets_

In order to make an assessment of the effectiveness of the European Directive it is necessary to define as clearly as possible what its actual objectives are. This is not an easy matter, not only because European takeover regulation is the outcome of many years' of work in a changing context, but also because it represents a final and ambiguous compromise. This compromise concerns those rules (the passivity rule and the breakthrough rule) which are subjected to the «optional arrangements» (art. 12).

Taking as our starting point the goals implicit in the text of the Directive, particular attention should be paid to recitals 20 and 2. These

declare, on the one hand, the need to safeguard, at a European level, «the interests of holders of the securities of companies governed by the law of a Member States when those companies are the subject of takeover bids, or of changes of control». While on the other hand it places the regulation of public takeover bids within the framework «of the free movement of capital and the relevant provisions of the treaty».

There is a close connection between the two statements. The need to protect investors is no longer a goal that can be delegated to single national legislators and supervisory authorities when the capital market for both raising and offering extends beyond the national borders. From the first point of view, the need to simplify the raising of capital from more than one European market is addressed by the Art. 17 of the Prospectus Directive (2003/71 of 4th November 2003 (8) which allows an offer of securities approved by the supervisory authority of its country of origin to be offered also to foreign investors (with positive effect on the times and costs of the operation). From the opposite point of view, when the shares are admitted to trading over more than one regulated market, the bidder should be granted the ability of extending its bid over all the markets at reasonable costs. For this purpose, Art. 6 of the Takeover Directive states that, when the «offer document (...) is subject to the prior approval of the supervisory authority and has been approved, it shall be recognised, subject to any translation required, in any other Member State on the market of which the offeree company’s securities are admitted to trading». By definition, therefore, investors’ protection gets an European dimension, since they have access to a super-national primary market for capital raising (in the case of public offers) and for public takeover bids.

But the protection provided by the takeover regulation goes beyond the transparency aspects (on which the Prospectus Directive is mainly focused). In particular, the mandatory offer provision (Art. 2, paragraph 1, letter a) of the Takeover Directive) offers stronger protection to investors. In substance, it ensures that they can exit from the company at an advantageous price in case of undesirable changes of control or acquisition of control (9). As a consequence, the mandatory offer rule should increase

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(8) Published on E.C.O.J. L.345/64, 31.12.2006
investors’ confidence in the securities market (by reducing the threat of remaining prisoners in the company) and boost market growth (10).

From this perspective the ambitious aim of the Directive is the creation and development of the European market for corporate control, where the nationalities of the companies should be different from those of controlling shareholders. The intention, in other words, is to remove the obstacles to cross-border control-acquiring operations (11) and to increase the number of bids in Europe (12).

The Commission document is quite explicit about this, more than the Directive itself (see next paragraph). A growing market for corporate control could benefit both companies and investors. Companies can take part of restructurings and reorganizations operations and find the ideal dimensions for competing in a global market. Furthermore, control transactions and company mergers are the means to improve management quality and company results (13). According to law and economics studies, the threat of a takeover acts as a monitoring force upon directors and management, who are subjected to continuous pressure to keep company’s shares at the highest possible level. Otherwise a decrease in stock prices will create an advantageous bargain for hostile bidders (14). Improved competitiveness and performance can therefore be beneficial to investors.

As a means to obtain these wide goals, the technique adopted by Art. 12 of the Directive (optional arrangements and reciprocity) appears a compromise. The criticism of being unsuitable to increase cross-border acquisitions of corporate control comes from the non-binding nature of the passivity rule and the breakthrough rule.

We submit two considerations in reply to this criticism to explain why the impact of the Directive on the market for corporate control should not be underestimated.

(10) P.L. Davies – K.J. Hopt (nt. 9), 179.
The first concerns the long process which led to the approval of the Thirteenth Directive, an approval which would probably never have been reached without granting wide flexibility to the legislators of the Member States (15). The torturous deliberative process of the Directive saw a trade-off between the level the playing-field goal and the concern raised by some Member States over a pan-European passivity rule. It was hardly to be expected that Member States would have found agreement over a rule which, not only banned defence activity, but which allowed no margin of flexibility at the transposition stage. On account of these considerations the European legislator preferred to waive strict equality of rules on the condition that some sort of regulation, even though not compulsory, was included (16). Nevertheless, a certain degree of uniformity (17), diffusion and equality in the legislation of the Member States has been reached (18). The passivity rule and the breakthrough rule, in the form laid down by the European text, are the only options for those States which intend to introduce constraints at directors’ behaviour in facing a hostile bid. So the Directive avoids the risk that national laws of differing intensity, severity or modality can exist in Europe since rules on takeovers defences must be substantially in line with the Directive text.

The second consideration concerns future prospects. Though the essential features of the Directive are not binding, this could be the right moment to reflect seriously on the most suitable rules for companies. Market appreciation of securities of companies open to the market for corporate control may provide an incentive to adopt articles which rule out the possibility that, even when permitted by the member-State, the company bans anti-takeover activities by its directors. The effect of the Directive may therefore be identified not only, as many have observed, in the competition between jurisdictions (19), but also in the capacity to increase competitiveness in the capital-raising market (20). This depends, however on the ability of the market to recognize and reward those companies which

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(15) M. Gatti (nt. 1), 419.
autonomously submit (where not required by national legislation) to the
mechanisms of the market for corporate control. The underlying idea is that
the cost of capital raising turn downs when market prices reflect this
judgement (21). Also from this point of view some sort of regulatory
uniformity has been reached since passivity rule and breakthrough rule can
be adopted in the articles of association only as provided by the Directive.

Lastly, the European legislator has not abandoned his goal of
levelling the playing field between the bidder and the target, it has merely
delegated it to the mechanism and consequences of the reciprocity rule. This
is also open to optional implementation, but it is apt to align, de facto, the
rules to which the contenders are subject (22). This alignment which, from a
legal point of view, has the effect of expressly allowing an involution of the
system, waiving compliance in some cases of the passivity rule and the
breakthrough rule, may be considered, as we will show, the premise for a
“virtuous” circle in accordance with the spirit of the Directive.

B. Contestability: a Goal Pursued by the Takeover Directive?
The development of the market for corporate control is recognized in the
European Commission document as the primary goal of the Directive. Its
direct consequence is seen as an increase in company competitiveness and
efficiency and the protection of minorities and investors. These arguments
implies an increasing number of control contests (23) which raises the level
of contestability of European companies.

This idea is acceptable in principle but gives rise to several
reservations. In reality it is by no means certain that the Directive really aims
to affect the contestability of European companies.

In order to clarify a point of possible confusion, it has to be said that
the provision for a mandatory public takeover bid (Art. 2, paragraph 1) does
not in itself constitute an element for enhancing contestability. Indeed, the
mandatory offer has been quite correctly classified among the structural
elements of a legislative system which are capable of limiting the number of

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(21) M. Gatti (nt. 1), 428.
(22) R. Cranston, “The Rise and Rise of the Hostile Takeover”, in European Takeover. Law
Takeover Regulation: Barriers to and Problem of Harmonizing Takeover law in the European
Community”, in European Takeover. Law and Practice, (eds. K.J. Hopt – E. Wymeersch), London-
Edinburgh, 1992, 165; M. Becht (nt. 12), 662; M. Burkart – F. Panunzi (nt. 14), 744; M. GATTI (nt.
1), 429.
(23) P.L. Davies – K.J. Hopt (nt. 9), 189.
control transactions, as a sort of anti-bid preventive measure." The reasons behind this statement are intuitive. The mandatory offer constitutes a very costly obligation, the more so when it implies an undertaking to buy all the remaining shares (which means one hundred per cent capital). On the contrary, where there is free contestability, that is to say in those legal systems which have not introduced the mandatory offer, it is more likely, precisely because the commitment required and costs are lower, that a market operation may be launched for the acquisition of a controlling holding.

A balance between company contestability and the mandatory offer is implicit in the premises to the mandatory offer as regulated by the City Code on Takeovers and Mergers of the United Kingdom and, as is known, Italy has taken a similar stance since 1998 in Art. 106, paragraph 106, Italian Consolidated Act.

In these jurisdictions the obligation to launch an offer of all the remaining shares is subsequent to the acquisition of control and arises, in particular, when a pre-established holding threshold is exceeded. This is fixed, in both the United Kingdom and in Italy, at thirty percent of the capital represented by voting shares. Thus set up, the premise of the mandatory offer permits the market to conserve a margin for free acquisitions of controlling stakes. This is because an acquisition of holdings of less than thirty per cent, even if controlling, does not result in the obligation to make a takeover bid. So conversely, all companies in which the first shareholder has a lower holding are freely taken over, that is to say they can be acquired without a takeover bid, providing the bidder, in his turn, keeps beneath the "critical" threshold. Under this rule, the market for corporate control is not affected by the burden of the mandatory offer provided that the control transactions keep the major shareholder below the thirty per cent threshold. Only more significant acquisitions, which permit a more stable exercise of control, result in the obligation to make an offer on all the shares.

Returning to the European regulations, it has to be said that the Directive does not contain a clear option in favour of contestability. Art. 2,
paragraph 1, letter a) provides only a general definition of a «takeover bid», which «shall mean a public offer (other than by the offeree company itself) made to the holders of the securities of a company to acquire all or some of those securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance to national law». In the absence of a univocal decision concerning the premise of the takeover bid, the European regulations legitimise, in effect, radical choices at the national level in favour of the mandatory offer for every kind of control transactions (25).

More precisely, Art. 2, paragraph 1, letter a) is substantially compatible with two different models for regulating the mandatory offer.

According to the first, the legislations of the Member States may choose to foresee the public takeover bid for all acquisitions of corporate control, so as to link the mandatory offer obligation to the target ownership structure. This means assessing, from case to case, which operations genuinely result in acquisition of control and must therefore be followed by a public takeover bid. For example, in a public company, the purchase of just one holding of ten percent might permit the exercise of control and impose a mandatory offer. In this context there would be no scope for “free” operations which result in a change of control, unburdened by the subsequent obligation of a takeover bid.

The second model corresponds to the formula underlying the self-regulatory code of the United Kingdom, which has subsequently been imitated by other jurisdictions. The public offer becomes mandatory when a significant holding threshold is exceeded, which is taken as a presumption of a stable control. Following this model, the premise of the takeover bid is still, as foreseen by the Directive, an operation «which follows or has as its objective the acquisition of control», but with the provision that such control must result from a holding corresponding to a threshold pre-established by the member-State. In this context the acquisition of control is free – and so contestability is greatly enhanced – for acquisitions of holdings below the threshold.

In conclusion, the development of the market for corporate control implies an increase in company contestability. From this point of view, the functioning of the market of control and company contestability in Europe does not only depend on the decisions which Member States have made or

THE CRITICAL RULES AND THEIR TRANSPONSTION

A. Board Neutrality or Passivity Rule

Art. 9 of the Directive is dedicated to what is traditionally called the passivity rule. The idea of passivity suggests the behaviour which the Directors of a target company are expected to undertake when a bid has been made public. From that moment they must avoid «taking any action (…) which may result in the frustration of the bid». The consequence, for the offering period, is a significant reduction in the powers of the Directors who may perform only actions or operations which carry no defensive implications.

The board neutrality is often considered synonymous with the passivity rule although, in the context of the Directive, the former seems the more appropriate definition. The passivity, in fact, is not absolute but regards solely the Board. Any authorization to defend the company against the bid is delegated to «the general meeting of the shareholders». The result, de facto, is not a limitation to the activities of the company but a shift of decisional power from the Directors to the shareholders. In other words, defensive activities by the target company are not ruled out entirely but subject to the condition that any such actions or operations proposed by the Directors are preventively approved by the shareholders. It is important to note that the shareholders are called to deliberate only when a bid has already been made and are, therefore, aware of the conditions of the offer and the future programmes of the bidder once control has been obtained.

Art. 9 of the Directive does not present a list of the operations which the Directors are forbidden to perform. They must assess case by case which actions and operations require specific authorization by the shareholders’ meeting (26). It does state, however, that authorization is necessary «before issuing any shares which may result in a lasting impediment to the offeror’s acquiring control of the offeree company», while it is not necessary in case of «seeking an alternative bid» by the Directors. Starting from the category of actions which involve the issuing of shares, the statement in the Directive raises an important question. If, on

the one hand, all operations involving the issue of shares should be considered defensive, since they make the entire operation more costly for the bidder, on the other hand the Directive only seems to limit the Directors’ powers with regard to share issues which *lastingly* impede the bid for control. This would seem to admit, for example, the legitimacy of a right issue to be executed by the directors for an amount which was unimportant in relation to the total capitalization of the target company, or a “bonus” issue of shares.

The provision that the shareholders’ meeting called to authorize the defensive measures is to be held during the offering period means that any actions or operations decided by the Directors before the beginning of the offer, but which may in some way hinder the success of the bid, must be reconsidered by the shareholders and submitted for further approval or ratification before they can be legitimately carried out (27). In an attempt to slim down the role of the shareholders’ meeting, Art. 12 paragraph 3 states that authorization should be requested for actions and operations which, as well as being defensive, do not «form part of the normal course of the company’s business». It appears, then, that the Directors may take such actions as are necessary for the carrying out of repetitive and day-to-day activities which do not imply any attempt to hinder the bid by changing the assets of the target company or increasing the difficulty of the operation.

The category of activities excluded by the passivity rule does not, furthermore, include any search for alternative bids on the part of subjects or coalitions close to the target company (28). This is because a competing bid is inherently to the benefit of shareholders (particularly in jurisdictions which allow a competing bid only if it offers better conditions than the original one), as well as because it would be useless to insist on the company’s authorization for an activity, such as the launching of a bid, which is not under the power of the target’s directors.

The action foreseen by Art. 9 paragraph 5 has to be considered as defensive against the takeover. However, it is not only permitted but required from the target company’s Board. This is a document which gives «its opinion of the bid and the reasons on which it is based, including its view in the effects on implementation of the bid on al the company’s interests an specifically employment, and on the offeror’s strategic plans for

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the offeree company and their likely repercussions on employment and the locations of the company’s places of business as set out in the offer document». It is clear that such a report will be supportive of the bidder’s proposals in the case of a friendly bid, whereas it would attempt to discourage the shareholders where the bid is hostile (29).

Problematic, in the light of past experience (30), is the question of when the board neutrality actually begins. The moment, that is, when the Directors’ powers become dependant on authorization by the shareholders’ meeting. On this point, Art. 9 paragraph 2 states that authorization by the shareholders’ meeting is required «at least from the time the board of the offeree company receive the information referred to in the first sentence of Article 6(1)» – this refers to the first communication by the bidder which may and usually does precede publication of the bid document – «and until the result of the bid is made public or the bid lapses». Member States also «may require that such authorisation be obtained at an earlier stage, for example as soon as the board of the offeree company become aware that the bid is imminent». This possibility, when used, increases the effectiveness of the passivity rule, applying it as soon as the target directors know about the incoming bid. In particular, it may become effective following any communication made to the public by the bidder in accordance with price sensitive regulation (31).

B. Board Neutrality or Passivity Rule

The passivity rule is applicable not only to the mandatory offer but also to the voluntary offer. Indeed, the most important doctrine concerning it derives from the debate developing in the United States where the mandatory offer does not exist.

It is not hard to explain why the passivity rule affects the functioning of any financial market, regardless of its particular takeover regulations. If we imagine a market where there are no restrictions to control transactions, the only hindrance to an efficient market for corporate control is the

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behaviour of the target company’s Directors. These latter, in a position of conflict of interests and wishing to conserve their mandates, could defend the company even if the bid would have been advantageous to the shareholders (32). From this derives the attention paid to the rules and principles affecting the Directors’ actions during a bid. Some have suggested they should remain totally inactive, in accordance with theories which rely on market forces and the disciplinary effect which takeover threats have on their performance.

In the United States the conduct expected of the Directors is not defined, as in Europe, on the basis of a valid ex ante model (that of passivity). Rather, it is guided by respect for their fiduciary duties towards shareholders, assessed in the specific context of a takeover and intended to safeguard the difficult compromise between the Directors’ freedom of action and the prevention of possible abuses. In particular, legal doctrine on the subject starts from the assumption that any defence made by the Directors must be proportionate to the risks which a successful bid would involve. They must not, therefore result in an excessive impoverishment of the company assets (33). Some doctrine describes more precisely the conduct required of the Directors, limiting it to a search for alternatives (34) or the negotiation of the highest possible price for shareholders (35). In short, the regulatory framework concerning defensive measures allows the Directors substantial freedom to defend the target company, to the extent that it may be wondered if this solution is adequate to resolve potential conflicts of interest between shareholders and Directors (36).

The European approach is different in that it is based on the definition of the conduct expected of the Directors. These are held to absolute passivity and must obtain authorization from the shareholders for any action or operation of a defensive nature (37). Nevertheless, even the model of Board neutrality defined by the Directive is not above criticism with regard to the question of the quorum of shareholders necessary to

(36) R.J. Gilson, Unocal “Fifteen Years later (And What we can do about it)”, 26 Del. J. Corp. L., 491, 495 (2001).
(37) P.L. Davies – K.J. Hopf (nt. 9), 165
approve the authorization requested by the Directors (38). Especially in financial markets characterized by concentrations of ownership structures, the possibility for a majority shareholder to vote in the shareholders’ meeting called to approve the defence of the target, take away from minorities shareholders the power to reject Directors’ proposals. In this case the role of the shareholders’ meeting is limited to that of scrutinize the Directors’ activities and providing the procedures with which to make public and legitimize their decisions (39).

In the context of the European regulations the board neutrality rule must be counted among those which help to improve the contestability of the market for corporate control. At the same time it compensates, to some extent, for the reduction in market contestability resulting from the introduction of the mandatory offer. This does not alter the fact, however, that the single legislations can adopt the board neutrality rule for any offer, mandatory or voluntary.

C. Transposition of the Passivity Rule by the Member States

The adoption of the Thirteenth Directive was made possible by the Italian and Portuguese proposal not to make the passivity rule and the breakthrough rule binding (40). If on the one hand, therefore, the passivity rule is established as a default rule by the European Community legislator, Art. 12 of the Thirteenth Directive permits single Member States to opt out of implementing it. When a member-State decides not to implement it, national companies must nevertheless be allowed to adopt voluntarily the rule.

In short, concrete adoption of the passivity rule depends on: i) the Member-State’s decision not to make use of the opt-out and therefore to implement Art. 9 of the Directive (41); or ii), the decision of each company, in the case that the Member-State decides for the opt-out, to include it in its

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(38) M. Ventoruzzo (nt. 1), 215; D. Regoli (nt. 29), 826.
(39) M. Ventoruzzo (nt. 1), 215.
(41) Member States should take a position about the opt-in/opt-out regime: J. Sanchez-Calero Guilar, La armonización disgregante: la directiva de OP-AS y el principio de neutralización de medidas defensivas, in http://www.ucm.es/info/mercantil, 3/2006, 39-40; M. Gatti (nt. 1), 420–421 argues that member- States choice “will lead to an outcome that cannot be deemed to be politically neutral” so the exam of such decisions “represents an important observation point to analyze the policy evolution in the regimes of takeover defenses”.

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articles of association (42). The decision of a company obviously cannot be compared with that of a Member-State. It is clear, in fact, that the adoption of the passivity rule by one listed company affects only its own opening towards the market corporate control and its future ownership structure. While the decision of the member-State produces more far-reaching effects, extending to the national economic system and rendering, other conditions being equal, all national companies listed in European regulated markets more open towards potential changes of control. Furthermore, the decisions of the single Member States are there for all to see whereas those of listed companies, though they must be communicated to the national watchdog authority in compliance with Art. 12, paragraph 2, of the Directive, are reversible and so less stable. The following considerations, therefore, essentially concern the adoption of the passivity rule by Member States.

According to the Commission’s statistics, 18 Member States out of 25 – 72% – have introduced (or intend to introduce) the passivity rule into their legal system (43). This will have the effect of making some 75% of listed European companies – 68% of the market capitalization – subject to the rule. In view of the fact that implementation by national legislations will make the rule applicable to three companies out of four, and that it is not unlikely that others will decide to adopt it voluntarily, European companies can be considered sufficiently contestable, at least as regards their ability to adopt defensive measures after a takeover bid has been launched.

Furthermore, the Commission’s statistics are updated only to February 2007 and so require modification on the basis of the latest developments concerning implementation of the Thirteenth Directive. In

(42) M. Gatti (nt. 1), 427-428 criticize the opt-out/opt-in mechanism: “As to the mechanics of the opt-out/opt-in scheme set forth by Article 12(1) and (2), it is questionable whether such a scheme is superior to an easier (and functionally equivalent) one in which Member States that do not impose the board neutrality rule as mandatory are required to set such a regime as the default rule with the possibility for companies to opt-out of it.51 It should be noted that this latter system, if compared with the opt-out/opt-in mechanism of Article 12(1) and (2), would have the virtue of clearly signalling to the market which issuers intend to depart from the pro-shareholders standard provided for by the board neutrality rule. In other words, a pro-takeover default is preferable, as it requires targets to take steps to reverse it, which is something that may have a negative impact on stock prices and will shine a spotlight on targets that try to hide, whereas, in the case of the adoption of a pro-incumbents default, the market will quite certainly not expect that many “virtuous” targets will take actions to reverse it (and targets will certainly not bother to make the market change its mind) will certainly not bother to make the market change its mind). In the same terms, see. F.M. Mucciarelli (nt. 1), 841 ss.

(43) See Report (nt. 2), 6. We note that EU Commission considered that passivity rule does not apply to Italian companies, even Italy did not yet implement the directive and the present legislation provides for the passivity rule.
particular, the European Commission has numbered Italy among the countries which have not adopted the passivity rule. In the light of current Italian legislation, as well as the recent declarations of the Minister of Economy, reported in the financial press (44), and the present legislative project for implementation of the Directive (45), it would seem more correct to include Italy among the countries in which the passivity rule is adopted. The Commission’s statistics therefore need to be corrected. Presumably, 19 out of 25 (76%) countries have now introduced or intend to introduce the rule and at least 80% of European companies – for a market capitalization of not lower than 76% – are subject to it. From a static point of view, at least, the adoption of the Thirteenth Directive, or at any rate of the rule of neutrality, should be considered positively as it finds application in about 4 companies out of 5.

However, a study of the contestability of European companies following implementation of the Thirteenth Directive cannot be simply limited to the number of Member States that have adopted the passivity rule or the number of companies subject to it. The dynamics of the situation also need to be verified. In other words, it is interesting to look at the impact of the Thirteenth Directive and its implementation in Member States on the European market for corporate control in terms of greater or lesser contestability. For this purpose we should compare the number of Member States which have adopted the passivity rule through implementation of the Directive with the number that already had such a rule.

Concerning this, before expiry of the term set by the Directive for implementation, some legal scholars had prognosticated that Member States’ decisions would be “path dependent”. It was considered unlikely that they would modify substantially their position with regard to such a fundamental aspect of their legal policies (46).

(44) See R. Sabbatini, Padua-Schioppa: la legge sull’Opa non cambierà, in Il sole24ore, 20 giugno 2007, 42.


(46) According M. Gatti (nt. 1), 427, it was “implausible that, after all the efforts that have been made to resist the board neutrality rule, a country like Germany, for instance, will eventually adopt it. On the other hand, it is not straightforward to understand the reasons, other than mere political retaliation or protectionism that can in any event be pursued by enacting the reciprocity device, why a Member State that has previously embraced board neutrality would decide to undo such a Policy”.

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It is interesting to note that, about a year after the term for implementation of the Thirteenth Directive (20th May 2006), this forecast seemed clearly confirmed by the document recently published by the Commission. In fact, only one of the Member States (namely: Malta) which had decided to adopt the passivity rule in their national legislations did not have a similar rule already. Looked at from the opposite point of view, with the exception of Malta, all Member States which did not previously have the passivity rule, have decided (or are going to decide) not to implement it (47).

As well as noting that implementation of the Directive has made precious little difference to the number of States adopting the passivity rule, it also has to be said that some of the Member States which have this rule have also implemented the reciprocity rule (48). They therefore permit national companies to add clauses to their articles of association which allow the Directors of target companies to adopt certain defensive measures when the bidding company, in its turn, is not subject to regulations which limit its freedom in setting up defensive measures in the case the latter is a bidding target. Since such a possibility, deriving directly from the Directive, seems not to have been contemplated previously in national takeover legislation, in a certain sense European legislation has actually moved backwards with respect to the proclaimed goal of creating a legal framework favourable to the market corporate control.

In conclusion, with regard to the passivity rule, on the basis of the statistics reported by the Commission document, it seems certain that the Thirteenth Directive has not produced the hoped-for result and that companies are no more open than they were before. Indeed, on the one hand, the number of States in which the passivity rule is adopted (and consequently the number of companies to which it is applied) has not significantly increased; on the other, the screen offered by the reciprocity rule, not previously present, could actually create situations in which target companies may legitimately defend themselves against bidders.

However, as we shall see later (cfr. § V.A), it still has to be seen whether such events will take place in practice, since it depends on the conduct of companies with head offices in countries which preferred the opt-out. In particular, if the raiding companies have included the passivity

(47) See Report (nt. 2), 6. Germany, Netherlands, Belgium, Luxemburg, Poland and Denmark have not (or will not) implement passivity rule.

(48) Such as France, Greece, Hungary, Portugal and Slovenia. For instance France has modified its commercial code by introducing article L. 233-33 that provides for reciprocity.
and/or neutrality rules in their articles of association, this would lessen the consequences of the reciprocity rule.

D. The Breakthrough Rule: its Aims

The second cardinal principle of the European takeover regulations is the breakthrough rule foreseen by Art. 11 of the Thirteenth Directive (49). This rule aims to neutralize, both during and after the period of the public takeover bid, the so-called defensive measures. These are, in particular, clauses contained in companies’ articles of association or in agreements between shareholders which affect the circulation of shares or the principle of proportionality between risk and power (50). The former include those which place restrictions on the transfer of shares, for example by limiting their circulation or possession; the latter include those which restrict the exercise of voting rights or attribute a multiple vote to certain shares.

It is generally held by legal scholars (51), even if not presently supported by empirical data (52) or unanimously agreed upon (53), that the limits described above constitute company or contractual defences which


(50) On disproportion between voting rights and cash flow rights, see G. Ferrarini, “«One Share - One Vote»: A European Rule?”, in ECFR, 2006, 147.


will affect the likelihood of a bid being made for a company which has them available. These clauses limit, in fact, the number of shares which the bidder can acquire, as in the case of shareholders’ agreements that limit the free transferability of shares. They may also not permit the bidder who has obtained a majority shareholding to exercise control on account of dual class shares structures (i.e. the existence of several categories of shares with differentiated voting rights). In particular, the dissociation between risk and power generated by the existence of more than one class of shares protects the controlling shareholders from hostile bids. Corporate control can only be transferred with the consent of the shareholders who have a majority of voting rights, regardless of the percentage of company capital they represent. The bidder who acquires shares representing a majority of the capital, but not of voting rights, will not obtain corporate control.

On this point, the solution adopted by the Directive clearly draws its inspiration from the suggestions made by the High Level Group, which considered the advantages of eliminating entirely such clauses (54). The High Level Group considered it necessary to introduce the breakthrough rule only in the presence of a public takeover bid, in order not to compromise its positive outcome (55). It did not consider it necessary to outlaw such clauses on principle, since this would be expensive and probably useless. It therefore proposes the breakthrough rule during bidding contests together with an obligation to give clear and complete information concerning the share structure of listed companies (56).

In more detail, the breakthrough rule states that “any restrictions on the transfer of securities provided for in the articles of association of the offeree company shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid laid down in Article 7(1)” (Art. 11, paragraph 2). The same principle is also applied to restrictions foreseen in contractual agreements between the issuing company and its shareholders as well as contractual agreements between the shareholders of the issuing company. The neutralization of any limits to the transfer of shares is evidently intended to favour the bidder, permitting him to acquire more easily a majority of corporate capital since the shareholders can decide

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(55) High Level Group (nt. 49), 23-24.
(56) Transparency on the ownership and capital structure of listed companies has been recently highlighted by High Level Group (nt. 49), 25 and it has been translated on the directive article 10.
whether or not to support the public takeover bid without the restrictions which the articles of association or shareholders’ agreements might otherwise impose (57).

With regard to restrictions to voting rights, paragraph 3 of Art. 11 states that “shall not have effect at the general meeting of shareholders which decides on any defensive measures in accordance with Article 9”. The same article, furthermore, declares that “multiple-vote securities shall carry only one vote each at the general meeting of shareholders which decides on any defensive measures in accordance with Article 9”. The rule intends to prevent any limits to the exercise of voting rights or any dual class share structures that alter the proportion between the number of shares held and voting rights from being used by a dominating minority – thanks to its “increased” voting rights – to authorize whatever defensive measures it wishes, regardless of those shareholders who, even while representing a majority of the capital, are not able to express a majority of the votes.

The fourth paragraph, lastly, provides for the neutralization of any limits in the articles of association to voting rights, as well as of the multiple vote if, following the bid, the bidder acquires a share of the capital equal to or greater than 75%. In such circumstances, “no restrictions on the transfer of securities or on voting rights referred to in paragraphs 2 and 3 nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of association of the offeree company shall apply; multiple-vote securities shall carry only one vote each at the first general meeting of shareholders following closure of the bid, called by the offeror in order to amend the articles of association or to remove or appoint board members”. As a result of this rule, the offeror who has acquired shares representing 75% of the capital will be able to appoint a new board of directors and to modify freely the articles of association. In particular, he may suppress restrictions to voting rights and multiple-vote shares (58).

To sum up, the breakthrough rule operates from the launch of the public takeover bid, neutralizing any restrictions to the transfer of shares or to the exercise of voting rights (59); but its effects also continues after its closure, making it impossible to apply defensive measures to the bidder ex post (60).

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(57) See High Level Group (nt. 49), 36-37.
(58) See M. Ventoruzzo (nt. 1), 210-211.
(59) Article 11, paragraphs 2 and 3.
(60) Article 11, paragraph 4.
The utility of the breakthrough rule has been questioned from various angles. Some scholars have pointed out that free transferability of shares is an essential requisite for listing, so the breakthrough rule, by neutralizing clauses which cannot be present anyway, will not have any favourable effect on bids \(^{(61)}\). However, the breakthrough rule contained in the Community Directive is not wholly superfluous from this point of view since it also refers to shares transfer limits foreseen by shareholders’ agreements, to which the free transferability rule does not apply.

More relevantly, many have remarked that only a few listed European companies would actually become contestable as a result of the breakthrough rule and that there are in any case perfectly legitimate ways of getting round it \(^{(62)}\).

Regarding the first point, it has been argued that only 3-4\% of listed European companies would become contestable thanks to this rule. This figure is obtained by a combined analysis of 1) the data relating to companies with dual class shares structures or which have limits to voting rights (caps) in their articles of association and 2) the data concerning shares holdings. In particular, recent studies have suggested that some 35\% of listed European companies would be potentially affected by the breakthrough rule \(^{(63)}\) as a result of company structures which do not comply with the principle of proportionality between voting rights and cash flow rights. However, it is suggested that many of these would not become any more vulnerable to hostile bidders, and this on account of their ownership structure. The breakthrough rule would have no effect, in fact, in companies where one shareholder holds an absolute majority or where a block minority holds at least 25\% of the company capital, this being the percentage necessary to prevent the \textit{ex post} application of the rule.

With regard to systems that permit controlling shareholders to retain management of the company despite the breakthrough rule, it has been observed that it would be enough for them to 1) increase their current holding of shares above the 25\% threshold or, 2) if that is too expensive,

\(^{(61)}\) V. Edwards (nt. 1), 437.
\(^{(62)}\) See J.C. Coates IV (nt. 18), 683.
\(^{(63)}\) According a recent study commissioned by the Association of British Insurers to Deminor, \textit{Application of the one share one vote principle in Europe – A study commissioned by ABI}, March 2005, available on \url{www.deminor.org/article}, 35\% of European listed companies have dual class structures or voting rights caps.
switch the ownership structure into a pyramidal one \((64)\) or even 3) move the head offices to a non-EU State \((65)\). Looked at this way the breakthrough rule would be thoroughly ineffective since it would not result in any concrete increase in company contestability and might even increase the opacity of the controlling structures, in clear contrast to the goals of the Directive, without considering the economic inefficiencies arising from the legal and transaction costs associated with these adaptive responses.

This reasoning seems correct, both as regards the argument that the introduction of the breakthrough would not in itself be sufficient to increase the contestability of listed companies, since their ownership structure also has to be examined, and as regards the suggestion that alternative solutions are available to majority shareholders with which to set at nought the pro-takeover effects of the rule.

\[E.\] Transposition of the Breakthrough Rule by Member States and Optional Agreements

As with the passivity rule, the Directive allows Member States the possibility of not implementing the breakthrough rule in their legislations. With this regard, Art. 12 states that Member States may reserve the right not to oblige companies with head offices in their countries to apply Art. 11. Nonetheless, Member States which take this option must permit such companies to apply voluntarily the dispositions of Art. 11. Furthermore, the decision by each single company to introduce the breakthrough rule is reversible by an extraordinary shareholders’ meeting.

Once again, the concrete adoption of the breakthrough rule depends either on the decision of the single Member States not to make use of the opt-out or, when the opt-out regime is adopted, on the decision of the single companies to include it in their articles of association. So here, too, the relevance for the system of the decision by the member-State or by the single company is different. A decision by a member-State constitutes a legal policy which, other conditions being equal – and so without taking into


account the considerations made above concerning the ownership structure – affects the opening up of the entire national economic system to the market for corporate control. However, there is a further reason which gives a decision at State level greater importance for the system than a decision by single companies. It must be remarked, in fact, that the introduction of the breakthrough rule via the articles of association is effective only with regard to the clauses in these articles and appears ineffective against any preventive defences contained in shareholders’ agreements (66). Furthermore, it seems that companies may adopt the breakthrough rule only partially, while Member States do not have this option (see § V.C below).

Early comments on the Thirteenth Directive suggest that the faculty for Member States to opt out of the breakthrough rule contributes to undermining the goals of the Directive, both in so far as it greatly decreases the effectiveness of the rule in assisting takeover bids, and in so far as it does not help the creation of a common market for corporate control (67). Moreover, it was expected that most Member States would decide to opt out of the breakthrough rule when implementing the Directive (68).

The recent study by the European Commission would seem to confirm these fears, at least as regards Member States’ decisions. According to the Commission statistics, in fact, only three out of 25 Member States (12%) have fully implemented – or intend to implement – the breakthrough rule (69). Furthermore, if we consider that the Member States which have introduced – or intend to introduce – the breakthrough rule do not include any of the main European economies, and if we look at the number of listed companies and their stock exchange capitalization, the Commissions’ investigations suggest results that are more discouraging still: just 1% of listed European companies, representing less than 1% of the capitalization of all listed companies, have become subject to the breakthrough rule as a result of implementation of the Directive by Member States (70). The Commission can find some small consolation in the fact that Italy, at least according to the press declarations by the Minister of the Economy and the recently-published project for implementation of the Thirteenth Directive,

(66) See Companies Act 2006 section 968.
(67) M. Venturuzzo (nt. 1), 205 argues that the opt in/opt out mechanism ‘raises serious questions on the creation of a leveled-playing field’ in the EU market. See M. Gatti (nt. 1), 417 and F.M. Mucciarelli (nt. 1), 833.
(68) F.M. Mucciarelli (nt. 1), 843; contra M. Gatti (nt. 1), 427 noting that it is not easy to make any previsions about the implementation by the Member States of the breakthrough rule.
(69) Namely: Lithuania, Latvia and Estonia.
(70) See Report (nt. 2), 7 and 19.
will not only not modify its own legislation, thereby maintaining in force the present breakthrough rule (see § V.C below), but will even introduce an article reproducing in their entirety the principles indicated in Art. 11 (71).

As the Commission itself has pointed out, application of the breakthrough rule will almost exclusively depend on the decision of companies to adopt it voluntarily (72). As things stand, however, it is difficult to forecast whether they will actually do so. It is felt that the decision will depend on numerous factors, such as whether or not Member States implement the reciprocity principle foreseen by the Directive (73). While the relationship between the reciprocity rule and the decision by single companies to adopt the breakthrough rule will be dealt with more fully in § V.B below, it may be presumed that companies with plans for cross-border acquisition will adopt voluntarily the breakthrough rule to avoid claims of reciprocity by possible target companies.

Ownership structures also seem likely to affect decisions over the breakthrough rule. In particular, in systems where shareholders’ agreements are not widespread and companies are characterized by the absence of one or more controlling shareholders, the adoption of the breakthrough rule seems useless, so the shareholders will probably not bother to do anything about it, thus effectively choosing not to apply it voluntarily. In the not uncommon case (74) of a shareholder with an absolute majority, any decision to introduce the rule into the articles would not increase the contestability of the company, since control could still only be transferred with the consent of the majority shareholder. And lastly, if we assume that voluntary adoption of breakthrough rule is also effective with regard to shareholders agreement, it seems reasonable to assume that companies controlled by shareholders bonded by shareholders’ agreements will not adopt the rule in order to protect the existing ownership structures.

The fact that the choice can be reversed might be an incentive for adopting the rule, since companies knows that they can escape from its application in any moment. However, as the Commission points out, companies can thereby adopt and relinquish the rule according to whether they are currently bidders or potential targets, creating a certain degree of confusion on the market.

(71) See “Schema di decreto legislativo” (nt. 45).
(72) See Report (nt. 2), 7
(73) See M. Gatti (nt. 1), 431; and F.M. Mucciarelli (nt. 1), 837, sceptical on the possibility that companies will opt-out from a regime that allows them to adopt anti-takeover defences.
(74) For some data regarding the ownership of European companies, see F. Barea – M. Becht, The Control of Corporate Europe, Oxford, 2002, 317-318.
One further potential incentive for voluntary adoption is to be found in the market mechanism: an efficient market certainly ought to take a positive view of a company’s adoption of the rule and this should favourably influence the market value of its securities.

After this brief analysis of the various incentives and disincentives for companies to adopt the breakthrough rule, it is worth returning to the Commission’s statistics concerning implementation by Member States, which do not seem to reflect a particularly satisfying situation. Nonetheless, the data deserve further examination. Certain observations somewhat mitigate the generally negative impression. First of all, it must be said that failure to adopt the breakthrough rule at a national level does not automatically mean that national legislations are in favour of share structures that are resistant to changes of corporate control by means of public takeover bids.

The position of Great Britain may be considered paradigmatic. As is well known, British company law does not impose any kind of restriction to the freedom of a company to choose its own financial structure, whether as regards the issuing of different classes of shares with different limits to voting rights or with multiple votes, or as regards limits to their circulation (75). While the British Government has pronounced itself in favour of company structures which respect the principle of proportionality between risk and power, it has nevertheless decided not to adopt the breakthrough rule, giving the following reasons: a) market forces are themselves able to reduce the number of companies with complex financial structures, with multiple-vote shares and non-voting shares, or with articles of association which limit circulation of the shares or voting rights (76); b) adoption of the breakthrough rule could result in a migration of companies towards legal systems which do not apply it, especially in the light of the Community legal jurisprudence concerning the transfer of company registered offices (77); c) the adoption of the breakthrough rule might reduce the flexibility enjoyed by companies to choose their own financial structures (78). Therefore the

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(76) According Deminor study (nt. 63) only 12% of British companies has a dual class share structure.
(78) DTI (nt. 53), 27-28.
breakthrough rule may voluntarily be adopted in Great Britain by single companies (79).

Concerning this, it has to be noted that in Great Britain the market forces exert a considerable pressure, which acts effectively – or, at least, more so than in other regulatory frameworks – on the autonomies of the different parties. This acts as a stringent brake on the adoption of rules in the articles of association which might prevent or hinder public takeover bids. In fact, in spite of the wide freedom allowed by British law for the definition of the company structure, in practice “it is not the present fashion for public companies to complicate their capital structure by having a large number of share classes” (80). This implies that, on the one hand, many British companies will see no compelling reason to introduce the breakthrough rule, since their articles do not contemplate defence mechanisms which would call for such neutralization; while, on the other hand, we may reasonably expect the voluntary introduction of the breakthrough rule in companies which do foresee defence mechanisms in their articles.

From the point of view of legal policies, the British example raises serious questions as to what is the best way to achieve contestability for listed companies or rather, whether this goal is more easily obtained by leaving it to market forces or by the imposition by Member States of binding rules. Looked at this way, it could be said that faith in self-regulation by the market provides an answer to the criticisms made of the wide freedom conceded by the Thirteenth Directive concerning the adoption of its cardinal principles, namely that the various optional systems would prevent the creation of a European market for corporate control. Following this argument, the intervention of market forces would make any coercive State action completely superfluous.

In the second place, as the Commission has recognized (81), some legislations have eliminated the most important defence mechanisms, such as multiple-vote shares or limits to share ownership, so any adoption of the breakthrough rule would not have any significant effect on contestability of corporate control, due to the fact that the obstacles it is intended to overcome have been already removed. An example is Germany which decided for the opt-out regime. Indeed some years ago Germany eliminated

(80) See P.L. Davies (nt. 75), 619; according Deminor study (nt. 63) only 12% of British companies has a dual class share structure.
(81) See Report (nt. 2), 7.
the possibility of introducing limits to the exercise of voting rights in the articles of listed companies – only unlisted companies are still allowed to do this – as well as that of issuing multiple-vote shares (82). Statistics show that, at least as regards defensive measures, there are few German companies to which the breakthrough rule could be applied (83), so the opt-out regime is not supposed to negatively affect the market for corporate control.

France, too, has chosen not to fully introduce the breakthrough rule, leaving single companies the faculty to adopt it in their articles of association (84). However, the situation in France is more complex than might appear from a rapid examination of the Commission’s statistics. In fact, the law which transposed the Thirteenth Directive into French legislation, on the one hand opted for the adoption of a minimal breakthrough rule (85), while on the other hand it introduced a new form of defence.

In particular, the implementation law modified the code de commerce, stating that limits to the exercise of voting rights, as of Art. L. 225-125, present «dans les statuts d’une société qui fait l’objet d’une offre publique et dont des actions sont admises à la négociation sur un marché réglementé, sont suspendus lors de la première assemblée générale qui suit la clôture de l’offre lorsque l’auteur de l’offre, agissant seul ou de concert, vient à détenir une fraction du capital ou des droits de vote de la société visée par l’offre supérieure à une quotité fixée par le règlement général de l’Autorité des marchés financiers, au moins égale à celle requise pour modifier les statuts, et dans la limite des trois quarts». The Autorité des marchés financiers established this threshold at two thirds of the capital or the voting rights of target companies, and thus at a lower level than that foreseen by the Directive (86). Furthermore, the same law introduced into the code de commerce Art. L. 233-34, which states that «sauf lorsqu’elles résultent d’une obligation législative, les clauses des statuts d’une société dont des actions sont admises à la négociation sur un marché réglementé prévoyant des restrictions statutaires au transfert d’actions de la société sont inopposables à l’auteur d’une offre publique pour les titres qui lui seraient apportés dans le

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(82) See section 1.20 KonTraG (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich) published on 27th April 1998.
(83) See Rapporto Deminor (nt. 63), 20 c 29.
(85) A partial transposition of the breakthrough rule is discussed, F.M. Mucciarelli (nt. 1), 834 opting for a negative solution.
(86) Règlement Général de l’Autorité des Marchés Financiers, article 231-43.
cadre de son offre. In any case, the two dispositions are not really new to French regulations since – in the secondary level of regulation – the Autorité des marchés financiers had already provided for the suspension of clauses in the company articles which limit the circulation of shares during a public takeover bid (87), as well as the neutralization of limits to voting rights when such a bid is successful (88).

The new defence mechanism comes under the category of poison pill warrants. The law implementing the Directive has, in fact, introduced into the code de commerce Art. L. 233-32, which states that an extraordinary shareholders’ meeting can provide, at any moment, for the issue of free warrants which permit those holding shares in the company at the moment of the launch of the bid to underwrite company shares at preferential conditions. The meeting can delegate the issue of such shares to the Board of Directors, determining the maximum capital increase as well as the maximum number of warrants assignable. The assignment of warrants is strictly linked to the launch of a public takeover bid and indeed, if the bid fails, the warrants «deviennent caduques ou sont retirées» (89). If the meeting at which the issue of the warrants was decided was held before the launching of the bid, a new meeting must be called during the bid to confirm the decision (90).

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(87) Règlement Général de l'Autorité des Marchés Financiers article 231-6. Lepetit report (nt. 84), 9 suggested that the principles should be translated in the state legislation.
(88) See Lepetit report (nt. 84), 11.
(89) According code de commerce, article L. 233-32, II: «... Sans préjudice des autres mesures permises par la loi, l’assemblée générale extraordinaire de la société visée, statuant dans les conditions de quorum et de majorité prévues à l'article L. 225-98, peut décider l’émission de bons permettant de souscrire, à des conditions préférentielles, à des actions de ladite société, et leur attribution gratuite à tous les actionnaires de cette société ayant cette qualité avant l’expiration de la période d’offre publique. L’assemblée générale peut déléguer cette compétence au conseil d’administration ou au directoire. Elle fixe le montant maximum de l’augmentation de capital pouvant résulter de l’exercice de ces bons ainsi que le nombre maximum de bons pouvant être émis. La délégation peut également prévoir la fixation de conditions relatives à l’obligation ou à l’interdiction, pour le conseil d’administration ou le directoire, de procéder à l’émission et à l’attribution gratuite de ces bons, d’y surseoir ou d’y renoncer. La société visée porte à la connaissance du public, avant la clôture de l’offre, son intention d’émettre ces bons. Les conditions d’exercice de ces bons, qui doivent être relatives aux termes de l’offre ou de toute offre concurrente éventuelle, ainsi que les autres caractéristiques de ces bons, dont le prix d’exercice ou les modalités de détermination de ce prix, sont fixées par l’assemblée générale ou, sur délégation de celle-ci, par le conseil d’administration ou le directoire. Ces bons deviennent caducs de plein droit dès que l’offre et toute offre concurrente éventuelle échouent, deviennent caduques ou sont retirées».
(90) Code de commerce, article L. 233-32, III.
As of today, the shareholders’ meetings of at least five companies have authorized the issue of such warrants (91). Nonetheless, the importance of these cases must not be overestimated and they are not to be taken as general evidence of a favourable attitude towards anti-takeover measures. Indeed, the financial press has reported episodes of “revolts” by small shareholders against poison pills proposed by the management (92).

In conclusion, in spite of protestations of an opening up of French companies to the market for corporate control (93), it does not appear that the French legislators, when implementing the Directive, have done very much to improve their contestability. On the one hand, the legislators have limited themselves to introducing a partial breakthrough rule by implementing only those dispositions of the Directive which existed in the national regulations anyway, though raising them to the level of primary legislation. Neutralization of provisions in company articles of association that limit the circulation of shares during a public takeover bid and of provisions that limit the exercise of voting rights in the first meeting following closure of the bid is foreseen, but other forms of defence are not covered by the French breakthrough rule. These include restrictions to voting rights and limits to the circulation of shares established by shareholders’ agreements and restrictions to voting rights in meetings called to decide upon subsequent defensive measures. On the other hand, any beneficial effect of the rule would seem to be set off, at least in part, by the new defence mechanism of the poison pill warrant. Following the American example (94), this has been introduced to provide controlling groups and the management of target companies wide room for manoeuvre when faced with an unwelcome bid, and so the chance to negotiate with the raider to obtain more favourable exit conditions for shareholders and for the management itself.

With regard to Italy, it has already been observed that the implementation law will presumably bring national legislation in line with

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(92) Newspaper article: Addio colbertismo anti-scalate? La Bastiglia dei piccoli azionisti contro le «poison pills» di Parigi, Corriere della Sera, 26th May 2007, 28, highlighting that shareholders of Technip, Essilor and Veolia voted against the adoption of poison pills proposed by the board.

(93) Lepetit report (nt. 84), 4.

the discipline foreseen by Art. 11 of the Directive. This will combine with confirmation of the breakthrough rules currently in force concerning shareholders’ agreements (Art. 123, paragraph 3, TUF) and limits to the exercise of voting rights (Art. 212, TUF). Italy should therefore become one of the few Member States in which the breakthrough rule will be fully applied.

In the light of our considerations on the adoption or not of the breakthrough rule in three of the major Member States (Great Britain, Germany and France) as well as in Italy, it is difficult to draw any general conclusions. As we have seen, the four major European economies have taken completely different approaches. The United Kingdom has not adopted the rule at all, trusting that market dynamics will result in transparent and contestable company structures; Germany has eliminated the principal barriers to the contestability of corporate control but has preferred not to introduce the breakthrough rule; France has taken a decidedly more cautious attitude, in line with previous secondary regulations but somewhat paradoxically introducing a new defence mechanism which practically offsets any advantages of the partial breakthrough rule adopted; while Italy already has a similar rule (see § V.C) and will probably implement the breakthrough rule as it appears in the Directive.

At the present time it is not easy to establish which approach might best achieve the goal of a livelier market for corporate control. It could also be argued that the effectiveness of the single models has to be assessed in their specific national contexts.

F. Reciprocity and the Transposition by Member States

The remaining area where the Thirteenth Directive allows full freedom to Member States is that of the introduction of the so-called reciprocity principle. Art. 12 paragraph 3 establishes that “Member States may, under the conditions determined by national law, exempt companies which apply Article 9(2) and (3) and/or Article 11 from applying Article 9(2) and (3) and/or Article 11 if they become the subject of an offer launched by a company which does not apply the same Articles as they do, or by a company controlled, directly or indirectly, by the latter”. The Directive therefore allows defenceless companies – whether they are so by their own choice or by that of the Member State – to respond to an attack by raising barriers against bidding companies which have anti-takeover defences available.
According to Community legislation, the erection of defences by target companies which have no anti-takeover mechanisms would depend on a combination of two factors: i) the decision of the single Member States to introduce the reciprocity principle into their national legislation and ii) by the decision of the single companies to avail themselves of it following a specific decision by the shareholders’ meeting. However, while a decision by a member-State to implement the passivity and breakthrough rules results in their automatic application to all national companies, a similar decision regarding the reciprocity principle does not necessarily mean it will be applied to all listed companies, since it also has to be specifically adopted by the shareholders’ meetings of the single companies (95).

This situation considerably influences any quantitative analysis of the companies which have or have not adopted the reciprocity rule. In particular, it does not seem possible to establish the number of companies that have decided to introduce the rule, since analysis would focus on the number of States which have allowed companies to adopt it and the companies potentially interested. Precise details can be obtained only concerning companies which cannot adopt the rule as a result of the decision by a member-State, while implementing the Directive, not to grant this faculty.

The Commission’s statistics show that most Member States (16 out of 25) have decided to implement the reciprocity rule, while the remainder, including Great Britain, have opted not to (96). As a result of implementation of the Directive by Member States, 53% of European companies – a capitalization equal to 38% of that of all European markets – may not make use of reciprocity. Conversely, less than half (47%) – but which amount to 62% of market capitalization – are permitted to avail themselves of reciprocity. However, this does not mean that all companies with head offices in Member States which have adopted the rule will actually make use of it since, as has been seen, they have to make a specific decision.

(95) See M. Gatti (nt. 1), 430 arguing that «companies alone cannot introduce reciprocity». Conversely, the European rules are clear in excluding that Member States cannot impose companies to apply reciprocity, provided that companies can choose not to introduce it. On this matter, according some scholars, it seems that France did not fully implement this principle in national legislation; indeed it looks like that the French law does not allow to the companies any choice: code de commerce, article L. 233-33 seems to bind companies and to impose them the application of reciprocity, even without any shareholders decision (see A. Pietrancostra - A. Maréchal, Transposition de la directive OPA: des incertitudes entourant le recours à la clause de réciprocité, in Bull. Joly Bourse, 2005, p. 797; ANSA, Transposition de la directive sur les OPA. Mesures anti OPA, n. 04-023, avr. 2005).

(96) France implemented reciprocity only referring to passivity rule.
to do so. And it is by no means certain that all companies will decide to make use of the rule. The fact that the decision authorizing it has to have been taken by the target company at least 18 months before the launch of the bid might be a strong disincentive. From the point of view of the shareholders it would mean giving the board a free hand without knowing what type of bid will be launched.

It is easy enough to understand the concern to create a levelled playing field and the protectionist fears which has caused national legislators to implement the reciprocity rule. It is more interesting, however, to look briefly at the reasons given for not adopting it. The observations made by the British DTI are particularly illuminating. While it recognized in principle that the reciprocity rule would be able to encourage companies to take a more liberal approach, it pointed out that the incentive lacks substance when it is considered that the optional decision granted to companies may be reversed at any moment \(^{(97)}\). Furthermore, the DTI feels that the advantages of the rule are more than counterbalanced by its disadvantages. In particular, adoption of the rule would not be welcomed by British market operators who are used to a liberal approach rather than a protectionist one. In the second place, an attempt to protect national companies from external attacks could result in “retaliation”, with considerable repercussions on both international commerce and on the free capital circulation. Lastly, considerations of simplicity and legal certainty counsel against adoption of the rule which, in the light of the other optional decisions allowed by the EU legislator, would greatly complicate implementation of the Directive. Without going into any of the problems which will be dealt with below (cf. § V.B), the relationship between optional decisions and the reciprocity principle is one of the most complex points in the European regulations. It is easy to imagine the problems that might arise when trying to identify the situations in which the rule might be invoked \(^{(98)}\).

V. PROBLEMS ARISING IN THE TRANSPOSITION PROCESS

\(^{(97)}\) See DTI (nt. 53), 28.

\(^{(98)}\) A recent implementation proposal coming from Italian government provided to give to Consob, the Italian authority controlling the stock exchange and listed companies, the power to verify the equivalence of rules applicable to the target and to the bidder. See art. 104-ter, par. 1 of “Schema di decreto legislativo di attuazione” (nt.45).
G. Optional Arrangements and Incentives for Member States

The optional arrangements contained in Art. 12 of the Directive, concerning both the board neutrality rule and the breakthrough rule, may give rise to several distinct configurations of the structure of national legislations and companies’ articles of association in Europe.

The first important moment of choice regards Member States’ decisions whether to adopt or not Art. 9 paragraphs 2 and 3 and Art. 11. This freedom results on four different options: i) the adoption of both the passivity rule and the breakthrough rule; ii) the adoption of neither; iii) the adoption of the passivity rule but not the breakthrough rule; iv) the adoption of the breakthrough rule but not the passivity rule.

The second moment of choice is left to the contractual autonomy intervention. When Art. 9 paragraphs 2 and 3 and Art. 11 are not transposed in the jurisdiction, the Member State must allow companies, by a reversible option, to provide for the passivity rule and the breakthrough rule in their articles of association in a version substantially similar to the Directive’s. Consequently, company articles of associations may contain various combinations of clauses adopting one or other, or both, of the rules.

The level of contestability of European companies is in inverse proportion to the freedom conceded to shareholders and Directors to make use of defensive strategies. If not imposed by the national law, this result depends on decisions which companies will make over the coming years. In those States which have decided not to implement the passivity rule and/or the breakthrough rule, companies will be open to the market for corporate control only thanks to the private contractual intervention.

The reciprocity rule (Art. 12, paragraph 3), works quite differently. It is applied where the State of origin has implemented one or both of the EU dispositions concerning defence against takeover bids (Art. 9 and Art. 11) and is an attempt to find a balance between the bidder’s strength of action and the target company’s ability to respond. Member States are provided with wide scope for intervention, to the extent of relieving from the application of the passivity and breakthrough rules when a foreign raider actually makes a bid. In particular, the option permits the introduction of a mechanism which is substantially able to attenuate the rigour of the ban on defensive measures during a bid or the ineffectiveness of ex-ante strategies. Reciprocity consists in authorization to waive the passivity and breakthrough rules when the target company is the object of a takeover bid.
launched «by a company which does not apply the same Article as they do, or by a company controlled, directly or indirectly, by the latter».

In order for a target company to make use of the opportunities offered by the reciprocity rule it is necessary for the rule to have been implemented by the laws of the member-State to which it belongs. It is also an essential condition that the bidder should not be subjected to any restriction on defensive measures, as happens when its State of origin has not adopted the passivity and breakthrough rules and, at the same time, when such rules have not been included voluntarily in its articles of association. In this case the shareholders and Directors of the target companies may make use of the possibility of setting aside the passivity and breakthrough rules, to which they would otherwise be subject on account of

i) implementation of these same by the State of origin of the target company or
ii) the voluntary adoption by the company of Art. 9 and Art. 11 in its articles of association.

It must nonetheless be emphasized that even in the presence of these conditions the freedom of the Directors to take defensive measures is by no means automatic. For each single company, in fact, reciprocity may be invoked only if it has been «subject to the authorisation of the general meeting of the shareholders of the offeree company, which must be granted not earlier than 18 months before the bid was made public». This is important since it reveals that the defensive force of the reciprocity rule is on the whole more limited than it might seem at first sight. There is in a certain sense a degree of symmetry between the board neutrality rule, as of Art. 9, and reciprocity as described in Art. 12 paragraph 5. The former frees the Directors from the passivity rule if so authorized by the shareholders during the bid, while the latter frees them from the same restriction but only if authorized at least 18 months before the beginning of the bid. It is therefore by no means a foregone conclusion that the issuing companies’ shareholders will hand over such powers to the Directors without knowledge of either the type of bid and the identity of the raider, purely on the hypothesis of a lack of reciprocity between the bidder and the target.

In order to understand this statement, it is important to clarify which interest are served by the reciprocity rule. In reality, the parity between bidder and target is not set up for the benefit of the players, given that restrictions to defensive measures affect and limit the target but not the bidder. In other words, there is no a priori reason why the target company’s shareholders should wish to authorize defensive measures against a raider
purely on the grounds that it originates from a legal system which is more liberal over defensive techniques.

The presence of the reciprocity rule among the complex options for implementation of the European Directive is a precise political choice, since it may represent a double incentive for Member States and for companies which have to decide whether to include the passivity or breakthrough rules in their articles of association. The point of view to take as a starting point is not that of the target company, which has every reason to want reciprocity, but that of a potential bidder. A company which considers itself as a probable future bidder for corporate control of another European company has a concrete interest in predetermining the application of a rule that can only be to its advantage. That is to say, a company which includes the passivity and breakthrough rules in its articles (where national legislation has not implemented them), cannot be subject to defensive measures by the target, since in this case reciprocity cannot be invoked. Furthermore, a company which take the decision to submit itself to the mechanisms of the market for corporate control (by stating anti takeover defence rules in its articles) find an incentive in the positive reactions of the market with regard to its securities.

In conclusion, the meaning of the reciprocity rule lies in its use as an incentive whose final effect is to produce a European takeover contest where the passivity and breakthrough rules are applied.

Reciprocity acts in the first place as an incentive for member-State legislators faced with the dilemma of whether to protect their national enterprises or whether to develop a more active market for corporate control. They should be more ready to implement the passivity rule and the breakthrough if companies can be exempted from them where a levelled playing field – or parity of regulatory restrictions – does not exist between the national company and the foreign bidder. In the second place, reciprocity should be a considerable incentive to company decisions. Companies which do not wish to have their cross-border bids hindered by invocation of reciprocity will be likely to incorporate Art. 9 and Art. 11 in their articles of association.

Though this may not be evident at first sight, reciprocity acts positively in the context of the complex systems of incentives contained in the Directive. It should induce Member States still tempted by protectionist leanings into adopting board neutrality and breakthrough on the grounds

\[\text{\footnotesize(99) M. Gatti (nt. 1), 431.}\]
that they can be waived. While the fear that reciprocity might be invoked should induce companies in States which have preferred the opt-out to include these rules in their articles, with an eye to probable future European bids. Consequently, as the number of companies legally or contractually subject to these rules increases, the cases where reciprocity could be invoked will be diminished and it will fade from the scene.

**B. Issues and Problems in the Transposition Process**

The flexible mechanism foreseen by Art. 12 of the Directive for the implementation of Articles 9 and 12 raises some particularly important matters. We will analyse the two which seem to us most significant.

The first concerns the breakthrough rule which, as has been seen, neutralizes the application of certain dispositions, whether they are contained in the company articles of association or whether they are part of shareholders’ agreements between shareholders or between shareholders and the company. In particular, the rule states that limits to the transfer of securities will not be effective during the offering period. Restrictions on voting rights, furthermore, are not to be applied at shareholders’ meetings called to vote on defensive measures, and multiple-vote shares will confer only a single vote at such meetings (Art. 11, paragraphs 2 and 3). The same neutralization effects will also apply following closure of the bid, in order to permit a bidder who has obtained more than 75% of voting rights to decide at the first meeting called after the operation is concluded (Art. 11, paragraph 4). Doubts arise concerning the possibility of applying the breakthrough rule only partially, covering some, but not all, of the cases foreseen by the Directive. Would it be permissible, for example, to neutralize clauses in the company articles of association but not in shareholders’ agreements? Or to neutralize the effects of multiple-vote shares but not those of restrictions to the transfer of securities?

A negative answer would seem most in line with the spirit of the Directive. According to this view, Member States must implement Art. 11 in the full version provided by the Directive (100). This seems to assist the achievement of a minimal level of harmonization.

Opting-in by the single companies is a different matter. A clause in a company’s articles of association is by its nature a question of private autonomy and therefore more open to “customized” treatment in so far as

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(100) F.M. Mucciarelli (nt. 1), 836.
the law permits. In the case of voluntary adoption, furthermore, the market and potential bidders would have to know of it, and this presupposes due transparency of the articles. It has to be said, in addition, that such clauses will neutralize dispositions contained in the company’s articles of association but, as far as we can see, they will have no effect on shareholders’ agreements, since company’s articles and shareholders’ agreements operate on different levels (101).

The second case of ambiguity concerns the use of the options foreseen by the Directive regarding the functioning of the reciprocity rule where a member-State has adopted only the passivity rule and not the breakthrough rule or vice versa. In this case the principle would seem to permit the target not to apply the rule to which the raider, in its turn, is not subjected by the current legislation of its country of origin. In this way a sort of equilibrium would be reached in Europe between bidders and companies facing takeover bids. Reciprocity would permit, in other words, compensation, within a market for corporate control of European dimensions, for the diversities which the single national legislations may present – as a result of the optional arrangement – with regard to defensive measures and obstacles to takeover bids.

Yet it has to be said that the opposite opinion has been expressed (102). Given that the practices developed over the years and the configurations of the ownership structures characterizing the European financial markets are very different, Member States might implement one rule while considering the other irrelevant in the specific context. We might imagine, as an example, the pointlessness of a rule which neutralizes the effects of multiple-vote shares in a legal framework that does not allow them anyway (as in Italy). Or the limited use of shareholders’ agreements in countries such as the United Kingdom, whereas they are common elsewhere and particularly in Italy. Where these agreements are little used (103), a member-State might be induced to implement the passivity rule but not the breakthrough rule. Our question is whether in such a case a bidder might be opposed with the non-application of the breakthrough rule, simply because its State of origin had not implemented it and it was not included in the company articles.

(101) F.M. Mucciarelli (nt. 1), 834 e 836.
(102) F.M. Mucciarelli (nt. 1), 838.
(103) A. Mazzoni, “Patti parasociali e regole di mercato nel diritto del commercio internazionale”, in Dir. comm. int., 2005, 489.
A negative answer, which we feel to be correct, puts the emphasis on company contestability. From this point of view it would be senseless to allow target companies to hinder the bidder’s offer on the basis of the claim that “the duel is not being fought with equal weapons”. Such an objection would be only theoretical where the bidder in reality does not adopt any defensive measures – nor are its shareholders bound by shareholders’ agreements – and the lack of a breakthrough rule therefore does not affect the openness of the market for corporate control towards the bidder. It must be remarked, by the way, that such a solution results in higher costs, since it would be necessary to assess on each single occasion whether bidder the operates in a system which gives it “equal weapons” compared with the target company.

C. The Italian Regulation as a Precursor of the Breakthrough Rule: A case for Amendment of Art 123 of the Italian Consolidated Act

The breakthrough rule should be considered the disposition which, more than any other, can increase the level of company contestability in the European financial markets. This statement can be illustrated with reference to the neutralization of «any restrictions on the transfer of securities provided for in contractual agreements (...) between holders of the offeree company’s securities» (Art. 11 paragraph 2). This disposition will have a considerable effect in those Member States where shareholders’ agreements are widespread and affect the companies’ ownership structure.

Shareholders’ agreements are made by coalitions of shareholders who can summon up between them sufficient voting shares to gain control (104). The strength and extent of the control exercised by such agreements depends on the terms of the agreement itself, including its duration and, above all, the penalties to be paid in case of breaking the agreement. The type of control exercised, single or joint, depends, in its turn, on the clauses of the agreement and the holding of each participant. In the case of a shareholders’ agreement which internally deliberates by majority, the company’s controlling shareholder will be the one which holds the majority of shares of the agreement and, consequently, the majority of votes at the shareholders’ meeting. If no shareholder can dominate on its own the total shares of the agreement, the company will be jointly controlled by the agreement.

(104) A. Mazzoni (nt. 107), 488.
Returning to the effects on contestability, companies with a controlling shareholder are not freely taken over. That is to say, their contestability decreases in proportion to the percentage of voting rights available to the controlling shareholder, practically reaching zero when one shareholder has a strong majority of voting rights. The same consideration applies when control is exercised through a contractual agreement between shareholders. A high concentration of shares, whether belonging to a single subject or to the aggregation of a compact group of shareholders, diminishes contestability, which may be defined as the likelihood that a raider may obtain control of the company through a market operation, without the need of acquiring by the incumbent majority shareholder. If a shareholders’ agreement makes exit difficult and costly for its participants, therefore, and if the motives underlying the coalition are still currently shared by them, the control exercised by shareholders’ agreements is comparable, both as to stability and as to ownership concentration, to control by a sole partner.

For this reason, in jurisdiction where shareholders’ agreements are widespread, the financial market show a smaller percentage of companies subject to the mechanisms and forces of the market for corporate control. In this situation, a bidder’s chances of success depend on the weakness of the shareholders’ interests underlying the coalition, to the penalties they would pay for breaking the agreement, or to the imminence of the expiry of the agreement itself.

It is clear that in a context such as that described the effect of the breakthrough rule could be explosive. Neutralizing the effects of shareholders’ agreements, and in particular those which impose limits on the transferability of securities, means that a public takeover bid for the company’s securities has a realistic chance of success. This neutralization sets at nought the terms of the shareholders’ agreement, with the result that its signatories can accept the bid without regard for the obligations and penalties provided by in the contractual agreement. Acceptance to the takeover bid is therefore to be considered unconditioned, and the shareholder who breaks away from the agreement cannot be penalized for its action.


\(^{(106)}\) A. Ferrell (nt. 26), 562; J. McCahery - L. Renneboog – P. Ritter – S. Haller (nt. 16), 622.
A rule with similar effects was enacted in Italy in 1998. Art. 123, paragraph 3, Italian Consolidated Act states that shareholders can withdraw without notice from the agreements indicated in Art. 122 in case of an offer launched in compliance with Articles 106 and 107. The declaration of withdrawal has effect only if the shareholders accept the bid.

This rule acts exactly as the breakthrough rule. Indeed, its application is wider still in so far as it concerns shareholders’ agreement in general and not only voting agreements or restrictions on the transfer of share. The effects on the concentration of the ownership structure are substantially reduced, since participants can leave the agreement freely in order to accept a takeover bid. The only condition is that the bid launched must be a mandatory offer, according to Articles 106 and 107 of the Italian Consolidated Act. The effects of the shareholders’ agreement are not neutralised in case of a non-mandatory takeover bid.

In its Italian version, therefore, the breakthrough rule affects the limitations on contestability represented by shareholders’ agreements only if the bidder intends to acquire control. As stated by the Italian law, the operation launched must involve purchase of a holding greater than 30% of the share capital represented by voting securities carrying the right to appoint or overturn the Directors or the members of the Board of Auditors (Art. 105 of the Italian Consolidated Act). From this point of view, Art. 123, paragraph 3 of the Italian Consolidated Act is in line with the Directive, which provides the application of the breakthrough rule in case of a bid «mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance to the national law» (Art. 2, paragraph 1, letter a).

Even though Italy has not yet implemented the Directive, it can be considered in the avant-garde because it long ago introduced a rule substantially similar to the breakthrough. If we bear in mind that Italian company law does not permit the issue of multiple-vote shares and that it is uncommon for companies’ articles of association to introduce limits to share transfers, we can reasonably say that the principal goals of Art. 11 of the Directive concerning company contestability are already met by current legislation. So, apart from a formal adjustment of Art. 123, paragraph 3, Italian Consolidated Act, which could be necessitated by a general revision of takeover discipline, this law could survive unchanged the transposition process.
Nevertheless, the Directive offers the Italian legislator a by no means negligible excuse to backtrack. The option not to implement the breakthrough rule, leaving the single companies to insert it in their articles if they wish, might be an incentive to eliminate this disposition. This would a case where European intervention, based on a compromise between the views of the different countries, actually resulted in a race to the bottom.

More fundamental is a second aspect of implementation open to Italy. This is the introduction of reciprocity which, as we have seen, has been implemented by most countries which have adopted board neutrality. Protectionist temptations could lead Italy to leave the current law (Art. 123, paragraph 2, Italian Consolidated Act) in place, since it is in line with the Directive, but to allow companies facing a takeover bid to waive it, invoking reciprocity. It has to be said, though, that the combination of the breakthrough rule with reciprocity comes up against legal tangles between the wish of the company to invoke the latter and the existence of shareholders’ agreements. A shareholders’ meeting called to authorize reciprocity would probably be powerless against agreements taken externally by some but not all of the company’s shareholders.

VI. SOME REMARKS

A. A Comparison Between Contestability in the National Market and in the European Market

The wish to create a European market for corporate control which is not distorted by “arbitrary diversities” in the regulations of the Member States (as stated in the Directive) forms the basis of the search for a common discipline applicable to cross-border acquisitions and which will result in a reasonable equivalence of the rules governing the bidder and the target company.

Attention has so far focused on the rules applicable to a takeover between two different Member States. However, the impact of the Directive on national regulations is not to be underestimated.

In principle, the Directive aims to regulate the conduct of bidders and targets during takeover bids throughout Europe. The most pressing problem is certainly that of cross-border acquisitions, where it is important that the bidder and the target should not suffer discrimination arising directly or indirectly from the national regulations. Moreover, the Thirteenth Directive constitutes as well a framework for national legislators since it
aims to provide a regulatory context for all financial markets. The European law inevitably results in rules to be transposed in each single European jurisdiction to affect internal takeover bids.

Nevertheless, as has already been observed, the goal to level the playing field is hindered by the fact that the implementation mechanism makes a fairly varied set of solutions available to national legislators. The question dealt with here is whether it is possible or likely that a national legislation, availing itself of the flexibility allowed by the Directive, could establish different rules, according to whether the public takeover bid is between two national companies, or whether the bidder is of another nationality.

The solution is based on the general principles of EC law. In particular, the principle of non-discrimination on the basis of the member-State of origin offers an important key to interpretation. This principle should rule out any solutions which, though theoretically possible on the grounds of optional arrangements, produce results contrary to the general principles of European legislation. The first immediate consequence of this principle lies in the illegitimacy of any strategy to implement the Directive in such a way as to enhance “internal” contestability of the national financial markets while leaving companies free to defend themselves against foreign bids. Member States are clearly not permitted to adopt the passivity and breakthrough rules only for takeover bids launched by national companies while not applying it to foreign bids. Any implementation of the Directive which permitted discrimination between bidders of different origins would constitute, other conditions being equal, a significant advantage for the national raider at the expense of the cross-border one. The decision whether to adopt or not the anti-defence rules of the Directive, preventively or subsequently, must at least be equal for all bids aimed at targets in the national market, no matter where the bidder comes from.

Some considerations need to be made concerning the possibility that a member-State does not implement the passivity or breakthrough rules, but implements reciprocity. In this case the lack of primary legislation regarding defence strategies and techniques means that reciprocity can be invoked only by any companies which have voluntarily included the passivity and breakthrough rules in their articles of association. Following the same argument as applied to the first question, any attempt to apply these rules in a way that discriminates between national and foreign bidders cannot be pursued using the reciprocity rule, either by the member-State or by contractual autonomy intervention. It is not permitted, therefore, to claim
exoneration from the passivity and breakthrough rules only when the raider – who is in his turn not bound by them – operates under foreign law. Once again the reason is plain: the principles of European law do not allow a situation where a target company can freely adopt defensive strategies and techniques when involved in a cross-border bid, but not when the bid takes place entirely on national territory.

An exactly opposite case is that in which a member-State decides to adopt the passivity and breakthrough rules with regard to offers by foreign bidders, but does not impose their application when the bid is launched by a national subject. Such a regulation, which puts national bidders at a disadvantage compared with foreign ones, would seem not to be in contrast with EC law, which permits so-called inverse discrimination (107). However, in the case of Italy the constitutional principle of equality would completely preclude its concrete adoption (108).

In conclusion, the flexibility allowed to Member States by the Directive, as well as the autonomy granted to regulate takeovers in the articles of association, cannot be taken so far as to create a sort of double scale between the rules applicable to cross-border bids and those between companies of the same nationality. The mechanism of optional arrangements does not permit Member States or companies to raise, by virtue of the adoption of the principles of the Directive, the contestability of the national financial market, with the aim of improving its efficiency, without at the same time also applying the same principles and extending their consequences to operations taking place on the European market for corporate control.

B. Global Contestability and the Response to a Non-European Raider

The subject of the contestability of the European market for corporate control requires us to pose one last question. This concerns the role and discipline to be applied to a non-European bidder intending to participate in this market.

(107) G. Tesauro, Diritto comunitario, Padova, 2003, 468; European Community Court of Justice Steen I, C332/90, decision 28th January 1992; Steen II, C-132/93, decision 16th June 1994; Poirrez, C-206/91, decision 16th December 1992.

The European Directive regards «takeovers bids for the securities of companies governed by the laws of the Member States, where all or some of those securities are admitted to trading (…) in one or more Member States» (Art. 1, paragraph 1). The competent authority is identified, on the basis of the criterion defined in Art. 4 as «that of the Member State in which the offeree company has its registered office if that company’s securities are admitted to trading on a regulated market in that Member State». The bidder is defined in Art. 2, paragraph 1, letter c) as «any natural or legal person governed by public or private law making a bid”. There is no mention, therefore, of his nationality.

It is necessary to clarify, therefore, whether the takeover Directive is also to be applied to offers launched by a non-European bidder for the securities of a European target company.

An affirmative answer would seem the right one (109). The takeover bid regulations which lay down procedure times, information for the market and shareholders, as well as organizational rules, and which influence company law concerning the conduct of the target company, must be identified on the basis of the nationality of the company whose shares are the object of the takeover bid. This point of view, if accepted, implies that the Thirteenth Directive provides framework regulations for all bids launched on the European market, regardless of where the raider comes from. This assumes the Directive has the goal of contributing to the development of the market for corporate control, of increasing the likelihood and number of takeover bids for European companies and of allowing and assisting free movement of control both within the European Union and between European and non-European shareholders.

It is less clear, however, whether Member States and companies can make use of the optional arrangements to implement the passivity and breakthrough rules, but making them applicable only to European raiders. This would discourage and hinder any takeover attempts from non-EU bidders. The same question may be asked of reciprocity. If the passivity and breakthrough rules have been adopted legally or in articles of association, could the exemption permitted on grounds of reciprocity be foreseen as applicable only towards non-European bidders?

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The possibility seems undeniable (110). It appears perfectly legitimate for a member-State to choose to discriminate between European and non-European raiders in its takeover regulation. That is to say, the opt-outs contained in the Directive do not rule out an implementation which plays creatively with the alternatives of adoption or non-adoption. It contains no provision which states that Member States are bound by the Directive in the case of a bid launched by a subject outside the EU on a European company.

VII. CONCLUSION

The Thirteenth Directive on public takeover bids provides a reference framework for operations aimed at acquiring control, preventively or subsequently, of companies listed in regulated markets. As well as affecting national legislation, which is required to bring internal dispositions in line with the European framework, the Directive is intended above all to regulate the procedures, as well as imposing restrictions and conditions, concerning operations that permit entry to company capital by foreign controlling shareholders and which will consequently be in a position to define new strategies and carry out complex company reorganizations. The express goal of the Directive is the protection of shareholders. Arising from this is a further, even more ambitious and far-reaching goal: the creation of a market for corporate control of European dimensions. We read in the Commission document that developing the market for corporate control means exploiting, to companies’ advantage, the efficiency induced by market forces, which are able to push company management towards maximum returns for shareholders and an attempt to find the best possible dimensions for European businesses.

In this context, the effectiveness of the dispositions of the Directive is somewhat ambiguous. On the one hand, Art. 9 (board neutrality rule) and Art. 11 (breakthrough rule) enhance company contestability since they limit Directors’ freedom to defend target companies and neutralize the effect of ex-ante strategies provided by in company articles of association or shareholders’ agreements (such as voting or block agreements, restrictions to share transfers or multiple-vote shares). On the other hand, the fact that the Directive does not take up a clear position as to the premises for public takeover bids – it does not clarify, that is to say, whether such an obligation must depend on exceeding a pre-established holding threshold or whether it results from any control transactions – means that the cost of this operation

(110) M. Ventoruzzo (nt. 1), 218.
cannot be properly assessed. In this latter case the total bid, which is in any
case extremely costly, would be mandatory for all control transactions, thus
reducing the number of operations that can be potentially realized.
Indiscriminate imposition of the mandatory offer means limiting the “free”
contestability of companies, preventing acquisition of control except by
takeover bid and restricting the space in which the market forces can work.
If public takeover bids were to be imposed in all cases of a change of
control we would therefore witness, not the development, but the
impoverishment of the market for corporate control.

Nonetheless, the strongest criticism so far moved against the
Directive has concerned the consequences of the mechanism of optional
arrangements and the reciprocity rule (Art. 12), which render the adoption
of board neutrality and the breakthrough optional, softening both their
rigour and their effects, both as regards uniformity of rules and as regards
contestability.

In our opinion, the criticisms moved against the Directive are
excessive. We have attempted to show how the system established by Art.
12 of the Directive for implementing the passivity and breakthrough rules
has to be judged in the light of the incentives it offers and the results it
should thereby induce.

This more lenient view takes as its starting-point the sheer fact that
the long history of the Thirteenth Directive would never have reached its
conclusion without leaving ample space for flexibility at the moment of
implementation of the more critical dispositions. Given that there was no
way of imposing board neutrality and the breakthrough rule across Europe,
its adoption was delegated to a series of incentives affecting both Member
States and companies. In the first case, even the Member States most
protective of their national businesses might opt to implement Articles 9
and 11 given that the reciprocity rule can be invoked to attenuate its
consequences. Whereas, in Member States where these two articles have not
been implemented, companies must be free to include the passivity and
breakthrough rules in their articles of association. In this case the likely
favourable response of the market towards the securities of companies
which open up to the market for corporate control in this way should be an
incentive for companies to adopt these rules where their national legislations
fail to do so.

This complex mechanism works at two levels since the insertion of
board neutrality and the breakthrough rule in articles of association not only
compensates its non-implementation by Member States but also weakens the scope the reciprocity rule, making it *de facto* unusable in the case of a takeover. To which we may add that the application of reciprocity is by no means to be taken for granted, since it can only be invoked when expressly and preventively authorized by the target company’s shareholders.

Argued thus, Art. 12 reveals its complex nature. Its *raison d’être* turns out to be more than a mere compromise to make up for the legislator’s failure to render Articles 9 and 11 compulsory. Rather, given the freedom allowed to States not to implement the two rules, the optional agreements and the reciprocity rule push towards a system where voluntary implementation and market forces will actually raise them to a dominating position.

All the same, it cannot be denied that the incentives implicit in the optional arrangements – especially those which trust in a favourable market response to the securities of the companies open to the market for corporate control – presuppose an environment where market forces are capable of discriminating and selecting the most efficient models. This premise is reasonable in certain financial markets – especially that of the United Kingdom – but elsewhere remains a mirage.

At the present time, therefore, the European picture, at a year from the expiry date for implementation of the Thirteenth Directive, can be considered only preliminary. Not only because in not all the Member States the Directive has not yet been implemented, but above all because the definitive setup of the regulations concerning takeover bids is strictly correlated to market reactions and to contractual autonomy intervention and it is not yet possible to know whether they will move in permissive or rigorous directions with regard to defences against takeovers.

As for the European market, it cannot be denied that certain recent events, widely reported in financial newspapers in recent months, point increasingly insistently to the existence even now of an active market for corporate control of which the dimensions or origin of its participants, go beyond national dimensions. So we must recognize a European market for corporate control of strong and immediate concreteness, to the development of which the European Directive intends to offer its contribution.