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A Comparative Study of Takeover Regulation in the UK and France

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Abstract

There has been a great deal of cross-border takeover activity in the EU over the past years. This is fortunate since the Commission views the increase of such activity and the ensuing restructuring of firms as vital to implement its aim of making Europe the most competitive economy by 2010. The Commission is concerned, however, by the fact that most Member States still have legal, cultural, or other structures, which either impede or reduce the occurrence of takeovers. The Commission is also concerned that the level of protection afforded to offeree shareholders in the context of takeovers differs from one Member State to another. Indeed, the offeree shareholders in some Member States enjoy a far better protection than their counterparts in other Member States. This thesis analyses these two aspects of takeover regulation from the point of view of the UK and France. The latter countries have had a significant impact upon the drafting of the Directive on takeover bids, as well as of numerous individual European countries' takeover regulations, due to their solid experience with national takeover regulation. It is therefore believed that the comparative analysis of the takeover regimes of these two jurisdictions will offer a better understanding of both the Directive on takeover bids and other European countries' takeover regulations. Such comparative analysis is further believed to offer an insight into how the level of growth of a particular market and the different ownership structures impact upon the rules governing takeovers.

This thesis begins by explaining the regulatory framework of takeovers in the UK and France as well as the ownership structures prevailing in these two jurisdictions. It subsequently analyses in a comparative manner the role of the offeree management and the equality of shareholders in these two countries. This thesis concludes with the gradual convergence of takeover regulations in the UK and France and throughout Europe more generally.

List of Selected Abbreviations

A.J.C.L.	Australian Journal of Corporate Law
All E.R.	All England Law Reports
Am. J. of Compar. L.	American Journal of Comparative Law
Aust. L.J.	Australian Law Journal
Banca Naz. Lav. Quart.	Banca nazionale del lavoro
Banque	Revue Banque
Banque et Droit	Revue Banque et Droit
B.C.L.C.	Butterworths Company Law Cases
BRDA	Bulletin rapide de droit des affaires
Bull. COB	Bulletin mensuel de la COB
Bull. Joly Soc.	Bulletin Joly Sociétés
Bus. Law.	Business Lawyer
CA	Companies Act Court of Appeal (Arrêt d'une) Cour d'Appel
Cahiers dr. entrepr.	Cahiers de droit de l'entreprise, supplément du JCP
Calif. L. Rev.	California Law Review
CalPERS	California Public Employees Retirement System
Cass. Com	Arrêt de la chambre commerciale de la Cour de Cassation
CDGF	Commission de Discipline de la Gestion Financière
CECEI	Comité des Etablissements de Crédit et des Entreprises d'Investissement
CfiLR	Company Financial and Insolvency Law Review
Ch.	Chancery Division Chambre
Civil Just. Q.	Civil Justice Quarterly
C.L.R.	Company Law Review
CMF	Conseil des Marchés Financiers
C.M.L. Rev.	Common Market Law Review
COB	Commission des Opérations Boursières
Co. Law.	Company Lawyer
Col. J. Eur. L.	Columbia Journal of European Law
Col. L. Rev.	Columbia Law Review
Contr.	Contrast
CREF	College Retirement Equities Fund
D.	Recueil Dalloz
Delaware J. Corp. L.	Delaware Journal of Corporate Law
DTI	Department of Trade and Industry
Duke J. of Comp. & Int'l L.	Duke Journal of Comparative and International Law

DWP	Department for Work and Pensions
EBF	European Banking Federation
E.B.L.R.	European Business Law Review
EBOR	European Business Organization Law Review
ecgi	European Corporate Governance Institute
ECHR	European Convention for the Protection of Human Rights
ECJ	European Court of Justice
éd.	édition
ERISA	US Department of Labor Interpretative Bulletin on Employment Retirement Income Security Act 1974
EU	European Union
Eur. Bull.	European Bulletin
Gaz. Pal.	Gazette du Palais
Geo. L.J.	Georgetown Law Journal
Harv. Bus. Rev.	Harvard Business Review
Harv. L. Rev.	Harvard Law Review
HL	House of Lords
Ibid.	Ibidem
IC	Investment Certificate
I.C.C.L.R.	International Company and Commercial law Review
I.F.L.Rev.	International Financial Law Review
Int'l Rev. L. & Econ.	International Review of Law and Economics
J. Bus. L.	Journal of Business Law
JCP éd. E	Juris-classeur périodique, édition entreprise
J. Fin. Econ.	Journal of Financial Economics
J. Law & Econ.	Journal of Law and Economics
J.O.	Journal officiel de la République française (lois et règlements)
J. of L. Econ. & Org.	Journal of Law, Economics, and Organization
and Capital Mkt. Law	Journal of Comparative Business and Capital Markets Law
Law & Econ.	Law and Economics
Law & Pol.	Law and Policy
McGill L.J.	McGill Law Journal
Mich. L. Rev.	Michigan Law Review
Modern L. Rev.	Modern Law Review

NAPF	National Association of Pension Funds
Nw. J. Int'l L. & Bus.	Northwestern Journal of International Law and Business
N.Y.U. L. Rev.	New York University Law Review
N.Z.L.R.	New Zealand Law Reports
Obs.	Observations
OECD	Organization for Economic Co-operation and Development
OPCVM	Organismes de Placement Collectif en Valeurs Mobilières
Oxf. Rev. Econ. Policy	Oxford Review of Economic Policy
Para	Paragraph
PC	Privy Council
PDG	Président-Directeur Général
PIRC	Pensions Investment Research Consultants
P.L.C.	Practical Law for Companies
Q. J. Econ.	Quarterly Journal of Economics
RD aff. int.	Revue de droit des affaires internationales
RD bancaire et bourse	Revue de droit bancaire et bourse
Rev. JP comm.	Revue de jurisprudence commerciale
Rev. Soc.	Revue des sociétés
R.J.D.A.	Revue de jurisprudence de droit des affaires
RTD com.	Revue trimestrielle de droit commercial
SA	Société Anonyme
SARs	Rules Governing Substantial Acquisitions of Shares
SBF	Société des Bourses Françaises
SIB	Securities and Investments Board
SICAV	Société d'Investissement à Capital Variable
Strateg. Manage. J.	Strategic Management Journal
T.	Tome
T. com.	Tribunal de Commerce
U. Chi. L. Rev.	University of Chicago Law Review
UCITS	Undertakings for Collective Investment in Transferable Securities
Yale L. J.	Yale Law Journal

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Contents

Introduction: Theory and Structure

EU Member States[1] are increasingly subject to cross-border takeover activity. This is because many companies seeking to expand operations in the EU consider acquiring an already established company. However, most MS still have structures which either prevent takeover bids[2] from occurring or render them less attractive for the offeror. Most of these structures exist due to the conflicts of interests as between the offeree management and the offeree shareholders in the context of takeover bids. On the other hand, the offeree shareholders in some MS are treated more equally than those in other MS. This derives from the fact that some MS better protect the offeree shareholders as against the offeror, whose interests conflict with those of the offeree shareholders. These conflicts of interests constitute the two topics that all national systems of takeover regulation need to address.

So far as the conflicts of interests between the offeree management and the offeree shareholders are concerned, the relation between the latter are generally analysed by reference to a non-legal agency relationship[3]. An agency relationship exists '*whenever one individual depends on the action of another. [...] The individual taking the action is called the agent. The affected party is the principal*'[4]. Viewed from this perspective, there is indeed a principal/agent relationship between the management of the offeree company and the offeree shareholders. This relationship is frequently marked by conflicts of interests. Indeed, the duty of managers is to maximise the return to shareholders. However, managers do not always act in the interests of their principals. For much of the benefit of each manager's performance inures to shareholders and no single manager receives the full benefit of his work[5]. Consequently, a manager will always be tempted to put his own interests ahead of those of the shareholders and

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[1] Hereafter the MS.
[2] In this thesis, the terms 'offeror' and 'bidder'; 'offeree' and 'target'; and 'offer' and 'bid' are used interchangeably.
[3] The term 'agency' used here derives from the economic literature and does not have a legal sense.
[4] J. Pratt and R. Zeckhauser, 'Principals and Agents: An Overview' in Pratt and Zeckhauser (eds), *Principals and Agents: The Structure of Business* (Boston, Mass.: Harvard Business School Press, 1985), p. 2.
[5] L. A. Bebchuk, 'The Case for Facilitating Competing Tender Offers: A Reply and Extension' (1982) 95 Harv L. Rev. 1028, p. 1030.

thus will impose agency costs on the latter. Indeed, as early as 1776, Adam Smith called attention to the conflicts of interest between owners of joint stock companies and their managers. Although he did not use the language of agency costs[6], he was in a sense the original agency theorist[7]. He noted

> *'Being the managers of other people's money than their own, it cannot well be expected, that [the managers of widely held companies] should watch over [public investors' wealth] with the same anxious vigilance with which the partners in private copartnery frequently watch over their own'*[8].

The law may serve to alleviate the above type of conflicts. Indeed, corporate and other law gives shareholders certain powers to protect their investment against expropriation by managers[9]. For instance, the law usually provides shareholders with the right to vote on important corporate matters, including the election of directors; and the right to sue the company for damages. The extent of legal protection afforded to shareholders differs across the countries. In addition to the law, a number of corporate governance mechanisms also help to reduce the conflicts of interests as between the offeree management and the offeree shareholders. Such mechanisms range from independent and active boards, incentive compensations, directors' fiduciary duties, to institutional investors, and to the managerial labour market and the capital markets.

When the above methods fail to reduce the agency problem between managers and shareholders, the market for corporate control comes into play. Indeed, Jensen (1986) observes that *'the external takeover market serves as a court of last resort*[10] *that plays an important role in protecting shareholders when the company's internal controls [...] are slow, clumsy, or defunct'*[11]. Pursuant to the 'efficient capital market hypothesis'[12], if the managers of a company are pursuing

[6] These costs include the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss; see M. C. Jensen and W. H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976), pp. 5-6, available at SSRN.
[7] M. C. Jensen, 'Self Interest, Altruism, Incentives, and Agency Theory' (1994), p. 12, available at SSRN.
[8] A. Smith, *The Wealth of Nations*, Vol. 2 (1776); see ibid, p. 12.
[9] R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R. Vishny, 'Agency Problems and Dividend Policies Around the World' (1998), p. 6, available at SSRN.
[10] Note that the author uses the term 'last resort' because of the concerns over takeover efficiency.
[11] M. Jensen, 'The Takeover Controversy: Analysis and Evidence' (1986), p. 10, available at SSRN.
[12] Hereafter the ECMH.

goals other than profit maximisation and deviate from shareholders' interests, then the actual value of the firm, as measured in its share price, will be lower than its potential value under a different management. If the gap between the actual and potential value becomes too great, other market participants will be tempted to make a hostile bid and remove the incumbent management[13]. The lower the stock price, relative to what it could be with a more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently[14]. In the words of Rappaport (1990), the market for corporate control '*represents the most effective check on management autonomy ever devised*'[15]. It should be noted, however, that the ECMH works only if there is a correlation between the share prices and the managerial performance[16]. This may not always be the case, however, since share prices also contain a large random element[17]. Furthermore, the ECMH demands a highly developed stock market and a favourable legal and cultural environment as regards the use of hostile takeovers[18].

The problem with takeovers, however, is that, due to the risk of losing their job, directors tend to defeat hostile bids by deploying a number of defensive measures. The success and efficiency of a hostile bid as a means to reduce the above agency problem therefore depends on the extent to which a jurisdiction allows such measures. Countries across the world are divided in their views as to the role of the offeree board in the face of a bid. Advocates of the 'managerial resistance' view argue that resistance by managers is a way to secure the best possible terms for shareholders who may not have the ability to deal effectively with the bidder,

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[13] Note, however, that a recent study of the UK by Franks and Mayer found little evidence that targets of hostile bids performed poorly prior to the bid; see J. Franks and C. Mayer, 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 J. Fin. Econ. 163, p. 164. In fact, companies subject to a hostile bid do not perform worse than the average listed firm on the London Stock Exchange; see J. Franks, C. Mayer and L. Renneboog, 'Managerial Disciplining and the Market for (Partial) Corporate Control in the UK' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), pp. 442-443.
[14] H. G. Manne, 'Mergers and the Market for Corporate Control' (1965), 73 Journal of Political Economy 110, p. 113.
[15] A. Rappaport, 'The Staying Power of the Public Corporation' 68 Harv. Bus. Rev. 96 (1990), p. 100.
[16] Hereafter the ECMH.
[17] i. e. events unrelated to managerial performance.
[18] J. M. Garrido and A. Rojo, 'Institutional Investors and Corporate Governance: Solution or Problem?' in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 429.

due to their collective action problem. Indeed, the use of defensive measures may result in a revised offer from the initial offeror[19], or in a competitive bid from an alternative offeror, which would result in a higher final takeover premium for the offeree shareholders[20]. This view is shared by Sudarsanam (1995) who argues that the management performs a co-ordinating role on behalf of such shareholders[21]. Similarly, Lipton (1979) argues that any uncoerced decision against acceptance of a bid can only be made at the board of directors level[22]. The US system is a typical illustration of this view. Indeed, defensive measures are viewed in the US as a necessary management response to takeover bids, subject to the requirements of the 'business judgment rule'[23]. According to Delaware courts, it is the board of directors that manages the company and their power includes, with some qualifications, the power to decide whether or not to accept a takeover bid[24]. As a result, offeree directors can take actions to resist a hostile takeover, provided that they act in good faith and with reasonable grounds for believing that a danger to corporate policy and effectiveness exists, and that the defensive measure is '*reasonable in relation to the threat posed*'[25]. Offeree directors can, for instance, adopt poison pills or take into account the impact of the bid on the offeree company's employees in order to defeat an unwelcome offer. Only when a bid is inevitable that the offeree directors are prohibited from resisting the bid and are required to obtain the best price available for the offeree shareholders[26]. In the

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[19] Empirical evidence suggests that the offeree board's resistance to an offer generally results in an increase in the offer price and in the offeree's share prices.
[20] D. Henry, 'Directors' Recommendations in Takeovers: An Agency and Governance Analysis' (2002), p. 4, available at http://mfs.rutgers.edu/conferences/10/mfcindex/files/MFC-003%20Henry.pdf.
[21] P. S. Sudarsanam, 'The Role of Defensive Strategies and Ownership Structure of Target Firms: Evidence from UK Hostile Takeover Bids' (1995) 1 European Financial Management 223, p. 226.
[22] M. Lipton, 'Takeover Bids in the Target's Boardroom' (1979) 35 Bus. Law. 101, p. 114.
[23] Indeed, the UK and the US have adopted significantly different approaches to this matter. While the UK practice prohibits the use of defensive tactics, the US perceives a need for such defences. US corporate law has permitted the growth of a number of anti-takeover defences of a type which are virtually never adopted in UK listed companies. In addition, most US States have enacted anti-takeover statutes which enable companies to adopt internal rules aimed at fending off hostile bids; see R. Sappideen, 'Takeover Bids and Target Shareholder Protection: The Regulatory Framework in the UK, United States and Australia' (1986) 8 J. of Compar. Bus. and Capital Mkt. Law 281, pp. 299-302. On the 'business judgement' rule, see J. H. Farrar, 'Business Judgement and Defensive Tactics in Hostile Takeover Bids' in J. H. Farrar (ed.), *Takeovers: Institutional Investors and the Modernization of Corporate Laws* (Auckland; Oxford: OUP, 1993), Ch. 11.
[24] M. Kahan, *Jurisprudential and Transactional Developments in Takeovers* (New York, 1998), p. 685.
[25] *Unocal Corp. v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985).
[26] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986).

latter circumstance, the locus of power shifts from the directors to offeree shareholders.

By contrast, advocates of the 'managerial passivity' view argue that, given the conflicting interests between managers and shareholders in the context of takeovers, it cannot possibly be assumed that the management will act in the best interests of shareholders. Managers might decide to obstruct a bid whose acceptance would be value-maximising in order to retain their independence, or facilitate an acquisition by a rival bidder offering a lower price to shareholders but a better deal for the management. Proponents of this view are therefore in favour of sidelining the management and giving shareholders the power to decide on the fate of a bid. Proponents of this view are split, however, in their views as to whether soliciting rival bids [27] is desirable. Advocates of the 'pure passivity' view suggest that offeree directors should refrain from taking any defensive measure, including soliciting rival bids[28]. In their view, managers should only carry out the company's ordinary business and issue a press release urging shareholders to accept or reject the offer[29]. By contrast, advocates of the 'modified passivity' view argue that offeree directors should be able to solicit rival bids. For, in their view, this rule compels the initial offeror to pay at least the premium that other potential buyers are willing to pay and thus ensures that shareholders obtain a higher price[30]. They further argue that the auctioneering rule ensures that the offeree company is taken over by a firm which values it more highly and therefore ensures that the resources in question are allocated to a more efficient use[31]. It should be noted, however, that the drawback of the 'managerial passivity' view is that this view regulates only certain forms of management entrenchment.

[27] This is referred to as auctioneering.

[28] The arguments put forward to support this view include the fact that even resistance that ultimately elicits a higher bid is socially wasteful. For the higher price received by offeree shareholders is exactly offset by the bidder's payment and thus by a loss to the bidder's shareholders. Accordingly, shareholders as a group gain nothing. The increase in the price is simply a transfer payment from the offeror's shareholders to offeree shareholders; see F. H. Easterbrook and D. R. Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 Harv. L. Rev. 1161, p. 1175.

[29] Ibid, p. 1201.

[30] L. A. Bebchuk (1982), supra n 5, p. 1041. See also R. Gilson, 'Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense' in F. Easterbrook and D. Fischel (eds), *Management's Fiduciary Duty and Takeover Defenses* (1993), p. 271.

[31] S. Deakin and G. Slinger, 'Hostile Takeovers, Corporate Law and the Theory of the Firm' in Deakin and Hughes (eds), *Enterprise and Community: New Directions in Corporate Governance* (Oxford: Blackwell Publishers, 1997), p. 7.

Indeed, the 'managerial passivity' view only regulates post-bid defences, to the exclusion of pre-bid defences. As a result, managers can embed defences in pre-bid decisions[32]. This in turn may deter potential offerors from launching a bid and thus reduce the likelihood of takeovers.

Both the UK and the French takeover regimes have endorsed the 'managerial passivity' view. For both regimes sideline the offeree management and give decision-making in the hands of the offeree shareholders. At the same time, both regimes have endorsed the 'modified passivity' view. Indeed, the City Code on Take-overs and Mergers[33] facilitates the entry of second bidders by requiring all offers to be kept open for a minimum of twenty-one days after their initial posting[34]' and by requiring any information given to one offeror to be given equally to another offeror even if that other offeror is less welcome[35]. Likewise, the General Regulation of the *Conseil des Marchés Financiers* requires a minimum offer period of twenty-five days[36] and the Regulation NO 2002-04 of the *Commission des Opérations de Bourse*[37] embodies the principle of equality of information[38].

It should be noted in this respect, however, that, although both the UK and France have opted for the 'managerial passivity' view, hostile takeover bids are less common in France than in the UK. Indeed, except in the UK, hostile takeovers are rather rare in Europe in general. This is mainly due to the different ownership structure of continental European countries as compared to the UK. Indeed, in the UK and the US, share ownership in listed companies is generally diffuse and most listed companies are controlled by professional managers. As a result, the main conflict of interest in the context of takeovers in the UK and the US is that between professional managers and offeree shareholders. If the professional

[32] J. Arlen and E. Talley, 'Unregulable Defenses and the Perils of Shareholder Choice' (2003), p. 18, available at SSRN.
[33] Hereafter the Code.
[34] Code, r. 31(1).
[35] Code, r.20(2).
[36] CMF regs, r.5-2-2.
[37] Hereafter the COB.
[38] COB regs, r.4.

managers underperform in running the company, then a control change is likely to take place by way of a takeover bid.

By contrast, in most continental MS, a single large shareholder, or a group of shareholders, retains a controlling stake in listed companies. The controlling shareholder generally takes an active interest in running the company, by choosing the management and directly taking executive positions[39]. In this situation, there is no risk of unaccountability by managers to the shareholders, since the directors are usually appointed by the controlling shareholder(s). There is however a risk that the controlling shareholder may not run the company in the interests of the minority shareholders. In other words, the main conflict of interest in the context of takeovers in continental MS is the legal expropriation of the minority by the controlling shareholders[40]. La Porta, Lopez-de-Silanes and Shleifer (1998) note that restricting such expropriation is the real challenge to corporate governance in most countries[41]. This type of expropriation cannot be remedied via hostile bids, due to the illiquidity of the shares of such listed companies.

The risk of such expropriation exists for instance in France, where the presence of large controlling shareholders in listed companies creates a conflict of interests between controlling shareholders and the minority. In this respect, probably the most important development in French company law has been the recognition by the legal scholars and the courts of a fiduciary duty of loyalty of controlling shareholders *vis-à-vis* minority shareholders[42]. The presence of large controlling shareholders in French listed companies does not mean, however, that takeover bids do not occur in France. On the contrary, France actually ranks second after the UK in terms of the level of takeover activity. However, takeover bids in France are not usually used as a means to effect control changes in listed companies. This is because control changes in French listed companies usually

[39] M. Pagano and A. Roell, 'The Choice of Stock Ownership Structure: Agency Costs, Monitoring, And the Decision to Go Public' (1998) Quarterly Journal of Economics 187, pp. 187-188.
[40] R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R. Vishny, 'Investor Protection and Corporate Valuation' (1999), p. 4, available at SSRN.
[41] R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, 'Corporate Ownership Around the World', WP No. 6625 (1998), available at SSRN, p. 29.
[42] See e.g. D. Schmidt, *Les Conflits d'Intérêts dans la Société Anonyme* (Paris 1999).

occur by way of private negotiations. As a result, takeover bids in France are usually used as a means to de-list an offeree company whose control has already been acquired via a private control transaction[43].

It should be noted that the fact that the conflicts of interests between the offeree management and the offeree shareholders is prevalent in the UK does not mean that the UK takeover regime has no provisions designed to solve the type of conflicts of interests which is prevailing in France. Indeed, the Listing Rules contain a number of requirements for companies applying for listing which have a dominant shareholder. These include the requirement that the applicant for listing must be capable at all times of operating and making decisions independently of any controlling shareholder, and that all transactions and relationships in the future between the applicant and any controlling shareholder must be at arm's length and on a normal commercial basis. The rationale behind this requirement is to eliminate the influence of the controlling shareholder[44].

So far as the conflicts of interests between the offeror and the offeree shareholders are concerned, the reason behind the disjunction between offerors' goals and shareholders' goals is that, offerors tend to keep their acquisition costs at a low level. To this end, in cases where there is already a controlling shareholder in the offeree company, they may wish to pay a premium to the controlling shareholder only, to the exclusion of the minority shareholders. This would allow the offeree company to offer a higher premium for the controlling shareholder, with a view to inducing him to sell his stake. In cases where there is no existing controlling shareholders, offerors may wish to acquire control of a company by way of market purchases made at different prices for different sellers, rather than by way of a public offer. All takeover regulations in the EU, including those of the UK

[43] In other words, the problem in such jurisdictions is that private ownership frees firms from the discipline imposed by the market for corporate control; see W. S. Schulz, M. H. Lubatkin, R. N. Dino and A. K. Buchholtz, 'Agency Relationships in Family Firms: Theory and Evidence' (2001) 12 Organization Science 99, p. 100. However, if large shareholders are non-managers and are simply external shareholders, such as institutional shareholders, then the latter problem would not arise. Indeed, in a recent UK study, Sudarsanam found that the presence of large institutional shareholders was an important factor in ensuring bidder success in hostile takeovers; see P. S. Sudarsanam, (1995), supra n 21, p. 223.
[44] E. Wymeersch, 'Do We Need a Law on Groups of Companies?', in K. J. Hopt and E. Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 589.

and France, aim at ensuring the equal treatment of offeree shareholders. By mandating terms on which bids have to be made, equality rules prevent individuals in privileged positions to have an unfair advantage over those who are less well situated.

Takeover regulations in the EU further aim at ensuring undistorted choice by offeree shareholders. Indeed, offerors tend to structure offers in a discriminatory fashion[45], with a view to acquiring the offeree company by paying a price per share which is inferior to the value of the firm which they wish to increase. By doing so, offerors wish to obtain all the profits of the value of a firm. Although offeree shareholders should reject such offers, they usually tend to accept them. This is because, following a successful discriminatory offer, the value of the non-tendered shares often trade at a discount. The discounted value of the non-tendered shares results from the fact that the newly acquired company may be operated for the benefit of the acquiring group, which may divert earnings away from the offeree company and its shareholders. As a result, offeree shareholders are rushed into selling as many of their shares as possible into the discriminatory offer, for fear of staying as a minority in the company, with the offeror as the controller. Thus, even if each shareholder prefers the offer to fail and even if most shareholders do not view the takeover as being in their collective interest, individual shareholders nevertheless feel compelled to tender. This phenomenon is referred to as a 'prisoner's dilemma'[46]. The latter is further exacerbated by the lack of co-ordination among shareholders due to the large number of shareholders in most listed companies and the short period of the takeover bid[47]. As a result, offerors who structure their bid in a discriminatory fashion may acquire control at a discount. Rules designed to prevent shareholder coercion aim at ensuring that an offeree company should be acquired if and only if its shareholders view selling

[45] e.g. two-tier offers where offeree shareholders must decide whether to tender. If they resist tendering, they risk the worst outcome, in which their shares are all taken in a low-valued, back-end merger because the other shareholders did tender and the offer succeeded. If they tender, they are assured of receiving the moderate outcome consisting of a prorata share of the higher-valued, front-end tender offer. The best outcome is available only if all or most shareholders resist tendering so that the offer fails; see R. Comment and G. A. Jarrell, 'Two-Tier and Negotiated Tender Offers: The Imprisonment of the Free-Riding Shareholder' (1987) 19 J. Fin. Econ. 283, pp. 287-288.
[46] This is also referred to as the 'pressure to tender', or as 'shareholder coercion'.
[47] G. A. Hune, 'Protection of Minority Shareholders in Cases of Takeover, with Special Reference to the German and European Law' (2003), p. 17, available at http://www.frg.eur.nl/rile/emle/Theses/hune.pdf.

their company as a value-maximising course of action[48]. If the shareholders judge the offer price to be lower than the independent offeree company's value, then the offer should be rejected[49].

It should be noted in this respect that a number of scholars do not support the equal treatment of shareholders. For instance, Javaras (1964) argues that, unlike the political arena, the overriding principle in company law should be the maximization of profits rather than of equality[50]. Others argue that some issues should be solved through the market forces, and in particular through the ability of investors to diversify, rather than through equality rules. For instance, Demott (1983) argues that *'if the market can even out apparent inequality by diversification, then the costs of unneeded regulation to promote equality might well be thought socially wasteful'*[51]. Other scholars particularly reject the idea that the non-controlling shareholders should participate in the premium paid for the controlling shares in circumstances where a controlling shareholder disposes of his shares. For instance, Easterbrook and Fischel (1982) argue that any attempt to require sharing simply reduces the likelihood that there will be any gains to share[52]. In addition, Hahn (1990) argues that there is no basis for a sharing rule since minority shareholders had already given up control before the change of control and need no further protection[53]. Furthermore, Partlett and Burton (1988) argue that shareholders may very well contract to be treated unequally as regards the premium for corporate control if that is the price of entry of a large investor who it is perceived will contribute to overall shareholder welfare[54].

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[48] L. A. Bebchuk, 'The Pressure to Tender: An Analysis and a Proposed Remedy' (1988) 12 Del. J. of Corp. L. 911, p. 915.

[49] L. A. Bebchuk, 'Toward Undistorted Choice and Equal Treatment in Corporate Takeovers' (1985) 98 Harv. L. Rev. 1693, p. 1701.

[50] G. B. Javaras, 'Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews' (1964) 32 U. Chi. L. Rev. 420, pp. 425-428.

[51] D. A. DeMott, 'Current Issues in Tender Offer Regulation: Lessons from the British' (1983) 58 NYU L. Rev. 945, p. 983. Note that Brudney (1983) notes that Demott's suggestion depends on the degree to which shareholders are able to diversify their investments; see V. Brudney, 'Equal Treatment of Shareholders in Corporate Distributions and Reorganizations' (1983) 71 Calif. L. Rev. 1072, p. 1072.

[52] F. H. Easterbrook and D. R. Fischel, 'Corporate Control Transactions' (1982) 91 Yale L. J. 698, p. 716.

[53] D. Hahn, 'Takeover Rules in the European Community: An Economic Analysis of Proposed Takeover Guidelines and Already Issued Disclosure Rules' (1990) 10 Int. Rev. of Law and Econ. 131, p.144.

[54] D. F. Partlett and G. Burton, 'The Share Repurchase Albatross and Corporation Law Theory' (1988) 62 Aust. L.J. 139, p.145.

The degree of equality afforded to offeree shareholders depends on whether a jurisdiction takes the 'managerial resistance' or the 'managerial passivity' view with respect to the issue of defensive measures. Indeed, ensuring equality of offeree shareholders is more important in jurisdictions which have decided to sideline the management. For in such jurisdictions equality rules act as substitutes for the absence of an active management to protect the offeree shareholders. The UK and France constitute examples of such jurisdictions. In particular, as will be seen in the following chapters, the neutrality rule embodied in the Code lies behind the strict regulation of the offeror's behaviour in the UK.

Scope of the thesis

This thesis deals with the UK and French takeover regimes. The reasons for choosing the UK and France are two-fold: First, these two countries have a solid experience with national takeover regulation. Indeed, the UK City Code was enacted as early as 1968. Similarly, France had already in 1972 enacted takeover regulation as part of the stock exchange's self-regulatory apparatus. As a result, both countries have a long-standing experience with takeovers. Secondly, the European Commission has finally adopted a Directive on takeover bids in 2004[55], with a view to harmonising certain aspects of European takeover regimes. Indeed, the harmonisation of European takeover regulations is, for the Commission, a *sine qua non* for the attainment of its broader objective, namely the creation of an integrated capital market by 2010.

The Directive is a framework Directive and establishes general principles governing takeovers without attempting detailed harmonisation. It is based on two policy objectives, these being the protection of investors [56] and the 'europeanisation' of firms. As far as the first objective is concerned, the Directive aims at providing a set standard of protection throughout the EU for minority shareholders of listed companies in the event of a change of control and at

[55] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids; OJ L142/12, 30/04/2004. Unless otherwise stated, referrals in this thesis to the 'Directive' means the Directive on takeover bids.
[56] Recital No. 2.

providing for minimum guidelines for the conduct of takeover bids. As far as the second objective is concerned, the Commission views takeover bids as a useful instrument to achieve the restructuring of European firms, which is indispensable for their international competitiveness[57]. Indeed, this view of the Commission is also shared by legal scholars such as Wymeersch (2002), who argues that European legal harmonisation is vital in order to prevent individual MS to use their legal systems to erect or maintain barriers to market access, with a view to protecting their own enterprises from takeovers[58].

The UK and France have had a significant impact upon the drafting of the Directive. Indeed, the Directive is essentially modelled on the UK's system. This is not surprising, due to the UK's comparatively vast experience in takeover regulation and the widespread acceptance that the City Code has been remarkably successful[59]. Accordingly, there are many similarities between the Code and the Directive. Given that the current French takeover regulation is also modelled on the Code, it is also possible to find parallels between the Directive on the one hand and the French takeover regime on the other. It is therefore believed that the comparison of these two takeover regimes will offer a better understanding of the provisions embodied in the Directive and of the harmonisation efforts taking place outside the Directive. Furthermore, the comparison of these two takeover regimes will provide an opportunity to call into question the efficiency of the Directive.

It should be noted that this thesis deals with the conflicts of interests as between the offeree management and the offeree shareholders, and as between the offeror and the offeree shareholders. There are other relationships in the context of takeover bids which give rise to conflicts of interests. These are the relationship between the offeror and its shareholders, and the relationship between the offeror and the stakeholders. The relationship between the offeror and its shareholders is outside the scope of this thesis. This is because the latter relationship is not dealt

[57] This is made explicit in the 'Bangemann memorandum' of 1990.
[58] E. Wymeersch, 'Takeover Regulation in Europe: The Battle for the 13th Directive on Takeovers' (2002) 15 A.J.C.L. 1, p. 8.
[59] S. Kenyon-Slade and M. Andenas, 'The Proposed Thirteenth Directive on Takeovers: Unravelling the UK's Self-Regulatory Success?' in Andenas and Kenyon-Slade (eds), *EC Financial Market Regulation and Company Law* 149 (1993), p. 149.

within the UK or French takeover regulation *per se*, but rather by general company. Reasons of space do not allow, however, a comparison of the numerous company law provisions which exist in the UK and France and which relate to this specific relationship. This thesis also excludes the relationship as between the offeror and the stakeholders, though it briefly deals with the relationship as between the offeror and the employees of the offeree company in the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids. The reason for not dealing with this relationship thoroughly is because the 'stakeholders' encompass too many constituencies and reasons of space once again rule out their detailed examination. It should be added that only companies whose securities are traded on a public market fall within the scope of this thesis.

Structure of the thesis

This thesis is comprised of seven chapters and proceeds in the following sequence:

Chapter I starts with the description of the regulatory framework prevailing in the UK and France as regards the regulation of takeovers. To this end, it provides an overview of the rules governing takeovers and of the takeover regulatory authorities in these two countries. This chapter further examines the relationship of the takeover regulatory authorities with other bodies which are, or may become, involved in takeovers.

Chapter II provides an overview of the main features of the capital markets and the ownership structure of listed companies in the UK and France, in terms of the level of concentration of share ownership and the identity of shareholders. This chapter also provides an insight into how the market for corporate control operates in these two jurisdictions.

Chapter III and Chapter IV examine the role of the offeree board under the UK and the French regimes, respectively. For this purpose, each of these chapters starts with a description of the rules governing directors' actions. These chapters subsequently give an overview of the permissible pre-bid and post-bid defences in the UK and France, respectively.

Chapter V and Chapter VI examine the operation of the equality principle under the UK and French regimes, respectively. In particular, they describe the operation of the principle within the offer; as between shareholders selling within the offer and those selling outside the offer; and in circumstances where control is either acquired in the market or transferred from an already existing controlling shareholder.

Chapter VII provides a critical analysis of the differences between the UK and French takeover regimes as regards the topics discussed in the preceding chapters. In doing so, this chapter also refers to the provisions of the Directive on takeover bids, with a view to identifying the impact of the latter upon the takeover regimes of the UK and France.

This thesis ends with a **conclusion,** which summarises its main findings and assesses the harmonisation efforts in the field of takeovers, which take place in the EU. The conclusion further attempts to anticipate the future developments in this area of law.

Chapter 1 The UK and French Regulatory Framework Concerning the Regulation of Takeovers

Introduction

The rules governing takeovers and the takeover regulators in the UK and France are prompted by similar concerns and work towards the same aims, namely to ensure that takeovers are conducted in an orderly fashion and that offeree shareholders are protected and treated equally. This is so in spite of the differences between these two jurisdictions regarding the nature of the rules governing takeovers and the scope of the regulators' powers. Indeed, the regulation of takeovers in France is mainly statutory. It should be noted, however, that, prior to the recent French regulatory overhaul that will be explained in more detail below, the French takeover system had contained an element of self-regulation in the form of the CMF. However, the creation of the Autorité des Marchés Financiers[60] and the resulting abolition of the CMF have resulted in the removal of an important fraction of France's self-regulation.

In contrast, the UK takeover regulation contains many self-regulatory elements and its main takeover regulator is self-regulatory. Despite its essentially self-regulatory nature, the UK takeover regime can no longer be characterised as entirely self-regulatory, however. This is because, as will be seen below, the UK takeover regulator has received the support of a number of organisations which are backed by statute. This change is believed to have occurred as a result of the failure of self-regulation to live up to the requirements of effective investor protection[61]. It can therefore be said that the UK currently has a mixture of statutory and self-regulatory takeover regime.

This chapter provides an overview of the regulatory framework in the UK and France. Section I describes the rules governing takeovers in the UK and France. Section II describes the takeover regulators in these two countries. Finally,

[60] Hereafter the AMF.
[61] C. Mayer, 'Regulatory Principles and the Financial Services and Markets Act 2000' in E. Ferran and C. A. E. Goodhart (eds), *Regulating Financial Services and Markets in the Twenty First Century* (Oxford: Hart, 2001), p. 26.

Section III examines the relationship of the takeover regulatory authorities with other bodies which may be involved in takeovers.

1.1 Rules Governing Takeovers

1.1.1 The UK

i) History

The regulation of takeovers in the UK dates back to 1959. Indeed, in the late 1950s, a number of takeover bids[62] involved defensive measures which left shareholders in a company without a clear choice between opposing proposals. Such measures included the issue by offeree boards of shares to friendly third parties during the course of an offer, with a view to frustrating offers. Concern over such measures led to the creation of the Notes on Amalgamations of British Businesses[63], which were produced in 1959 under the auspices of the then Governor of the Bank of England. The Notes recognised for the first time that takeover tactics required guidance[64]. Subsequent takeover bids involved instances where shareholders were not treated alike. In particular, controlling interests were purchased in companies at a considerable premium over the market price, without providing the remaining shareholders with an opportunity to share in the premium. This in turn led to a revision of the Notes in 1963[65], with a view to establishing the principle that a person who buys shares in the market or by private treaty shall offer similar terms to the remaining shareholders. The Revised Notes proved insufficient, however, especially after 1963, when a great deal of takeover activity took place. Indeed, the Revised Notes failed to check what many regarded as undesirable practices. Hence the decision in 1967 of the then Governor of the

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[62] For an overview of these bids, see A. Johnston, *The City Takeover Code* (OUP, 1980). Note that some of these bids are referred to in the chapter on the regulation of defensive measures in the UK.
[63] Hereafter the Notes.
[64] M. Blanden, 'The City Regulations on Mergers and Takeovers' in J. M. Samuels (ed.), *Readings on Mergers and Takeovers* (London, 1972), p. 201.
[65] Hereafter the Revised Notes.

Bank of England to reconvene the City Working Party, with a mandate to draw up a Code. The latter was published in March 1968[66].

ii) Current framework

There is comparatively little legislation in the UK regulating the conduct of takeover bids. The real strength of the control of takeover bids lies in the system of self-regulation rather than the legislation[67]. Indeed, the great bulk of regulation in relation to takeovers is to be found in the Code. The objective of the Code is to ensure fair and equal treatment of shareholders during takeover bids and to provide an orderly framework within which takeovers are conducted[68]. To this end, the Code contains a substantial number of principles and rules relating to takeover bids. The particularity of the Code is that it is a self-regulatory instrument, a code of conduct. Its rules were developed by the Takeover Panel, which, as will be seen below, is a self-regulatory body. As a result, the Code has not the force of law. This is in line with the fact that the self-regulatory approach has historically been a distinctive feature of financial services regulation in the UK[69]. Because of its self-regulatory nature, the Code meets all the criteria usually found in self-regulatory systems, namely the informality of operation; the speed with which decisions can be taken; the ability to adapt the principles to changing market circumstances; and the lower costs[70]. In particular, the speed with which the Code can be amended to meet changing circumstances is an incomparable advantage over the lengthy legislative process under a statutory code.

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[66] For an analysis of the events leading to the publication of the City Code, see A. Johnston (1980), supra n 62, Chs 1-2; and E. Stamp and C. Marley, *Accounting Principles and the City Code* (Butterworths, 1970), Ch. 1-2.

[67] T. P. Lee, 'Takeovers-The United Kingdom Experience' in J. H. Farrar (ed.), *Takeovers, Institutional Investors and the Modernization of Corporate Laws* (Auckland; Oxford: OUP, 1993), p. 192.

[68] Code, Introduction, 1(a).

[69] E. Ferran and C. A. E. Goodhart, 'Regulating Financial Services and Markets in the Twenty First Century: An Overview' in E. Ferran and C. A. E. Goodhart (eds), *Regulating Financial Services and Markets in the Twenty First Century* (Oxford: Hart, 2001), p. 5.

[70] N. Gunnigham and J. Rees, 'Industry Self Regulation: An Institutional Perspective' (1997) 19 Law & Pol. 363, p. 366.

It should be noted that a number of statutory rules are also applicable during takeover bids. For instance, the Companies Act 1985[71] applies when the minority requests to be bought out by the bidder who has obtained acceptances from the holders of ninety per cent of the shares for which the bid is made. The same Law also applies where the bidder compels the remaining ten per cent shareholders to transfer their shares to it. Furthermore, Part V of the Criminal Justice Act 1993, which contains rules on insider dealing, applies when there are suspicions of insider dealing in the context of a takeover. Indeed, bid situations give rise to opportunities for directors and other persons who have inside information to profit by market dealings before the information is published. Moreover, the Financial Services and Markets Act of 2000[72] applies in the context of takeovers, as it contains rules prohibiting market abuse, of which insider dealing is an example. As a result, the above legislation affecting takeovers supplements and reinforces the Code in relation to related matters[73]. It should be added that, in addition to the above statutory rules, the UK Listing Authority's Listing Rules[74] are also applicable in the context of a takeover where the parties to the takeover have their shares listed on the London Stock Exchange.

1.1.2 France

i) History

Takeover bids were long ignored by the French legislator, until the early 1960s when the occurrence of two takeover bids[75] made it necessary to have a regulation specific to takeovers. The first regulation resulted from an exchange of letters in

[71] Hereafter the CA 1985.
[72] Hereafter the FSMA. The latter has replaced, *inter alia*, the Insurance Companies Act 1982, the Financial Services Act 1986, and the Banking Act 1987.
[73] R. R. Pennington, 'Corporate Takeovers Through the Public Markets-United Kingdom' in P. J. Kozyris (ed.), *Corporate Takeovers Through the Public Markets* (The Hague; Boston: Kluwer, 1996), p. 304.
[74] Note that, as from May 2000, the function of competent authority for listing, together with the responsibility for the Listing Rules, has been transferred from the London Stock Exchange to the FSA.
[75] These were the share-exchange offer in 1960 by Compagnie Française des Pétroles for the shares of Omnium Français des Pétroles, and the cash offer in 1964 by the US bank Lazard for the shares of Compagnie Franco-Wyoming Oil Company.

1966[76] between the Minister of the Economy and the *Chambre Syndicale*[77], which resulted in the approval by the former of the procedure laid down by the latter. This procedure had an informal nature and was intended to monitor cash offers and prevent market abuses. At the same time, the procedure avoided to hinder cash offers, which were believed by the then market authorities to animate the financial market[78]. The 1966 regulation proved inadequate, however, as it did not provide a solution to a number of problems which often appear during a takeover battle. In addition, it only concerned cash offers, to the exclusion of share-exchange offers. As a result, a new regulation was introduced between 1970 and 1974[79]. However, the new regulation also proved inadequate, especially following the hostile bid in 1977 by the *SNCDV* for the shares of the *CNM.* The latter bid, which turned into a protracted battle as a result of successive counter-offers, proved to be uncontrollable within the existing framework. As a result, a reform in 1978 resulted in the adoption by the COB of two general decisions concerning cash and share-exchange offers as well as the price guarantee procedure[80], and in the introduction of provisions concerning cash and share-exchange offers in the General Regulation of the *Chambre Syndicale*[81].

Subsequently, in 1989, the French government decided to overhaul the takeover regulation with a view to giving it a firmer statutory basis[82]. This decision was taken as a result of the increase in the number of takeovers, the disturbing features of some takeovers, and the need to adapt the French takeover regime to the imperatives of the Community law. The 1989 reform merely laid down the general principles applicable to takeovers, leaving the market authorities to set out the conditions and the procedure. Hence the adoption by the *Conseil des Bourses*

[76] Letters of 4 April, 6 July and 29 November 1966.
[77] This was created by the Law No. 66-1009 of 28 December 1966 and is the predecessor of the *Conseil des Bourses de Valeurs*, which in turn is the predecessor of the *Conseil des Marchés Financiers* (hereafter the CMF).
[78] P. Bézard, *Les Offres Publiques d'Achat* (Paris: Masson, 1982), p. 25.
[79] This consisted of the adoption in 1970 by the *Chambre Syndicale* of a new regulation and the adoption by the *Commission des Opérations de Bourse* of a code of good conduct.
[80] General Decisions of the COB of 25 July 1978, modified by the regulation No. 86-01 of 13 March 1986.
[81] Title VI, ch. 2.
[82] Law No. 89-531 of 2 August 1989 on the security and transparency of the financial market.

de Valeurs[83] of its General Regulation, and by the COB of its Regulation No. 89-03[84]. The reform process continued in 1992, when Book V of the CBV's General Regulation was amended. This amendment had the effect of strengthening the rights of minority shareholders by requiring the offeror to bid for all the shares of an offeree company, as opposed to the previous rule under which the offeror was required to bid for only two-thirds of the offeree company. In 1996, the French Parliament adopted the Financial Activities Modernisation Act [85], which transposed into the French law the EU Directive on investment services[86], and which merged the CBV and the *Conseil du Marché à Terme* into one single entity, namely the CMF[87]. The rationale underlying the latter merger was that the traditional distinction between securities and derivatives markets no longer reflected the economic reality of the transactions and the operators[88]. The 2001 Law on the New Economic Regulations[89] conferred new powers on employees during the currency of takeovers; increased the powers of the COB and the CMF; and recognised the validity of shareholder agreements during the currency of takeovers. Though presented as an historic reform, the Law of 2001 did not bring about major changes to the previous framework, however. Finally, the Law of 2003 on Financial Security[90] has merged the CMF and the COB to create a single securities regulator, namely the *Autorité des Marchés Financiers*[91], whose functions include the regulation of takeovers.

[83] Hereafter the CBV. The latter was created by the Law No. 88-70 of 22 January 1988 to replace both the *Compagnie Nationale des Agents de Change* and its *Chambre Syndicale.*

[84] Thus, the CMF adopted a General Regulation and the COB adopted regulation No. 89-03, which has now been replaced by regulation No. 2002-04.

[85] Law No. 96-597 of 2 July 1996.

[86] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field; OJ L 141, 11/06/1993 P. 0027 – 0046.

[87] Law of 2 July 1996, art. 27.

[88] C. Merkin and B. Saint Mars, 'Le Conseil des Marchés Financiers' in T. Bonneau et al. (eds), *La Modernisation des Activités Financières* (GLN Joly, 1996), p. 80. For more information on the background to the creation of the CMF, see E. Fayet, *L'Autorité Professionnelle de Marché: du CBV au CMF*, Thesis, Paris V (2000).

[89] Law No. 2001-420 of 15 May 2001.

[90] Law No. 2003-706 of 1 August 2003 on financial security.

[91] Hereafter the AMF.

ii) Current framework

The main sources of regulation for public takeovers in France are the General Regulation of the CMF[92] and the Regulation No. 2002-04 of the COB[93]. The Code of Commerce also contains some provisions relating to defensive measures, such as the rules relating to capital increase and the rules relating to the shares held by subsidiaries in the capital of their parents[94]. The existence of both statutory and self-regulatory rules indicates that the French takeover regime cannot be characterised as being entirely statutory or entirely self-regulatory. Indeed, it is a mixture of statutory regulation and self-regulation[95]. The self-regulatory element lies in the fact that the primary regulations, namely the CMF and the COB Regulations, were laid down by professionals. The statutory element lies in the fact that these regulations find their basis in the statute and they are subject to the approval of the Minister of the Economy.

It should be noted that, although the AMF has taken on the functions previously carried out by the COB and the CMF, it has yet to publish its own set of regulations. At the time of writing, the AMF has not yet introduced its own General Regulation, which will replace both the CMF's General Regulation and the COB's Regulations. This new General Regulation is likely to be introduced in autumn 2004[96]. Until then, the separate regulations of the CMF and the COB will remain in force. References in this thesis are therefore to the old Regulations, namely the CMF's General Regulation and the COB's Regulation No. 2002-04.

It is noteworthy, however, that the AMF's new General Regulation will not fundamentally change the existing takeover regime in France. This is because the AMF has recently published a draft General Regulation. The latter's analysis

[92] Note that references in this thesis are to the November 2002 edition of the CMF's General Regulation. The rules applicable to tender offers are contained in Book V of the latter.
[93] Note that, unless otherwise stated, references in this thesis are to this Regulation of the COB (JO of 27 April 2002).
[94] Note that the French machinery regulating tender offers also includes Book IV of the Code of Commerce relating to competition; and the EC Merger Regulation No. 139/2004 of 1 May 2004.
[95] A. Viandier, 'Les Offres Publiques d'Achat en Droit Français des Marchés Financiers' in *Les Prises de Participations: L'Exemple des OPA*, Colloque, Centre d'Etudes Juridiques Européennes, Genève (Payot Lausanne, 1990), p. 413.
[96] *Consultation Publique sur le Projet de Réglement Général de l'AMF*, Communiqué de Presse, July 30, 2004, available at AMF website.

shows that the provisions relating to tender offers have not received any changes, save for minor changes which in no way affect the discussions that follow. Indeed, the draft General Regulation does not even propose changes to some provisions that this author was expecting the AMF to amend, with a view to clarifying them[97], or to rendering them compatible with the Directive on takeover bids[98]. Although the draft General Regulation is currently subject to consultation, its provisions which regulate tender offers and which are relevant to this thesis have been reproduced in the Annex to this thesis, with a view to showing the new numbering of such provisions.

1.2 Takeover Regulatory Authorities

1.2.1 The UK

The regulation and policing of the conduct of takeovers and mergers in the UK fall under the remit of the Panel on Takeovers and Mergers[99], which was created in 1968. The Panel forms part of the UK regulatory system of securities regulation[100]. However, unlike other constituent parts of that regulatory system, it is a self-regulating body in the sense that it connotes '*a system whereby a group of people, acting in concert, use their collective power to force themselves and others to comply with a code of conduct of their own devising*'[101]. The Panel's objective is to ensure equality of treatment and opportunity for all shareholders in the context of takeover bids. It should be noted, however, that the Panel is not concerned with the merits of an offer[102]. In the view of the Panel, these are matters for the company and its shareholders. The Panel is simply concerned with the quality of the information provided by the parties to a bid. Thus, unlike the

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[97] e. g. Rule 5-2-9 of the CMF's General Regulation, which, as will be seen below, needs clarification.
[98] e. g. Rule 5-5-2 of the CMF's Regulation, which concerns the price of mandatory bids, or Rule 4 of the COB's Regulation No. 2002-04, which stipulates an obligation of notification for non-routine managerial actions.
[99] Hereafter the Panel.
[100] G. K. Morse, 'The City Code on Takeovers and Mergers – Self Regulation or Self Protection?' (1991) J. Bus. L. 509, p. 509.
[101] *R v Panel on Takeovers and Mergers, Ex parte Datafin* [1987] 1 All ER 564, p. 567.
[102] Code, Introduction, 1(a).

French regulator which will be examined below, the Panel does not assess the price of offers falling within its scope.

The Panel consists of representatives from a number of financial organisations and professional associations in the City of London. Its members include individuals appointed by the Governor of the Bank of England, the Association of British Insurers, the Association of Investment Trusts Companies, the Association of Private Client Investment Managers and Stockbrokers, the British Bankers' Association, the Confederation of British Industry[103], the Institute of Chartered Accountants in England and Wales, the Investment Management Association, the London Investment Banking Association, and the NAPF [104]. The wide representation of interests on the Panel indicates that the Code represents the collective opinion of those professionally involved in the field of takeovers as to good business standards and as to how fairness to shareholders can be achieved[105].

The general administration of the Panel is carried out by the Executive. The latter's duties include the conduct of investigations and the monitoring of dealings in the context of takeovers[106]. As the courts put it, the Executive acts '*as a sort of fire brigade to extinguish quickly the flames of unacceptable and unfair practice*' [107]. The Executive comprises a Director-General and a number of assistant directors who are usually seconded to the Panel by the banks, the law firms, or the accounting firms to which they belong. The mix of permanent staff and secondees is one of the great strengths of the Panel. For whilst the permanent staff provides the essential continuity, the secondees offer their practical experience of current practice and thinking[108]. The fact that there is a willingness on the part of various employers to release their high-quality members of staff to the Panel for a couple of years is an indication of the importance which is attached to the work of the Panel[109].

[103] Hereafter the CBI.
[104] Code, Introduction, 2(a).
[105] Code, Introduction, 1(a).
[106] Code, Introduction, 2(b).
[107] *R v. Panel on Takeovers and Mergers, ex parte Guinness plc* [1990] 1 QB 146.
[108] T. P. Lee (1993), supra n 67, p. 196.
[109] D. Calcutt, 'Company Law Lecture-The Work of the Takeover Panel' (1990) 11 Co. Law. 203, p. 204.

Despite its self-regulatory nature, the Panel has a number of sanctions at its disposal to enforce its decisions. First and foremost, the Panel can resort to private reprimand and public censure. In particular the public censure acts as a powerful deterrent. For it can affect the profit and loss account of a company, and adversely affect the career of an individual[110]. Secondly, and more importantly, the Panel can avail itself from the sanctions available to some regulatory authorities. This is logical since, as will be seen in more detail below, the Panel is tied in, statutorily, with the work of other financial regulatory bodies, such as the Financial Services Authority[111] or the London Stock Exchange[112]. The Panel may thus report the offender's conduct to the regulatory authorities concerned with investment business[113] so that the latter exercise their powers to impose disciplinary sanctions or, in appropriate cases, to take legal action[114]. It should be noted, however, that, although the sanctions are a useful stick to wield, the Panel works best through prevention[115]. This is done by encouraging parties to a takeover to consult the Panel in advance of taking any action.

It should be added that the rulings of both the Panel Executive and the full Panel are subject to appeal. Indeed, the rulings of the Executive may be appealed to the full Panel[116]. The full Panel meets, on average, about six times a year to hear appeals or references from the Executive. The procedure before it is informal and legal representation in the strict sense is not normally allowed[117]. Furthermore, an appeal lies from the Panel to the Appeal Committee on disciplinary matters or on matters concerning the jurisdiction of the Panel[118]. The Appeal Committee meets less than once a year on average. Furthermore, Panel rulings are subject to judicial challenge. However, despite the existence of an appeal procedure and of the possibility to challenge Panel rulings before the courts, the Panel's rulings are usually complied with. The rationale behind this is two-fold: First, the government threatens to introduce legislation and to create a statutory body in the

[110] T. P. Lee (1993), supra n 67, p. 194.
[111] Hereafter the FSA.
[112] D. Calcutt (1990), supra n 109, p. 206.
[113] e. g. the DTI, the FSA, or the Bank of England.
[114] Introduction, 3(d).
[115] M. Blanden (1972), supra n 64, p. 213.
[116] Code, Introduction, 3(c).
[117] Code, Introduction, 3(e).
[118] Code, Introduction, 3(f).

field of takeovers, should the City fail to voluntarily comply with Panel rulings. Secondly, most companies receiving a ruling from the Panel are members of a body which is itself a member of the Panel. They, therefore, indirectly subscribe to the Panel and its rules, and so are unlikely to wish to challenge its decisions[119]. For otherwise they would be liable to be in trouble with their own authority[120].

1.2.2 France

i) Duality of takeover authorities under the old system

Until recently, takeovers in France were governed by two bodies, namely the COB and the CMF. The COB was the oldest institution of its kind in Europe. It was set up in 1967[121] as an independent administrative authority having public law prerogatives[122]. Its creation formed part of a series of State interventions in the economic field, which were intended to encourage long-term investment in securities and to facilitate the financing of companies[123]. Drafters of the COB's founding Ordinance were inspired by the example of the US Securities and Exchange Commission. Their main focus was on improving the information provided to investors with a view to attracting investors to the stock exchange[124]. Indeed, the COB's duty was to ensure the protection of investors, the adequacy of the information provided to the latter and the proper operation of the securities market[125]. Like all administrative authorities, the COB did not have legal personality. As a result, investors who were prejudiced by a decision of the COB had to bring an action against the State.

The COB was composed of nine members. Three of the members represented the principal judicial institutions[126], one represented the Bank of France, one

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[119] T. P. Lee (1993), supra n 67, p. 194.
[120] G. K. Morse, 'Controlling Takeovers-The Self Regulation Option in the UK' (1998) J. Bus .L. 58, p. 59.
[121] Ordinance No. 67-833 of 28 September 1967, supplemented by Decree No. 68-23 and Decree No. 68-30 of 3 January 1968 relating to the administrative and financial organisation of the COB.
[122] Constitutional Council, Dec. No. 89-260 DC, 28 July 1989, JO 1 August 1989, p. 9676.
[123] N. Decoopman, *La COB et le Droit des Sociétés* (Economica, 1979), p. 17.
[124] S. Loisy, *Prix et Contrepartie dans les Offres Publiques*, Thesis, Paris V (1998), pp. 6-7.
[125] Ordinance of 1967, art. 1 (now repealed).
[126] These are the *Conseil d'Etat*, the Supreme Court, and the *Cour des Comptes*.

represented the CMF, and three were designated by the Speaker of the Senate, the Speaker of the National Assembly and the chairman of the Economic and Social Council, for their financial and legal expertise as well as their experience in the field of public offering. In addition to the above members, a representative of the Ministry of Economy had to be heard before any decision was taken by the COB, save for individual decisions[127]. The rationale behind having a representative of the Ministry of Economy was to broaden the institutional composition of the COB and to increase the weight of the executive power. The latter argument was seen, however, as being in contradiction with the independent nature of the COB[128]. Indeed, Vauplane, Germain and Bornet (2001) believed that the fact that the French market could not entirely free itself from the influence of the executive power constituted a paradox of the French market [129].

The COB's main power for our purposes resulted from its ability to approve or disapprove the information memorandum published in connection with a cash or a share exchange offer. Indeed, the offeror who would file an offer document with the CMF was further required to file an information memorandum[130] with the COB. This memorandum, which was prepared by the sponsoring bank(s) on behalf of the offeror, was intended to inform the investors of the proposed transaction, the offeror's organisation, its financial situation, and the evolution of its activity[131]. The approval of the memorandum by the COB meant that the essential elements shareholders needed to know in order to decide whether or not they would participate in the transaction were contained in the memorandum. As the courts put it, the COB's approval was a substantial guarantee of the right of investors to honest and complete information[132]. The COB's approval was not a seal of quality, however. In other words, the COB's approval was not an approval of the merits of the offer. Nor was it an assessment of the situation of the offeror company or an authentication of the financial and accounting elements contained

[127] e.g. where the COB decides to carry out an investigation; approves or withdraws its approval from a portfolio management company; issues an injunction; or imposes a pecuniary sanction.
[128] N. Decoopman 'La Commission des Opérations de Bourse', in Th. Bonneau, *La Modernisation des Autorités Financières* (GLN Joly, 1996), p. 112.
[129] H. Vauplane, M. Germain and J. P. Bornet, *Droit des Marchés Financiers* (Litec: 2001), p. 122.
[130] Referred to in France as the 'note d'information'.
[131] Code Monétaire et Financier, art. L. 412-1.
[132] CA Paris, 28 March 1988 (1988) Gaz. Pal., p. 308.

in the memorandum. The COB's control was a mere verification of the pertinence and the coherence of the information disseminated to the investors[133].

In the event of non-conformity of the information embodied in the memorandum with the COB's requirements, the COB could refuse its approval, which would in practice prevent the offer from taking place. Given the COB's power to approve the information memorandum was a discretionary administrative act, offerors whose memorandum was disapproved could subsequently challenge the COB's decision before the Paris Court of Appeal. However, without going that far, the COB could simply accompany its approval with a warning aimed at warning potential investors on the quality of the information disseminated by the offeror[134]. The warning was intended to draw the attention of investors to certain factual elements which were essential for an estimation of the risks likely to derive from the subscription or acquisition of shares by the investors during an offer, or to more specific elements concerning the structure of the companies concerned[135]. In the event of an offer carried out without the COB's approval, the COB could impose financial sanctions against the offeror, amounting to as much as ten million French Francs or, when profits had been realised, up to ten times their amount[136]. The COB could also apply to the courts for a suspension of the offer until the regularisation of the situation.

The CMF, on the other hand, was a professional market authority. It was entrusted with an administrative public service duty, namely to control the financial markets[137]. Unlike the COB, the CMF was a body subject to private law and had a legal personality. The CMF was composed of sixteen members, who were appointed by the Minister of the Economy. Of these sixteen members, fourteen were appointed after consultation of professional or union organisations.

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[133] CA Paris, 19 May 1998, No. 97/26141, *Buckel c/Fermière du Casino municipal de Cannes* (1998) Bourse et Produits financiers 651, p. 651.
[134] See e.g. the cash offer by *Rémy & Associés* for the shares of *Bénédictine* where the COB approved the information memorandum with a warning, on the grounds that the memorandum did not contain sufficient information about the situation and the evolution of the activity of the offeror company; see COB Report (1988), p. 80.
[135] e.g. ongoing litigation.
[136] The amount of financial sanctions imposed by the COB in 2001 was €269,662.49; see (2002) 2 Bull. Joly, p. 176.
[137] Bulletin COB, No. 260, July-August 1992, p. 6.

The Minister was not bound, however, by the opinions put forward by the latter organisations. Of these fourteen members, six represented the brokers, one represented the commodities market, three represented the issuers, three represented the investors, and one represented the employees of both the brokerage firms and the market operator[138]. The governor of the Bank of France as well as a *commissaire du gouvernement* could also participate in the deliberations of the CMF. Because of the presence of a *commissaire du gouvernement*, as opposed to the representative of government within the COB, Vauplane, Germain and Bornet (2001) were of the opinion that, despite its self-regulatory nature, the CMF continued to be under the authority of the government[139].

The CMF's task was to regulate, through the enactment of its General Regulation, the French securities market. Its main power for our purposes resulted from its ability to adjudicate upon the admissibility of offers. Indeed, all tender offers in France had to be filed with the CMF, which was responsible for controlling their terms and in particular their price. The CMF would do so on the basis of '*customary and objective criteria of evaluation and the characteristics of the offeree company*'[140]. Following its adjudication, the CMF would require the offeror to review either the proposed price or exchange value, or the threshold below which the offeror reserved the right to withdraw its offer, if there was any[141]. This power of the CMF served to ensure that minority shareholders received a fair price in an offer.

The duality of the securities regulators was increasingly criticised, however. As a result, the Law of 2003 has introduced a single regulator[142].

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[138] The market operator is a commercial company which ensures the functioning and development of the markets. The market operator in France is Euronext-Paris SA. The latter was born in September 2000 out of a full merger between the stock exchanges of Paris, Amsterdam and Brussels, and represents some 1,900 listed companies with a total market capitalisation of around €2,700 billion; see L. Bloch and E. Kremp, 'Ownership and Voting Power in France' in F. Barca and M. Becht (eds), *The Control of Corporate Europe* (OUP, 2001), p. 124.
[139] H. Vauplane, M. Germain and J-P. Bornet (2001), supra n 129, p. 197.
[140] CMF regs, r.5-1-9.
[141] CMF regs, r.5-1-9.
[142] Note, however, that legal scholars have been promoting the creation of a single authority since 1990; see e. g. A. Viandier (1990), supra n 95, p. 415.

ii) AMF: a single financial regulator

The French financial institutional framework underwent a drastic change in 2003. The Law of 2003 on Financial Security has actually merged the two prudential institutions – the COB and the CMF – and the Supervisory Committee for Asset Managers to create a single market authority[143], namely the AMF. The regulatory overhaul has been likened to the reform in the UK that resulted in the creation of the Financial Services Authority in 1997[144]. However, unlike the UK, France has not merged its banking and insurance regulators[145] into the AMF.

The rationale underlying the merger was three-fold: First, it was believed that the creation of a single authority would increase the competitiveness of the Paris financial market place [146] by improving the clarity and efficiency of its institutional organisation. Indeed, with the creation of the AMF, professionals and investors would have one single port of call. The initiator of a takeover bid would need to make one single filing instead of two[147]. This would not only avoid the overlapping of the regulatory responsibilities of the previous institutions[148], but also remedy the uncertainty created under the previous regime for French securities markets participants [149]. Indeed, due to some overlapping responsibilities, there was room for conflicting decisions by the two authorities. This could in turn result in the creation of two parallel securities laws. The

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[143] Note that the previous authorities, and in particular the CMF, were against the proposed merger, on the grounds that the previous framework was working effectively and that there was no necessity for reforming the dual system; see 'L'Organisation de la Commission des Offres Publiques me Laisse Perplexe', *Les Echos*, February 7, 2001.

[144] 'New French Regulator Starts Work', *eFinancialNews.com*, November 23, 2003, available at Lexis-Nexis Executive

[145] Respectively the *Comité des Etablissements de Crédit et des Entreprises d'Investissement* (hereafter the CECEI) and the *Commission de Contrôle des Assurances.*

[146] P. Marini, 'La Loi du 15 Mai sur les NRE: Un Texte qui Reste à Parfaire' (2001) 198 Petites Affiches 4, p. 6.

[147] 'Spain/France: French Toast', *The Lawyer*, February 9, 2003, available at Lexis-Nexis Executive.

[148] Note that this was seen by Conac as beneficial, on the grounds that it resulted in a competition between the two authorities and that it made it possible for one authority to correct the other's mistakes. He had therefore suggested that the dual system should be preserved but that the CMF should be placed under the authority of the COB; see P. H. Conac, 'La Fusion de la COB et du CMF', in *Droit Bancaire et Financier, Mélanges AEDBF-France*, t. III (Paris: Banque éditeur, 2001), p. 68.

[149] D. A. Katz, J. R. Cammaker and P. Gachot, 'Creation of a Stronger French Securities Market Regulator' (2004), p. 1, available at http://www.realcorporatelawyer.com/pdfs/wlrk010603.pdf

potential for conflict was further exacerbated by the fact that the legislator had not created a hierarchy between the two authorities[150].

Secondly, it was believed that the merger would render the French system more akin to other countries' systems[151]. Indeed, many European countries have set up a single authority, including the UK which has inspired the French merger proposal[152]. Indeed, as will be seen below, the UK has set up a single regulator in 1997, which has been entrusted the duties of the self regulating professional authorities[153]. The UK has preserved the Takeover Panel, however, which is the professional authority in the field of takeovers and mergers. It should be noted in this respect that the creation of a single authority for financial markets further contributes to the convergence of regulatory and supervisory structures, identified by the Committee of Wise Men[154] as a key condition for the success of the Lamfalussy approach[155] to integrated EU financial markets[156].

Thirdly, in conceptual terms, the merger of the COB and the CMF brought an end to the legal distinction, which has become artificial over the years, between an administrative and a professional form of regulation. Indeed, even prior to the creation of the AMF, professionals on the Paris financial market sat on the board of the COB. Furthermore, the latter would always carry out broad professional consultations before proposing rules for homologation by the Minister of the Economy[157].

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[150] M. Charbonnier and H. Vauplane, 'Le Contrôle des Entreprises Cotées, Hors Offres Publiques, en Droit Français' (1998) 124 Petites Affiches 3, p. 3.
[151] L. Bloch and E. Kremp (2001), supra n 138, p. 124.
[152] Indeed, Briault notes that there has been a reconsideration of regulatory structures in other countries, as a result of the creation of the FSA in the UK; see C. Briault, *The Rationale for a Single National Financial Regulator*, FSA Occasional Paper No. 2 (London, FSMA, 1999), p. 11.
[153] Note that the regulation in the UK underwent a fundamental change in 2000, as a result of which the previous two-tier regulatory regime for investment business established under the Financial Services Act 1986 has been replaced with an integrated regime and a single regulator being the FSA.
[154] *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (Lamfalussy Report)*, 15 February 2001, p. 38, available at europa website.
[155] This approach consists of establishing a new 4-level regulatory approach, with a view to changing the current regulatory framework which is considered to be too slow, too rigid, and ill-adapted to the pace of global financial market change.
[156] Opinion of the ECB of 18 December 2002 on a draft law on financial security (CON/2002/32), p. 4. Lomnicka notes, however, that there are some dangers associated with a single regulator, deriving from its enormous size, its wide scope and its monopoly position; see E. Lomnicka, 'Reforming UK Financial Services Regulation: The Creation of a Single Regulator' (1999) J. Bus. L. 480, p. 488.
[157] 'Spain/France: French Toast', supra n 147.

Pursuant to the Law of 2003, the AMF is an independent administrative authority. The rationale behind the conferral of a 'public authority' status on the AMF is that the AMF has policing powers that it exercises on behalf of the State. In addition, all its members are appointed by other public authorities. Despite the latter, the AMF is not a traditional public authority. This is because, unlike France's other independent administrative authorities, the AMF has a legal personality. It can therefore bring a civil action before the courts through the intermediary of its chairman. It can also raise taxes directly, and recruit professionals using contracts that are subject to private law[158]. Conversely, an injured third party will be able to act directly against it before the courts, and not against the State, as was previously the case with the COB.

The AMF's ambit is to safeguard savings invested in financial products, to ensure that investors receive material information, and to maintain orderly markets in financial instruments[159]. It sets rules for and monitors transactions involving the securities of listed companies, such as initial public offerings[160], capital increases, mergers. It also monitors companies to ensure that they provide relevant information on a timely basis and in an equitable manner to all market participants. The AMF further authorises the formation of collective investment schemes, such as SICAVs and FCPs[161], establishes the principles of organisation and operation for market undertakings and clearing and settlement systems, and lays down and enforces the stock market conduct of business rules which are imposed on persons authorised to provide investment services or advice on financial investments. More importantly for our purposes, the AMF ensures that takeovers are conducted in an orderly fashion. To this end, it regulates and approves tender offers. Indeed, the Regulations require all offer documents to be filed with the AMF. The latter will approve them only if the terms of the offer are in line with the AMF's regulations. The foregoing indicates that the AMF combines the previous competences of the COB, the CMF and the CDGF.

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[158] Law of 2003, art. 7.
[159] Code monétaire et financier, art. L. 621-1.
[160] Hereafter the IPOs.
[161] The SICAVs are open-ended investment companies and the FCPs (Fonds Commun de Placement) are unincorporated investment funds. The latter constitute the French UCITS and are referred to in France as the OPCVM (i. e. organismes de placement collectif en valeurs mobilières).

To carry out the above duties, the AMF is composed of two separate collegial bodies, namely the Board and the Disciplinary Commission[162]. The rationale behind the creation of two separate bodies is to segregate the prosecutorial and disciplinary functions of the AMF. This idea arose out of criticism previously directed towards the COB. Indeed, the COB's authority was seriously undermined by a ruling of the Paris Court of Appeal[163] that invalidated a financial sanction that the COB had imposed on some market participants. In this case, the Court of Appeal held that the procedure followed by the COB ran counter the 'right to a fair trial', which is stated in the ECHR[164]. In the words of the Court, '*the procedure of the COB whereby the COB indicts, formulates the grievances, decides upon the culpability of a person and finally sanctions, could not be regarded as objectively impartial*'[165].

The Board adopts the General Regulations and takes individual decisions. It is composed of sixteen members. These are the chairman appointed by the President of the Republic; three high-ranking judges; a representative of the governor of the Bank of France; the chairman of the National Accounting Council; three qualified persons appointed for their financial and legal expertise as well as their experience in the field of public offering; six qualified persons appointed following consultation with organisations representing issuers, intermediaries, investors, and market undertakings, for their financial and legal expertise as well as their experience in the field of public offering; and a representative of employee-shareholders designated by the Minister of the Economy following consultations with labour unions and employee associations[166]. The composition of the Board thus ensures an appropriate balance between representatives of public authorities on the one hand, and representatives of the market and employee-shareholders on the other.

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[162] Code monétaire et financier, art. L. 621-2.
[163] e.g. CA Paris, 7 March 2000, *Sté KPMG Fiduciare de France* (2000) JCP éd. E, p. 538.
[164] art. 6.
[165] R. Salomon, 'La Réforme de la Procédure de Sanction de la COB par les Décrets du 1er Août 2000' (2000) 5 RD bancaire 312, p. 313.
[166] Code monétaire et financier, art. L. 621-2.

To enforce its decisions, the Board may issue administrative injunctions. Indeed, the Board may order that practices contrary to the legislative or regulatory provisions be brought to an end when they create a distortion of the market, provide unfair advantages to the persons involved, prejudice the equal treatment of investors, or provide advantages to issuers and investors as a result of breaches by intermediaries of their professional obligations [167]. In case the person concerned does not comply with such injunction, the Board may refer the case to the Disciplinary Commission. On the other hand, the chairman of the AMF may request the presiding magistrate of the *Tribunal de Grande Instance* of Paris to put an end to an irregularity which has been observed, or to eliminate its effects, when such irregularity is likely to affect the rights of investors[168]. This judicial injunction is immediately enforceable and may be accompanied by a penalty to induce the person concerned to comply with the order[169]. Moreover, the chairman of the AMF may request the presiding magistrate of the same Tribunal to give an order taking temporary possession of funds, valuables, securities or rights belonging to persons believed by the chairman to be guilty of wrongdoing. It should be added that, in return for this strong delegation of power from the State, a representative of the government, appointed by the Minister of the Economy, sits on the Board of the AMF. This representative has no power to vote. He can request a second deliberation, however, save for the matters concerning the sanctions[170]. The presence of this representative, coupled with the fact that the General Regulation of the AMF is subject to the Minister of the Economy's approval[171], indicates that the State has influence on the action of the AMF.

It should be noted that, despite the Board's authority to investigate[172] and to decide whether to refer a case to the Disciplinary Commission, the latter has sole power to conduct the proceeding and to decide what sanctions to impose, if any. The Commission is composed of twelve members, none of whom is also a member of the Board[173]. Applicable sanctions are warning, reprimand, temporary

[167] Code monétaire et financier, art. L. 621-14.
[168] Code monétaire et financier, art. L. 621-14.
[169] Code monétaire et financier, art. L. 621-14.
[170] Code monétaire et financier, art. L. 621-3.
[171] Code monétaire et financier, art. L. 621-6.
[172] To this end, the Board may conduct on-site and documentary inspections.
[173] Code monétaire et financier, art. L. 621-2.

or permanent prohibition on carrying out all or part of the authorised services. The Commission may further order, either *in lieu of* or in addition to the above sanctions, fines up to €1.5 million or ten times the amount of realised profits[174]. In any event, the sanction depends on the level of the infringement committed and is proportionate to the advantages or profits derived from the infringement. All disciplinary decisions can be challenged before the Paris Court of Appeal[175].

1.3 Relationship of the Takeover Regulatory Authorities with Other Authorities

In both the UK and France, the takeover regulatory authorities collaborate with other authorities. It should be noted from the outset, however, that the following is not an exhaustive review of all such authorities but only of those authorities which often are, or may become, involved in the takeover process.

1.3.1 The UK

The Panel's status is reinforced through its collaboration with such authorities as the Financial Services Authority[176], the antitrust authorities, the London Stock Exchange, and the courts.

i) FSA: the single financial services regulator

The FSA is an independent body which regulates financial services. Its objectives include the maintenance of market confidence, the promotion of public understanding of the financial system, the protection of consumers, and the fight against financial crime. The FSA has formally endorsed the Code as a relevant instrument of self-regulation[177]. This means that the FSA may, at the request of the Panel, take enforcement action against those who fail to comply with the Code or a Panel ruling. Such action by the FSA include public censure, the imposition

[174] Code monétaire et financier, art. L. 621-15.
[175] Note, however, that appeals against decisions involving sanctions against professional entities must be made to the *Conseil d'Etat*.
[176] Hereafter the FSA.
[177] FSMA 2000, s.143.

of fines, the refusal or suspension of listing of the securities of an issuer[178], the removal of authorisation, the imposition of injunctions, and of restitution orders[179]. More importantly, the FSA prohibits City financial institutions[180] from providing services in connection with a takeover undertaken by a person whom they have reason to believe would not comply with the UK practice and standards in takeovers[181]. The latter provision serves to put pressure on the offeror and offeree companies and their directors to comply with the provisions of the Code, by depriving them of advisers if they propose to act in breach of the Code[182].

ii) Antitrust authorities

Pursuant to the Code, an offer will lapse upon reference to the UK Competition Commission[183]. Such reference occurs where the Office of Fair Trading believes that a relevant merger situation[184] has been created[185], or that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation[186], and the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods or services.

iii) London Stock Exchange plc

The London Stock Exchange is the principal stock exchange for the UK. It is a public limited company, which is responsible for both the Official List[187] and the

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[178] FSMA 2000, s.75 and 77. The power of the FSA to refuse the listing application of an issuer constitutes a strong sanction, in particular where the offeror offers securities as consideration of its offer and wishes such securities to be listed.
[179] Code, Introduction, 1(c).
[180] e. g. the merchant banks and their corporate finance subsidiaries, institutional investors, or members of the Stock Exchange.
[181] FSA, Code of Market Conduct, s.4-3-1.
[182] P. L. Davies, *Gower's Principles of Modern Company Law* (London: Sweet & Maxwell, 7th ed., 2003), p. 709.
[183] Code, r.12(1)(a).
[184] For the definition of this concept, see the Enterprise Act, art. 23.
[185] The Enterprise Act 2002, art. 22(1).
[186] The Enterprise Act 2002, art. 33(1).
[187] The Main Market has more than 2000 companies, including more than 400 international issuers from 60 countries.

Alternative Investment Market[188]. The London Stock Exchange itself is listed on the Official List since July 2001. Since most takeovers take place between companies whose shares are listed on the Stock Exchange, a major element in the enforcement of the Code is the sanctions which the Stock Exchange possesses over listed companies[189]. It should further be noted that, in particular where the offeror offers securities as consideration of its offer and if such securities are to be listed, then the offeror must make a separate application to the London Stock Exchange for trading, in addition to drawing a prospectus or listing particulars, which are subject to approval by the UKLA.

iv) Courts

Decisions of the Panel are subject to review by the courts. This is because, although the Panel is not a government administration, it does fulfil functions of a public, regulatory character[190]. Indeed, in *Datafin*, the court held that, although the Panel is a self-regulatory body without any direct statutory base, '*it is supported and sustained by a periphery of statutory powers and penalties*'[191]. It should be noted, however, that, since the Code has generally been regarded as providing the appropriate means of resolving takeovers within a set timetable and with a degree of flexibility, its operation has tended to discourage participants from resorting to litigation[192]. The Panel's standing has been reinforced by the UK courts' decision not to interfere with Panel rulings during the course of a bid. Indeed, in *Datafin*, the court held

> '*In the light of the special adventure of the Panel, its functions, the market in which it is operating, the time scales which are inherent in that market and the need to safeguard the position of third parties, [...] all of whom are entitled to continue to trade upon the assumption of the validity of the Panel's rules and decisions, unless and until they are quashed by the court, [...] the relationship between the Panel and the court is historic rather than contemporaneous*'[193].

[188] Hereafter the AIM. The latter has been created in June 1995 and is a market for smaller, growing companies. The AIM has more than 700 companies, including 50 overseas issuers.
[189] *R v Panel on Takeovers and Mergers, Ex parte Datafin*, supra n 101, p. 586.
[190] R. R. Pennington (1996), supra n 73, p. 306.
[191] *R v Panel on Takeovers and Mergers, Ex parte Datafin*, supra n 101, p. 574.
[192] *M&A Litigation – Findings of a Survey About Litigation Trends in M&A Activity in the UK and Continental Europe* (2002), p. 2, available at http://www. herbertsmith.com/uploads/HSpdfs/ LitigationSurvey.pdf.
[193] *R v Panel on Takeovers and Mergers, Ex parte Datafin*, supra n 101, p. 579.

Thus, UK courts intervene, if at all, in retrospect by declaratory orders which would enable the Panel not to repeat any error and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules. The courts will intervene, however, where the Panel has made an error of law, or has failed to give persons accused of breaching the Code a fair hearing, or if its decision is one which no reasonably and appropriately experienced person could have reached[194].

The foregoing indicates that, whilst it is theoretically possible for the courts to review Panel rulings, there is virtually no litigation in the UK in the context of takeovers. Two caveats must be made in this regard, however. First, it should be noted that the new UK market abuse regime, which has been introduced in 2001, might increase the scope for litigation during bids[195]. This would be unfortunate, for takeovers remain an area where the advantages of self-regulation, particularly the absence of opportunities to use litigation for tactical reasons during the course of a bid, are still valued[196]. It should be noted, however, that the FSA will not exercise its powers under the market abuse regime during a takeover bid, save for exceptional circumstances, provided the Panel itself takes adequate action to deal with the misconduct in question. Furthermore, the FSA's Code of Market Conduct expressly provides specific examples of conduct permitted by the Code, with a view to providing a legal safe harbour for such conduct[197]. The FSA will also keep itself informed about the way the Panel interprets the Code, which is likely to minimise the scope for differences of view between the two regulators in relation to a particular conduct. Secondly, it should be noted that, although there has traditionally been a less appetite for litigation in the context of takeovers in the UK, a survey by the law firm Herbert Smith suggests that there is an increasingly litigious attitude being adopted in the UK[198]. Over two-thirds of their

[194] R. R. Pennington (1996), supra n 73, p. 306.
[195] *Public Takeovers in the UK* (2003), p. 2, available at http://www.freshfieldsbruckhausderinger. com/ practice/corporate/publications/ pdfs/6563. pdf.
[196] E. Ferran and C. A. E. Goodhart (2001), supra n 69, p. 8.
[197] These safe harbours apply in relation to behaviour likely to give rise to a false or misleading impression, and behaviour which would, or would be likely to, give rise to distortion, but not in relation to behaviour based on the misuse of information; see FSA, Code of Conduct 2004, s.1-7-5.
[198] Ibid, p. 2.

sample [199] said they were likely to consider invoking litigation or threat of litigation in a takeover situation in the next three to five years, though the great majority believed that merger and acquisition litigation as a feature of public transactions would remain less common than in the US[200].

1.3.2 France

The following is an overview of the French authorities which are likely become involved in a takeover.

i) Minister of the Economy

The State has lost its power to directly control the market, following the decision of the legislator to entrust the professionals a large part of the organisation and functioning of the markets[201]. However, the State still plays an important role in the supervision of financial markets through the Minister of the Economy. Though the latter has, since 1986, no right to oppose a takeover bid which has been approved by the AMF, the Minister still has power to approve the General Regulation of the AMF [202], and to designate a representative to attend the meetings of the Board of the AMF [203]. Moreover, the Minister ensures that takeover bids are compatible with the anti-trust regulations[204]. He does so by initiating review and approval proceedings upon notification by the parties[205]. It should be noted in this respect that the French competition law underwent a drastic change in 2001. Indeed, the Law of 2001 brought French law into line with the law of most MS, by establishing a mandatory notification procedure

[199] Their sample was 100 people who have major responsibility in the conduct of M&A deals in their respective companies. 86 companies came from the FTSE 250, including 46 from the FTSE 100.
[200] *M&A Litigation* (2002), supra n 192, p. 7.
[201] This occurred following the introduction of Law No. 88-70 of 22 January 1988.
[202] Code Monétaire et Financier, art. L. 622-7.
[203] This representative has the right to provoke a second deliberation within four days following the deliberation of the Board.
[204] Note that the reason for not examining the French antitrust authorities separately is because, as will be seen below, until recently, the French regulation did not permit the offeror to condition its offer to the receipt of satisfactory approvals by the competition authorities.
[205] Code of Commerce, art. L. 430-5(3).

by establishing a mandatory notification procedure where a transaction creates a concentration exceeding the turnover threshold stated in the 2001 Law[206].

ii) Bank of France

The Bank of France also plays an important role in the French financial landscape[207]. Indeed, a representative of the Bank is designated by the governor to sit on the Board of the AMF. In addition, the General Regulation of the AMF must be submitted to the Governor of the Bank of France for his/her opinion. More importantly for our purposes, a person who intends to take over a credit institution in France must inform the governor of the Bank of France eight days before the filing or the public announcement of his/her offer, whichever is sooner[208]. This requirement has been criticised as re-introducing the State's intervention into the French securities law. For instance, Marini (2001) argues that this requirement not only harms the competitiveness of France, but also jeopardises the confidentiality of such offers due to the time lag between the date when the governor is informed and the date when the offer is filed[209].

iii) Euronext-Paris SA

As seen above, Euronext is the market undertaking in France. It is in charge of suspending trading of the offeree's shares, and if appropriate, of the offeror's shares, upon request of the AMF, following the publication by the latter of the notice specifying the main terms of the offer. Euronext is further in charge of delivering the tendered shares, which were delivered to it by the offeree shareholders' market intermediaries, to a custodian selected by the offeror. At the same time, Euronext is responsible for transferring the offer price to the offeror's market intermediary, which subsequently transfers it to the sellers' market intermediaries. It should further be noted that, like the FSA, Euronext has a

[206] Code of Commerce, art. L. 430-3. Note that, prior to this reform, the French antitrust regime was based on a procedure of voluntary notification.
[207] H. Vauplane, M. Germain and J-P. Bornet (2001), supra n 129, p. 230.
[208] Code Monétaire et Financier, art. L. 511-10.
[209] P. Marini, (2001), supra n 146, p. 5.

number of sanctions at its disposal to force listed companies to comply with its rules. These include the suspension of all or some of a member's trading rights.

iv) Courts

Parties to an offer can challenge the individual decisions of the AMF relating to takeovers before the Paris Court of Appeal. Litigation is an increasingly common feature of hostile takeovers in France[210]. Indeed, a number of significant acquisitions recently carried out in France have all resulted in litigation. This has for instance been the case for BNP Paribas/Société Générale, and Kingfisher/Castorama. According to a survey by the law firm Herbert Smith, litigation is the most frequent means of defence in France against takeover bids[211]. The rationale underlying the latter is that the French legal approach is mainly comprised of general rules. This in turn leaves the Paris Court of Appeal with a significant role to play in the context of takeovers. As a result of the participation of the courts in the regulation of the market through their rulings[212], Bézard (1999) argues that the securities regulation cannot be understood without taking the judicial decisions into account[213].

Such challenges do not suspend the decision of the AMF, however, though the presiding magistrate of the Paris Court of Appeal may order a stay of execution where the decision is likely to have manifestly excessive consequences[214]. He will do so, for instance, where the immediate enforcement of the AMF's administrative sanction would prejudice the activities of the company[215]. The Court of Appeal may further reform or quash the decision of the AMF approving the offer document. It should be noted, however, that the Paris Court of Appeal

[210] The reason for this increase partly lies in the rise in recent years of the number of special shareholder groups created by the minority shareholders of listed companies, referred to as the 'associations'.
[211] *M&A Litigation* (2002), supra n 192, pp. 17-18.
[212] G. Canivet, 'Le Juge et l'Autorité de Marché' (1992) Rev. JP comm. 185, p. 198.
[213] P. Bézard, 'Actualités du Droit Boursier et des Marchés Financiers' (1999) 76 RD bancaire 203, p. 204.
[214] Code Monétaire et Financier, art. L. 621-30
[215] Prem. Pres. Paris, ord. 19 June 1991, RG:COB SAE 1/2001, *Caisse Centrale de Crédit Coopératif* (2001) 6 RD bancaire, p. 362.

has rarely obliged a bidder to revise the terms of its offer[216]. Likewise, it is very rare for the Paris Court of Appeal to quash an admissibility decision of the AMF. The Court only did so in the OCP[217] and the Schneider/Legrand cases[218]. In the former case, the Court did so on the grounds that the irrevocable covenants impeded the principle of fair competition embodied in the then COB Regulation No. 89-03. In the latter case, the Court quashed the admissibility decision of the AMF with respect to the offer of Schneider for the shares of Legrand, on the grounds that the AMF did not sufficiently control the method deployed by the offeror to determine the exchange rate. Following these decisions, the Court of Appeal rather restricted itself to the control of the grounds upon which the AMF delivers its decision, though such control is exercised vigorously[219].

The foregoing indicates that there is a close collaboration both in the UK and France between the market regulators, in spite of the fact that each of the latter maintains its separate identity, autonomous views and reactions[220].

Conclusion

As the foregoing indicates, both countries present a number of features which are unique to them: First, whereas the AMF is statutory, the Panel is non-statutory. Some in the UK have advocated that the existing framework should be replaced by a statutory regulation, whereby the FSA would also regulate takeovers. Such a system would be similar to that in France and in the US, whereby the AMF and the SEC respectively regulate all aspects of securities laws including takeovers. In particular, pressure from Europe, which relies more heavily on formal, statutory regulation, has been of considerable importance in promoting changes to UK's self-regulation[221].

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[216] *Public Takeovers in France* (2003), available at http://www.freshfields.com/practice/corporate/publications/pdfs/publictakeovers/france2003.pdf, p. 2.
[217] CA Paris, 27 April 1993, *Mutuelle du Mans Assurance-Vie et autres c/Sté OCP* (1994) JCP éd. E, p. 457.
[218] CA Paris, 1re ch., section H, 3 May 2001, *ADAM et autres c/ SA Schneider Electric SA et SA Legrand* (2001) JCP éd. E., No. 25, pp. 1046-1050.
[219] Ibid.
[220] Bulletin COB, No. 260, July-August 1992, pp. 8-9.
[221] R. Baggott, 'Regulatory Reform in Britain: The Changing Face of Self-Regulation' (1989) 67 Pub. Admin. 435, p. 448.

It should be noted, however, that, as seen above, some statutory elements have already been included in the UK's takeover regime. Indeed, the UK is no longer a 'haven for self-regulation', as Baggott (1989) once suggested[222]. This is evidenced by the fact that, although it retains its freedom to set and interpret its own rules, the Panel is tied in with the FSA on the sanctions front. It is therefore suggested that there is no real difference of nature between the Panel and the AMF on the sanctions front. However, this does not exclude the fact that the Panel still benefits from the advantages of self-regulation, such as the ability to respond quickly to changing circumstances. It is believed that, as long as the Panel succeeds in operating as it did to date, the likelihood for government intervention to bring an entirely statutory regime is unlikely in the UK.

Secondly, the AMF has considerable power, especially regarding price, in the context of takeover bids. Indeed, as seen above, the AMF has power to approve the price of offers in a substantive sense. If the AMF thinks the price is inadequate, it will likely refuse to approve the offer document, in which case the offeror will have to change the terms of its offer, if it wishes its offer to proceed. Thus, the market in France is not free from government interference. In contrast, the Panel has no authority whatsoever to approve the price of offers. The offer price in the UK is set by the offeror and its acceptance or rejection is left exclusively to the decision of offeree shareholders.

It should be noted in this respect that there is a debate amongst French legal scholars over the legitimacy of the AMF's power to control the price. Indeed, Baj (2001) criticises the AMF's role in the determination of the offer price, on the grounds that, since a public offer is a market operation, its price should be determined by the confrontation of buyers and sellers. In his view, an offer should fail if and only if its price is inadequate, rather than as a result of a decision by the AMF or the courts[223]. His view is shared by Viandier (1999) who argues that one of the *raisons d'être* of takeovers is to acquire control of a company at a price

[222] Ibid, p. 438.
[223] C. Baj, 'Offre Publique de Schneider sur Legrand: Réflexions sur l'Annulation de la Recevabilité de l'Offre par les Arrêts COB and CMF du 3 Mai 2001' (2001) RD bancaire et bourse 183, p. 187.

lower than its real value[224]. He therefore suggests that the offeror should be free to determine the offer price and the AMF or the courts should not interfere with its determination. As a response to the latter criticisms, Daigre (2002) argues, however, that the determination of the offer price cannot be left to the arbiter of the offeror, as this would harm the interests of the investors as well as the interest of the market, which in his view is a form of national interest and hence *'d'ordre public'*[225]. He therefore concludes that the offer price must be controlled in accordance with objective criteria, with a view to assessing whether it corresponds to the real value of the shares[226]. Likewise, Martel (2001) supports the interposition of the AMF between the offeror and the market to declare the admissibility of an offer. He argues that the admissibility decision by the AMF is vital for the sound operation of the market, as factors other than price are also taken into account in the admissibility process, such as the nature of the shares, the objectives and the agreements relating to the offer. He further argues that, in the absence of an admissibility decision by the AMF, offerors in France would resort to courts to launch offers, in which case it would be very difficult to control their length or their outcome[227].

It is suggested that the discretion of the AMF should be seen as a substitute for the absence of a number of minority protection rules under the French takeover regime. Indeed, as will be seen in the chapter on the principle of equality of shareholders and the protection of the minority under the French takeover regime, there is no rule in France which requires the offer price to be no less favourable than the highest price paid by the offeror for the acquisition of shares in the offeree company within the three-month period prior to the commencement of the offer period[228]. Likewise, there is no highest price requirement in France in the context of mandatory bids[229]. The intervention of the AMF is therefore believed to be necessary in the latter instances, in order to ensure equality of shareholders.

[224] A. Viandier, *OPA,OPE et Autres Offres Publiques* (Francis Lefevbre, 1999), p. 154.
[225] J-J. Daigre, 'Droit Boursier et des Marchés Financiers' (2002) 12 JCP éd. E 518, pp. 518-519.
[226] J-J. Daigre, 'Le Prix des Offres Publiques' (2002) 2 RD bancaire et bourse 55, p. 55.
[227] J. P. Martel, *La Protection des Investisseurs dans le Cadre des Offres Publiques* (2001), p. 3 available at http://www.amf-france.org/styles/ default/documents/general/3932_1.pdf.
[228] Code, r.6(1).
[229] For mandatory bids, see below.

In contrast, the UK takeover regime contains the above minority protection rules and therefore does not need the Panel's '*tutelle*'.

Third, as far as judicial challenges are concerned, there have been major efforts not to allow this in UK, at least in the course of a bid. Such efforts have been successful, since parties to a takeover usually do comply with the Panel's rulings. In contrast, courts play a greater role in France and this seems to cause no problems with the regulation of bids. Several reasons may lie behind the latter: First, unlike the Panel, the AMF is a regulatory body which is more representative of the Government than the marketplace. This is because a significant part of the AMF's members are appointed by the Government. As a result, unlike in the UK, companies may feel more at ease to challenge the AMF's decisions, as doing so would not make them liable in trouble with their own authority. Secondly, commercial litigation between merchants in France is held before a Tribunal of Commerce, which is a court specialised in commercial litigation. Although the magistrates of the Tribunal of Commerce are lay judges, they generally have good training in their respective fields. In smaller cities, these lay judges may not have significant legal training, but are well-known business people in the local community[230]. This indicates that litigants trust these magistrates' ability to try their case. This contrasts the way courts are viewed in the UK. Indeed, according to a survey by Herbert Smith, nearly a quarter of the respondents have responded that UK judges and courts are not very well equipped to deal with litigation in mergers and acquisitions cases[231].

[230] J. W. Polier, 'French-American Commercial Litigation' (2004), p. 1, available at http://www.paris-law.com/articles/Fench_comercial_litigation-en.htm
[231] *M&A Litigation* (2002), supra n 192, p. 11.

Chapter 2 The Ownership Structure of Listed Companies and the Market for Corporate Control in the UK and France

Introduction

The ownership structure of listed companies in a given jurisdiction plays an important role in devising the rules governing takeovers in that jurisdiction. By way of example, if a jurisdiction has a concentrated share ownership structure, the takeover rules therein will place more emphasis in solving the conflicts of interests between the controlling shareholders and their minority counterparts. Conversely, if a jurisdiction displays a dispersed share ownership structure, then the takeover rules therein will tend to focus more on the relationship between the offeror and the offeree management. On the other hand, the market for corporate control will be more developed in a country with a dispersed ownership structure and with a stock market containing a large number of listed companies than in a country with a concentrated ownership structure and a with a stock market containing a few number of listed companies. It is therefore believed that identifying the state of the capital markets and the ownership structure of listed companies in the UK and France is vital to comprehend the topics which are dealt with in the following chapters.

This chapter provides an overview of the main features of the capital markets and the ownership structure of listed companies in the UK and France, in terms of both the degree of concentration of share ownership and the identity of shareholders. This chapter also provides an insight into how the market for corporate control operates in these two jurisdictions. Section I examines the above issues in relation to the UK and Section II examines them in relation to France.

2.1 The UK

2.1.1 UK Capital Markets and Level of Concentration of Share Ownership

The UK market presents a number of features which are substantially different than the French market: First, the UK market is characterised by a large number of listed companies. Indeed, as of 2002, there were 1701 domestic companies listed in the UK. With the inclusion of foreign listed companies, the total number amounted to 2120[232]. The total capitalisation of domestic companies constitutes 184 per cent of GDP. In addition, the number of new listings is higher in the UK than in France. Indeed, only in 2002, 59 new companies were listed on the UK markets. With the inclusion of foreign listed companies, this figure amounted to 68. It is noteworthy in this respect that, on average, UK companies go public at a much earlier point in their life cycle. Indeed, the average age of companies at the time of their IPO is only 8 years in the UK[233]. The foregoing indicates that equity finance seems to be an important source of finance for UK companies and the UK market is therefore characterised as a market-based system[234].

Secondly, ownership and control are frequently traded in the UK, which ensures that UK capital markets are among the most liquid in the world. Indeed, as far as the level of concentration of share ownership is concerned, about 81 per cent of the largest 100 listed UK firms do not have any shareholder controlling more than 25 per cent of the voting equity[235]. In only 16 per cent of these firms a single shareholder owns more than 25 per cent of the shares[236]. Furthermore, full majority control in UK listed companies is rare, a mere 7 per cent[237]. It is not

[232] These figures are of October 2002; see http://www.londonstockexchange.com/cmsattach/1478.pdf.
[233] C. Mayer, 'Corporate Governance in the UK', Hume Papers on Public Policy (2000), p. 1.
[234] R. Cranston, 'The Rise and Rise of the Hostile Takeover' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), p. 92.
[235] Note that this figure dates from 1997; see J. Franks and C. Mayer, 'Corporate Ownership and Control in the UK, Germany, and France' in *Studies in International and Corporate Finance and Governance Systems* (1997), p. 283.
[236] Note that this figure dates from 1997; see ibid, p. 283.
[237] E. Wymeersch 'A Status Report on Corporate Governance Rules and Practices in Some Continental European States' in K. J. Hopt et al. (eds) *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford, New York:, New York: Clarendon Press, OUP, 1998), p. 1170.

precisely clear when the Berle-Means corporation has become dominant in the UK. Some suggest that, by the 1950s, the divorce of ownership and management had proceeded sufficiently to ensure that a wide range of listed companies were vulnerable to takeover bids. Chandler (1976) points to the 1970s, however, arguing that during the 1970s managerial enterprise rapidly replaced personal capitalism. To support his assertion, he cites hiring practices. Indeed, by the 1970s, only a small percentage of directors had family connections with important shareholders, which suggests that top executives were being selected primarily on the basis of their managerial qualifications[238]. It should be noted, however, that, as will be seen in more detail below, while most of listed firms in the UK have a dispersed ownership, shareholdings in the UK have become to a significant degree re-concentrated in recent decades in the hands of the institutions[239]. Indeed, a company's 20 largest institutional investors can be expected to own a majority of the shares[240].

2.1.2 Identity of Shareholders of Listed Companies

As far as the identity of shareholders of listed companies is concerned, the largest shareholders are institutions. Indeed, as of 1998, domestic and foreign institutions together owned 80 per cent of the UK equity market[241]. It should be noted in this respect that UK institutions no longer dominate the UK stock market. As of 1999, some 29.3 per cent of the stock market was owned by overseas investors, compared with 12.8 per cent a decade ago[242]. It should further be noted that, despite their aggregate large stake in the UK equity market, individual institutional investors in the UK seldom hold large percentage stakes in individual

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[238] A. D. Chandler, 'The Development of Modern Management Structure in the US and the UK' in L. Hannah (ed.), *Management Strategy and Business Development: An Historical and Comparative Study* (London: Macmillan, 1976), p. 46.
[239] P. L. Davies, 'Shareholder Value, Company Law, and Securities Markets Law: A British View' in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 271.
[240] B. Cheffins, 'Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 153.
[241] The breakdown of the institutions' shareholdings was as follows: insurance companies (23.5); pension funds (22.1); unit trusts, investment trusts and other institutions (10.6); and foreign investors (24); see G. Stapledon, 'Analysis and Data of Share Ownership and Control in UK' (1999), p. 3, Table 1, available at DTI website.
[242] 'The Institutional Investor Starts to Stir', *The Financial Times*, July 23, 2001.

companies[243]. This is so even though there are no legal constraints on their share ownership. The rationale behind this self-imposed limitation is that the institutions believe that large blocks of shares would render them illiquid[244].

The high level of institutional shareholding in UK listed companies can be illustrated by the ownership structure of Vodaphone, which possesses the ownership characteristics of a typical UK listed company. Indeed, more than 85 per cent of the shares in Vodaphone are held by banks or through nominee accounts. The beneficial owners are mostly institutional investors. The only significant shareholdings in the company are all owned by institutional investors and add up to 17 per cent of the equity. These are a 5.8 per cent holding by Mercury Asset Management Limited; a 5.1 per cent holding by Schroder Investment Management Limited; a 3.1 per cent holding by Legal and General Investment Management Limited; and a 3 per cent holding by Prudential Corporation group of companies. The sum of the shares beneficially held by the directors is 477,948 out of a total of 3.1 billion outstanding shares[245].

UK institutions mainly consist of occupational pension funds, insurance companies[246], unit trusts, and investment trusts. Amongst the latter, the growth of funded pension funds[247] has been spectacular. Indeed, in 1963, funded pension schemes held a mere 7 per cent of all UK equities. By 1993, their stake increased to 34.7 per cent[248]. Indeed, US and UK pension funds together represent about 72 per cent of total pension fund assets in the Western world[249]. A striking feature of

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[243] J. Charkham and A. Simpson, *Fair Shares: The Future of Shareholder Power and Responsibility* (OUP, 1999), p.140.
[244] J. C. Coffee, 'Liquidity Versus Control: The Institutional Investor as Corporate Monitor' (1991), 91 Col. L. Rev. 1277, p. 1310.
[245] M. Goergen and L. Renneboog, 'United Kingdom' in K. Gugler (ed.), *Corporate Governance and Economic Performance* (Oxford: OUP, 2001), pp. 184-186.
[246] These had £1.1 trillion worth of assets in 1999.
[247] These are either defined benefit schemes where the pension formula is defined in advance by the sponsor, independently of the contributions and asset returns; or defined-contribution schemes where contributions are fixed and benefits therefore depend solely on the returns on the assets of the fund. It should be noted that defined-benefit schemes are the most common in the UK; see B. Steil, *The European Equity Markets: The State of the Union and an Agenda for the Millennium* (London: Royal Institute of International Affairs, 1996), p. 186.
[248] M. Faccio and M. A. Lasfer, 'Institutional Shareholders and Corporate Governance: The Case of UK Pension Funds' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 605.
[249] *Corporate Governance in Europe,* Report of the Centre for European Policy Studies' Working Party (1995), p. v, available at ecgi website.

UK pensions funds is that they have been more heavily invested in equities than most foreign comparators. Between 1963 and 1998, pension funds achieved average annual returns of 12.1 per cent on their equity investments[250]. The rationale behind this investment strategy is three-fold: First, long-term assets such as equities are suitable investments for funded pension schemes, as the latter have long-term liabilities[251]. Secondly, pension funds are exempt from the capital gains tax. In addition, they can claim back a tax credit when they receive dividends[252]. This in turn is an incentive for them to invest in equities. Finally, strong historic equity returns appeared to have encouraged investors to keep their investments in equities, despite inflation having fallen over more recent years[253].

It is questionable, however, whether UK pension funds' penchant for equities will remain at this high level. Indeed, UK pension funds have cut their asset allocations in domestic equities to 43 per cent, from 47 per cent in 2001 and 49 per cent in 2000[254]. The reduced weightings have been partly shifted into fixed-income investments[255], with 23 per cent of fund assets being held in that asset class in 2002[256], compared with 21 per cent in 2001 and 19 per cent in 2000[257]. Some pension funds have even more than doubled their fixed-income holdings in the past three years[258]. The most radical change from equities to bonds has been made by Boots, which sold its equities investments and moved its £2.3 billion-worth of pension fund into triple-A rated bonds, over the years 2000-2002. Similarly, ICI, Philips, British Airways and Scottish Power have all raised their bond weightings by at least 10 percentage points during 2002. The reasons behind the shift from equity to fixed-income include the weakness of the equity market,

[250] *Institutional Investment in the UK: A Review* (March, 2001), p. 28, available at HM Treasury website. Hereafter the Myners Review.
[251] B. Steil (1996), supra n 247, p. 187.
[252] M. Faccio and M. A. Lasfer (2002), supra n 248, p. 605.
[253] *Institutional Investment in the UK* (2001), supra n 250, pp. 31-32.
[254] 'Pension Funds' Tumbling Equity Weightings', *Funds International*, November 30, 2002, available at Lexis-Nexis Executive.
[255] 'Pension Funds Shift to Bonds', *eFinancialNews.com*, January 5, 2003, available at Lexis-Nexis Executive.
[256] Within bonds, pension funds favour the corporate sector, which offers higher yields than the gilts market.
[257] 'Pension Funds' Tumbling Equity Weightings', supra n 254. Note that a similar picture can also bee seen in continental Europe where the proportion of equities in institutional portfolios has fallen from 36 per cent to 30 per cent since the end of 1999.
[258] 'Pension Funds Shun Equities for Bonds', *The Financial Times*, December 23, 2003.

which saw a drastic fall in the levels of return in 2001 and 2002[259]; the scandals of the past few years in the stock market; the introduction of a minimum funding requirement[260]; the introduction of a new accounting standard[261]; the fact that equities have become a riskier investment because of the rise of the proportion of retirees to members; and the desire of companies to lengthen the duration of their debt by relying less on bank loans[262]. It is noteworthy that the investment consultants anticipate that bonds will account for approximately 40 per cent of fund assets in the next five years. This means that £75 billion-worth of equity sales will likely be realised by pension schemes by 2007[263].

The next most significant holders are individuals, with an aggregate stake of 16 per cent[264]. It should be noted in this respect that, despite the significant decrease in ownership by individuals, the growth in institutional shareholdings represents an indirect growth in equity investment by individuals, as pensions and life insurance are merely a vehicle for long-term personal savings[265]. Other categories of shareholders are the corporate sector with 3 per cent; the government with 1 per cent[266]; and banks with 1 per cent. It should be noted in this respect that, unlike some continental economies and Japan, banks in the UK tend not to be significant shareholders in their own right[267], though they were to a significant degree involved in the business affairs of their clients in the inter-war years due to economic problems of the time[268]. Influenced by a strong bias in favour of liquidity, banks have dismissed the ownership of shares as an option, on the

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[259] According to Financial News' survey, the average return had fallen from 13.5 per cent to –2.2 per cent by 2002; see 'Pension Funds Shift to Bonds', supra n 255.

[260] Pensions Act 1995, ss.56-60.

[261] i.e. FRS17. The latter requires funds to match liabilities with assets every year in their financial statements to avoid shortfalls; see 'Pension Funds' Tumbling Equity Weightings', supra n 254.

[262] 'Fund Demand to Top Fixed-Income Supply: FRS17 Rule Fuels Shifts to Bonds', *European Fund Management*, March 11, 2002, available at Lexis-Nexis Executive.

[263] 'Credit Market: The Evolving Fixed Income Market', *Pensions Week*, May 6, 2002, available at Lexis-Nexis Executive.

[264] This figure is of 2000; see V. Grigorov, Y. Chen, O. Schneck and L. Barbier, 'Ownership Structure and Minority Shareholder Rights', (2000), p. 4, available at www.fek.lu.se/grundutb/bredd/ corgovern/A1.ppt.

[265] H. Short and K. Keasey, 'Institutional Shareholders and Corporate Governance in the United Kingdom' in Keasey, Thompson and Wright (eds), *Corporate Governance: Economic and Financial Issues* (OUP, 1997), p. 20.

[266] These figures are of 2000; see ibid.

[267] *Institutional Investment in the UK* (2001), supra n 250, p. 38.

[268] F. Capie and M. Collins, *Have the Banks Failed British Industry?: An Historical Survey of Bank-Industry Relations in Britain, 1870 -1990* (London, 1992), p. 45.

grounds of poor marketability and high risk[269]. It is interesting to note that banks did so even though they were and still are free to own shares[270]. This is in contrast to the US, which passed laws that deterred big financial institutions from taking a close interest in the governance of industrial and commercial enterprises, with a view to ensuring a widely dispersed share ownership pattern in US markets. It should be noted, however, that most large UK banks have fund management arms which manage equities on behalf of pension funds and other institutions. However, the shares beneficially owned by banks are few and are mostly the result of debt-for-equity swaps[271].

2.1.3 Operation of the Market for Corporate Control

The UK is the only European jurisdiction with an active market for corporate control. Indeed, there are currently around 230 takeovers of publicly listed companies per annum in the UK[272]. Since January 2000, there have been twenty-one unsolicited bids for UK listed companies, which, at least initially, were not recommended[273]. It is interesting to note in this respect that, in the first half of the twentieth century, there were no hostile takeovers in the UK. Indeed, as Franks, Mayer and Rossi (2004) note, all mergers were the result of an agreement between the two or more boards of the merging companies. Mergers were thus the result of co-operation rather than competition between companies for a target in an auction market[274]. However, over the years, about 8 to 10 per cent of listed companies have been involved as targets of a takeover that was effectively published. If one adds the number of transactions that have not materialised or were not published, then the relationship to all listed companies increases to about

[269] J. Armour, B. R. Cheffins and D. A. Skeel, 'Corporate Ownership Structure and the Evolution of Bankruptcy Law in the US and UK' (2002), pp. 15-16, available at http://www.cbr.cam.ac.uk/pdf/WP226.pdf.
[270] Note that the same reasoning was behind the insurance companies' then reluctance to play an active role in the governance of industrial and commercial enterprises.
[271] G. P. Stapledon and J. J. Bates, 'Reducing the Costs of Proxy Voting' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 571.
[272] C. Mayer (2000), supra n 233, p. 7.
[273] W. Underhill and A. Austmann, 'Defence Tactics' in J. Payne (ed.), *Takeovers in English and German Law* (Oxford: Hart, 2002), p. 87.
[274] J. Franks, C. Mayer and S. Rossi, 'Spending Less Time with the Family: The Decline of Family Ownership in the UK' (2004) p. 4, available at SSRN.

15 per cent to 20 per cent[275]. This demonstrates that markets – and not the majority shareholder - decide a control contest in the UK.

The easiness with which potential offerors can mount hostile bids in the UK mainly lies in the high dispersion of share ownership in UK listed companies. Another major factor is that the institutions have managed to deter managers from taking pre-bid defences which are likely to harm their pecuniary interests. By way of example, it is the institutions which further restricted listed companies' ability to issue shares without pre-emption rights. Indeed, as will be seen in the chapter on the regulation of defensive measures in the UK, the pre-emption guidelines issued by the Pre-emption Group restrain companies' ability to dis-apply such rights. Although the guidelines do not have the force of law, virtually all UK public companies comply with them[276]. This is because the institutions threaten companies which fail to abide by the guidelines that they will vote down resolutions proposed by the directors[277]. This is a very strong threat for companies given the significant voting power that institutional shareholders have through their large shareholdings. Indeed, the least popular resolutions proposed by the board are those seeking authority to issue shares without pre-emption rights[278]. The power of deterrence of the institutions further stems from the fact that, if listed companies take pre-bid defences which are likely to deter value-enhancing offers, the institutions would then sell their shares and cause the company's share price to plunge to considerable low levels.

Other types of pre-bid defences have also been subject to the institutions' intervention. For instance, as will be seen in more detail in the following chapter, the Association of British Insurers[279] has issued informal guidelines with respect to share buy-backs, with a view to protecting the interests of shareholders[280]. Likewise, the Listing Rules' requirement that listed companies seek prior approval of their shareholders in general meeting where they decide to carry out

[275] E. Wymeersch (1998), supra n 237, pp. 1190-1191.
[276] G. Knighton, 'Shareholder Activism' (2001) 12 P.L.C., p. 38.
[277] Ibid, p. 36.
[278] J. Charkham and A. Simpson (1999), supra n 243, p. 139.
[279] Hereafter the ABI.
[280] *Own Purchase of Shares* (August, 1993), available at http://www.ivis.co.uk/pages/framegu.html.

significant transactions[281] results from the representations that the ABI had made to the Stock Exchange. It should be noted in this respect that the UK is the only European jurisdiction that enhances shareholders' rights by requiring issuers to put proposed major transactions to a shareholder vote. Recently, upon proposals to abolish this requirement, the Listing Review has highlighted the importance of the shareholder vote on such transactions, by stating that '*the threat that shareholders could vote down undesired transactions forces companies to examine all such proposals in terms of their impact on shareholders*' [282]. Similarly, it is due to institutional pressure that several companies had enfranchised their non-voting shares during 1992-1994.

It should be noted, however, that, despite the foregoing, voting by some institutions is mediocre [283] and there is no legal obligation for institutional shareholders to vote[284]. In particular, pension funds do not always vote at the annual general meetings. The same does not hold true, however, for insurance companies. Indeed, in 1996, 87 per cent of insurance companies exercised their voting rights whilst only 59 per cent of pension funds did so[285]. The rationale behind the low level of voting by pension funds partly lies in the way pension funds' assets are managed. Indeed, most pension funds employ external fund-management firms to undertake the investment of their funds[286], rather than managing the funds themselves. In other words, it is fund managers - rather than the pension fund trustees - who interact with the management of companies in which shares are held. As of 1993, 78 per cent of directly invested UK pension funds employed external fund-management firms. Only 14 per cent managed their investments wholly 'in-house', and 8 per cent used both external and internal

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[281] Listing Rules, Ch.10.

[282] *Review of the Listing* Regime, CP No. 203 (October, 2003), pp. 50-51, available at FSA website.

[283] In 2000, only 48 per cent of the votes were registered for AGMs, well below the government's unofficial target of 60 per cent; see 'The Institutional Investor Starts to Stir', supra n 242.

[284] See, however, Combined Code, Principle E.1 (as introduced in July 2003) which states that contracts entered into between institutional shareholders and fund managers should reflect the principles embodied in 'The Responsibilities of Institutional Shareholders in the UK', issued by the Institutional Shareholders' Committee.

[285] R. Crespi-Cladera and L. Renneboog, 'United We Stand: Corporate Monitoring by Shareholder Coalitions in the UK' (2000), p. 6, available at SSRN.

[286] Note, however, that the government plans to push through legislation that will force pension funds to raise the level of expertise of their lay trustees, following criticism that trustees have become overly reliant on the advice they receive from fund managers and investment consultants; see 'Pension Fund Trustees' Role is Facing Overhaul', *The Financial Times Weekly Review of the Investment Industry*, March 15, 2004.

managers[287]. These external managers are usually the investment-management arms of financial conglomerates, though the fund-management arms of some insurance companies are also prominent. The problem with externally managed funds is that there are likely to be conflicts of interest between the fund management and other arms of financial conglomerates, which are likely to deter the fund managers from actively involving in the management of companies in which shares are held. By contrast, internally managed occupational pension funds[288] do not have such conflicts. Furthermore, internally managed pension funds have a stronger incentive to monitor. For their objective is to maximise the value of funds under management in order to minimise the company's contributions and, possibly, use any pension fund surplus to inflate the company's profits[289]. The foregoing is line with Guercio and Hawkins' (1999) argument that the level of monitoring by pension funds depends significantly on the way their assets are managed[290].

The reluctance of external fund managers to intervene in companies where they legally own substantial shareholdings, even when this would be in their clients' financial interests, was recently underlined in the Myners Review[291]. The latter underlined the value lost to institutional investors through the reluctance of fund managers to actively engage with companies in which they have holdings, even where they have strong reservations about a company's strategy, personnel or other causes of corporate underperformance. As a result, it recommended that all pension fund trustees should incorporate, into the fund management mandates, the 1994 guidance of the Employee Retirement Income Security Act[292]. The latter articulates the duties of fund managers to intervene in companies – by voting or otherwise – where there is a reasonable expectation that doing so might raise the value of the investment. In line with the recommendations of the Myners Review, the Government is currently proposing to impose, on all those involved in pension

[287] Note that, unlike pension funds, insurance companies' funds are managed by investment-management subsidiaries of the various insurers.
[288] e.g. Hermes is owned by, and is the principal fund manager for, the UK's largest pension scheme, namely the BT plc.
[289] H. Short and K. Keasey (1997), supra n 265, p. 27.
[290] D. D.Guercio and J. Hawkins, 'The Motivation and Impact of Pension Fund Activism' (1999) 52 J. Fin. Econ. 293, p. 301.
[291] See supra n 250.
[292] This is to be found in Department of Labor Interpretative Bulletin 94-2.

fund management[293], a statutory duty to use shareholders' powers to intervene in investee companies where this is in a pension scheme's best interests[294]. The problem with such proposal is that, even if fund managers regularly intervene in investee companies, it will be relatively difficult to monitor whether the institutions voted after due consideration of the issues involved[295]. The latter problem is also reflected by the European Commission, which argues that, due to a lack of time or resources, institutional investors might simply vote in favour of any proposed resolution to fulfil such requirement[296]. The Commission therefore believes that it would be undesirable to require institutional investors to systematically exercise their voting rights

It should be added that the CLR proposed in its final report that institutional investors should disclose to their clients on demand the manner in which they have exercised their discretion in voting and on takeovers, with an appropriate explanation, and that the Secretary of State should have power to require institutional investors to publish such information[297]. The government refused to implement the CLR's proposal, however, on the grounds that there might be practical difficulties in carrying it out through company legislation[298]. The CLR further proposed to change s.360 of the CA to enable the investors behind the nominees to exercise their voting rights directly[299]. The rationale behind such proposal is that, to an increasing extent, the beneficial owners are hidden behind nominees, who are registered in the share register on behalf of their clients. The problem with such nominees is that they have no incentive to use their powers since any advantage from doing so would accrue to the beneficial owners[300]. The problem worsened since the introduction of Crest in 1996, a new computerised

[293] It should be noted that, whilst the Myners' Review proposed that the new duty should apply only to fund managers, the Government is minded that the duty should also apply to trustees.
[294] *Encouraging Shareholder Activism: A Consultation Document* (February, 2002), pp. 6-7, available at DWP website.
[295] P. L. Davies, 'The United Kingdom' in Baums and Wymeersch (eds) *Shareholder Voting Rights and Practices in Europe and the United States* (London: Kluwer Law International, 1999), p. 339.
[296] *Modernising Company Law in the European Union - A Plan to Move Forward*, Cm 5553 (July, 2002), p. 13, available at DTI website.
[297] *Modern Company Law for a Competitive Economy: Final Report* (July, 2001), p. 148, available at DTI website.
[298] *Modernising Company Law* (2002), supra n 296, p. 25,
[299] *Modern Company Law* (2001), supra n 297, p.153.
[300] R. C. Nolan, 'Indirect Investors: A Greater Say in the Company?', 3CL/CBR Conference, Faculty of Law, University of Cambridge, *Using Law to Promote Competitiveness and Enterprise: Will Corporate Law Deliver?*, July 4, 2002, pp. 2-3.

system for settling purchases and sales of shares[301]. Indeed, members of Crest can hold their shares through a nominee account, rather than registering them in their name. The government has agreed with the Review on this issue and has decided to amend the law so as to make it clear that companies are able to recognise, if they wish, the rights of the beneficial owners, at the request of the registered shareholder[302].

2.2 France

2.2.1 French Capital Markets and Level of Concentration of Share `Ownership

Unlike the UK market, the French stock market[303] is usually characterised as a market with a few listed companies and a high level of concentration of ownership due to significant family ownership[304]. Indeed, the French market is an illiquid market where ownership and control are infrequently traded, where there are complex systems of intercorporate holdings[305], and where there are many holding-company structures controlling large industrial groups[306]. The French market is further defined as a hybrid system between a 'relationship banking' financial system found in some continental jurisdictions and a 'market-based' financial system found in Anglo-Saxon jurisdictions[307].

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[301] J. W. Winter, 'Cross-Border Voting in Europe' in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 394. Thus, the Crest has replaced the old paper-based process of settling share deals, known as the 'Talisman' system.
[302] *Modernising Company Law* (2002), supra n 296, p. 23.
[303] The Paris Stock Exchange is composed of three regulated markets: the Premier Marché, the Second Marché and the Nouveau Marché. A non-regulated market, referred to as the Marché-Libre, has also been established in 1996, which replaced the previous Hors-Cote.
[304] L. Renneboog, 'Shareholding Concentration and Pyramidal Ownership Structures in Belgium: Stylized Facts' (1996), p. 5, available at SSRN.
[305] Ibid, p. 5. Such intercorporate holdings are present, *inter alia*, between Alcatel and Générale des Eaux; Havas and Canal Plus; Paribas and AXA-UAP; see F. Morin, 'A Transformation in the French Model of Shareholding and Management' (2000) 29 Economy and Society 36, p. 39.
[306] A. E. Murphy, 'Corporate Ownership in France: The Importance of History' (2004), p. 5, available at http://www.nber.org/books/corp-owner03/murphy11-6-03.pdf.
[307] E. Davis, 'The Development of Pension Funds: An Approaching Financial Revolution for Continental Europe' in R. O'Brian (ed.), *Finance and the International Economy* (Oxford: OUP, 1993), p. 126. Note that, until the mid-1980s, the capital structure of French firms, compared to other countries, was heavily biased towards bank financing; see E. Bertero, 'The Banking System, Financial Markets, and Capital Structure: Some New Evidence from France' (1994) 10 Oxf. Rev. Econ. Policy 68, p. 69.

As far as the state of the French stock market is concerned, it should be noted that, prior to the second half of the twentieth century, the French policy tended to undermine stock markets. This was because left-wing politicians had little sympathy with capitalism, stock markets and securities institutions[308]. As a result, the French industry had not significantly raised funds on the stock market. It is only in 1978, when the then Minister of the Economy had introduced a tax rebate in favour of tax payers buying equities of French companies, that financing by public issues of equity became more important[309]. Indeed, during the second half of 1978, 850,000 taxpayers bought new equities and about half the total of investors came to the stock market for the first time[310]. The market capitalisation of listed companies grew by 105.3 per cent during 1975-1999[311] and the number of IPOs increased by 131.2 per cent during 1990-1999[312]. The latter developments, coupled with the creation of Euronext, have served to accelerate the growth of the Paris stock exchange. The latter currently ranks first in the euro zone in terms of the market capitalisation of listed firms and comes second only to London as the most active European stock market in terms of the number of companies listed. Indeed, the aggregate number of domestic companies listed on all three regulated markets is 737. With the inclusion of foreign listed companies, the total number amounts to 874[313]. There has been a decline, however, in the number of new listings. Indeed, only 11 new companies were listed on the French regulated markets in 2002, as opposed to 29 in 2001[314].

As far as the level of concentration of share ownership is concerned, the concentration of direct ownership and voting power is very high in France for listed companies, even for the CAC 40 companies, which constitute the *crème de*

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308 M. J. Roe, 'Political Foundations for Separating Ownership from Control' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 126.
309 This tax rebate was introduced by the Law Monory, which allowed investors to deduct their investments in shares from taxable income.
310 P. Stonham, *Major Stock Markets in Europe* (Aldershot: Gower, 1982), p. 85.
311 C. Van der Elst, 'The Equity Markets, Ownership Structures and Control: Towards and International Harmonisation?' (2000), available at http://www.econ- pol.unisi.it/scdbanc/ CONFERENZA/FILE_PDF/1-1VanderElst.pdf, p. 8, Table 6.
312 It should be noted in this respect that, during the nineties, the equity market of France grew much more than that of the UK; see ibid, p. 8.
313 These figures are of December 2002; see http://www.bourse-de- paris.fr/stat/telecharge/ asa20031128.pdf.
314 2 have been listed on the Premier Marché, 7 on the Second Marché, and 2 on the Nouveau Marché; see COB, *Présentation du 35ème Rapport Annuel de la COB*, March 14, 2003.

la crème of the French economy[315]. It should be noted, however, that the degree of concentration of share ownership presents a different picture depending on the market on which the shares are traded. As of 1995, 184 companies were listed on the *Premier Marché* and the percentage of not majority-controlled companies therein amounted to a mere 36.96 per cent[316]. Indeed, the three most important shareholders dominated 53.8 per cent of companies listed on the *Premier Marché*[317], and in only 5 out of these 184 companies could one find a concentration of less than 10 per cent for the three largest shareholders[318]. On the other hand, 203 companies were listed on the *Second Marché* and 67.5 per cent of them were fully controlled by the main reporting shareholder[319]. The aggregate holding of the three most important shareholders for the *Premier* and the *Second Marchés* amounted to 71.58 per cent of companies listed on these two markets. In only 7 out of 387 companies listed on these two markets could one find a concentration of less than 10 per cent for the three largest shareholders.

Several factors lie behind the concentrated ownership of the French market. First, the reason underlying the relatively small size of the French stock market and the concentrated ownership in French firms may be the absence of strong investor protection in the laws and regulations of France[320]. Indeed, La Porta, Lopez-de-Silanes and Shleifer (1998) argue that, in countries with good shareholder protection, where expropriation of the minority is limited by law, investors pay higher prices for their shares, which induces controlling shareholders to reduce their stakes[321]. This in turn results in a more dispersed ownership of listed firms[322]. Secondly, historical reasons may lie behind the concentrated nature of share ownership in listed firms. Indeed, Murphy (2003) emphasises the importance of history in the evolution of France's corporate ownership structure, though he admits the existence of other variables that help explain the high degree of

315 L. Bloch and E. Kremp (2001), supra n 138, p. 123.
316 E. Wymeersch (1998), supra n 237, pp. 1157-1158.
317 Ibid, p. 1158.
318 Ibid, p. 1158.
319 Ibid, pp. 1157-1158.
320 R. La Porta, F. Lopez-de-Silanes, A. Shleifer (1998), supra n 41, p. 29.
321 Ibid, p. 29.
322 Note, however, that Franks, Mayer and Rossi refute this argument by pointing out that this has not been the case in the UK. In their view, for most of the first century of company law, minority shareholders in the UK were virtually defenceless; see J. Franks, C. Mayer and S. Rossi, 'The Origination and Evolution of Ownership and Control' (2003), p. 12, available at SSRN.

concentration of corporate ownership by families in France[323]. He argues that in France, over the last three hundred years, historical factors have produced a weak capital and banking structure. These weaknesses led to a reliance on significant self-financing, which in turn resulted in the strengthening of the concentration of ownership in the hands of individuals and families[324]. As a result, his argument goes, it is not surprising to see French families owning such a large proportion of French companies[325].

2.2.2 Identity of Shareholders of Listed Companies

As far as the identity of listed companies' shareholders is concerned, the breakdown of shareholding is as follows: foreign investors 36 per cent; financial sector 27 per cent; corporate sector[326] 18 per cent; individuals 11 per cent; and the State 6[327] per cent[328]. Thus, foreign institutions constitute the largest category of shareholders in France. In 1998, US and British funds together represented over 10 per cent of the market capitalisation of the Paris stock exchange[329]. To give an example, the US investment fund Templeton Global Investors invested FF7.9 billion of its assets in equities of companies listed in France. Likewise, CalPERS (US) invested FF7.2 billion, Commercial Union (UK) FF6 billion, and Fidelity (US) FF5.3 billion of their assets in equities of companies listed in France. More importantly, foreign investors hold over 40 per cent of the capital of about ten largest French companies, such as Accor and Péchiney[330]. In TotalFina, foreign shareholders own more than 75 per cent of the shares[331]. Thus, the French stock

[323] A. E. Murphy (2004), supra n 306, p. 2.
[324] Ibid, p. 3.
[325] Ibid, p. 32.
[326] i. e. non-financial companies.
[327] Note that this figure is of 1990; see C. Van Der Elst, (2000), supra n 311, p. 24.
[328] Ibid, pp. 23-28. It should be noted, however, that establishing accurately the identity of shareholders is difficult since only a few studies have been undertaken. This task is exacerbated by the fact that pyramiding and other arrangements separating capital contribution and control further complicate the interpretation of data; see B. Steil (1996), supra n 246, pp. 151-152.
[329] *Les Critères d'Investissement des Grands Gestionnaires de Fonds Internationaux dans les Entreprises Françaises* (1998) 322 Bull. COB 1, p. 10.
[330] Ibid, p. 1.
[331] C. Van Der Elst (2000), supra n 311, p. 28.

exchange depends heavily on foreign investors[332]. The evolutions, which have contributed in making the French market attractive to foreign investors, have been the under-valuation of the French stock exchange as compared with other foreign exchanges; the privatisations; and the adoption by the privatised companies of techniques highly appreciated by Anglo-Saxon investors, such as the refocusing on core activities and the reduction of costs[333]. The AMF suggests that the increasing presence of foreign investors is likely to change the ownership structure of French companies, in that foreign shareholders will substitute the traditional controlling shareholder in listed companies, be it another French company, an individual, or the State[334].

As far as French institutions are concerned, these consist of pension funds, insurance companies, and the unit and investment trusts. However, French pension funds are currently of minor importance in France. This is because most people in France do not have private funded pensions[335], and the few who do are mainly at executive level. Indeed, the vast majority of people rely on the state PAYG system, whereby contributions taken in are paid out straight away to fund the benefits of those already retired. The rationale behind the large reliance on the PAYG system is that relatively underdeveloped capital markets made unfunded schemes attractive in the initial postwar period. Over the years, the French remained attached to the concept of social solidarity, which underlies their pensions system[336]. The most direct implication for corporate governance of the maintenance of a largely unfunded regime has been the absence of substantial holdings of equity shares by institutional investors of the kind which have developed in most funded regimes[337]. The relative absence of private funded pensions further explains the greater presence of foreign institutions in French listed companies, as compared with domestic institutions. The insignificance of

[332] H. Sherman 'Corporate Governance Changes Make Inroads in Europe' in D. H. Chew (ed.), *Studies in International Corporate Finance and Governance Systems: A Comparison of the US, Japan, and Europe* (Oxford; New York: OUP, 1997), p. 347.
[333] *Les Critères d'Investissement* (1998), supra n 329, p. 8.
[334] Ibid, pp. 20-21.
[335] Indeed, as of 1996, less than 10 per cent of the workforce was covered by a privately funded pension scheme, as opposed to 75 per cent in the UK.
[336] 'Ageing World Upsets Calculations', *The Financial Times*, May 12, 2000.
[337] T. Hadden, 'Corporate Governance by Institutional Investors?: Some Problems From an International Perspective' in T. Baums, R. M. Buxbaum and K. J. Hopt (eds), *Institutional Investors and Corporate Governance* (Berlin: W. de Gruyter, 1994), p. 96.

pension funds in France also stems from the fact that France places limits on pension funds by asset type. Indeed, pension funds in France cannot invest more than 65 per cent of their assets in listed equities[338]. Indeed, whereas UK pension funds invested 77.6 per cent of their assets in equities and only 13.9 per cent in fixed income in 1995, French pension funds invested a mere 13.6 per cent in equities and 38 per cent in fixed income the same year[339]. These restrictions do bear a negative impact upon the growth of French pension funds[340].

There is, however, a pressure in France to shift to a private funded pension system due to the sharp future increase in the proportion of the elderly[341]. Indeed, persons over 60 years-old will by 2040 represent 48.3 per cent of the population[342]. This means a dramatic increase in the ratio of elderly people to working population, with a predicted dependency ratio for 2030 of 39 per cent[343]. Without action, France would experience considerable annual deficits, which have been projected to reach more than €46 million a year by 2020[344]. The reason behind the lack of reform thus far has been the inability or reluctance of politicians to undertake significant reform. In 1995, the centre-right government of Alain Juppé attempted to introduce a law on private pension funds[345]. This law would have introduced defined contribution personal pensions, which would have supplemented the existing pension arrangements[346], namely the state-managed and the employer-managed pensions. Both the latter are mandatory and operate on a PAYG basis. The socialist government which took power in 1997 never issued the application decree, however, which was necessary for the enactment of the law[347]. Following

338 *Survey of Investment Regulation of Pension Funds* (May, 2001), p. 4, Table 1, available at OECD website.
339 K. De Ryck, 'Asset Allocation, Financial Market Behaviour and Impact of EU Pension Funds on European Capital Markets' in *Institutional Investors in the New Financial Landscape*, OECD Proceedings, 1998, p. 270, Table 4.
340 E. P. Davis, 'Regulation of Pension Fund Assets' in *Institutional Investors in the New Financial Landscape*, OECD Proceedings, 1998, p. 372.
341 E. Davis (1993), supra n 307, p. 109.
342 'Et Si les Fonds de Pension Avaient Existé?', *L'Expansion*, October 26, 2000.
343 M. Rhodes and D. Natali, 'Welfare Regimes and Pension Reform Agendas', Conference on Pension Reform in Europe: Shared Problems, Sharing Solutions, LSE, December 5, 2003, p. 5.
344 'Political Weight Behind Reform', *European Pensions and Investments News*, March 12, 2002, available at Lexis-Nexis Executive.
345 Law Thomas of 25 mars 1997.
346 'France Economy: Government's Intentions on Pension Funds are Unclear', *EIU ViewsWire*, December 19, 2002, available at Lexis-Nexis Executive.
347 Note that the law was eventually repealed in 2001.

elections in 2002, the new centre-right government, which defeated the socialists[348], reverted to the policies of the Juppé government. Indeed, the Prime Minister Jean-Pierre Raffarin, claiming that the pensions issue was '*about the survival of the republic*', decided to extend the Juppé reform to the public sector, despite extensive protests by public-sector workers[349]. The current reform introduces funded occupational and personal pensions that will operate on a voluntary basis. In addition, it establishes a link between the level of pension and the average life expectancy of the population. As a result, the years of contributions required to have a full pension will rise from between 37 and 40 years at present to 41 years by 2012[350].

As far as French insurance companies are concerned, as in the case of pension funds, the size of their assets remains small. This is because restrictions similar to those applied to pension funds are applied to insurance companies. Indeed, these cannot invest more than 65 per cent of their assets in equities and cannot hold more than 5 per cent of the securities of a single issuer[351]. However, the major French insurance companies - led by AXA and AGF - are quite powerful, especially as they tend to concentrate their holdings. As of 1994, the two companies together held between 3 and 10 per cent of twenty companies[352]. As far as French unit and investment trusts[353] are concerned, France currently ranks first in Europe and second in the world behind the US for the size of its collective investment management, which amounts to about $500 billion[354]. Despite the latter, however, French unit and investment trusts invest in equities a far lower share of their assets than their counterparts elsewhere in the OECD area[355]. This is because French unit and investment trusts cannot invest more than 5 per cent of

[348] Note that the socialists were defeated because of their attempt to extend the pension reform, which initially only covered the private sector, to the public sector, which constitutes about one-fifth of the workforce.
[349] 'The Crumbling Pillars of Old Age', *The Economist*, September 27, 2003.
[350] *European Pension Reform and Private Pensions: An Analysis of the EU's Six Largest Countries* (May, 2004) p. 6, available at ABI website.
[351] Codes des Assurances, art. R332-3, as amended by Decree No. 2000-142 of February 18, 2000.
[352] J. P. Charkham, 'France' in *Keeping Good Company: A Study of Corporate Governance in Five Countries* (OUP, 1994), pp. 145-146.
[353] i. e. the OPCVM.
[354] *Création de Valeur Actionnariale et Communication Financière*, Bull. COB, No. 346 (June, 2000), pp. 43-44, available at AMF website.
[355] A. Goldstein, 'Privatizations and Corporate Governance in France' (1996) 199 Banca Naz. Lav. Quart. R. 455, p. 474.

their assets in equities of a single issuer and cannot hold more than 10 per cent of the equities of a single issuer[356].

As far as banks are concerned, these have some large minority shareholdings in listed companies. Most industrial companies like having banks as shareholders and often approach them to take an equity stake. Companies see it as an insurance policy for protection against takeovers whilst the banks see it as a way of cementing a banking relationship[357]. Despite the latter, French banks face high legal obstacles to acquire equity stakes in non-financial enterprises[358]. Indeed, banks can only own up to 10 per cent of a single non-financial enterprise. In addition, their stake must not result in the exercise of a 'notable influence'. Furthermore, their stake in a single enterprise must not exceed 15 per cent of their own capital, and their total stake must not exceed 60 per cent of their own capital. Moreover, the total annual turnover from non-banking activities must not exceed 10 per cent of net banking revenue[359]. It should be added that there is an increasing closeness of banks and insurance companies due to the marketing of insurance products through banks and the provision of loans and guarantees by insurance companies. Some banks have even bought insurance subsidiaries, such as Suez buying Victoria[360]. This is a matter of considerable interest not only to the parties concerned but also to the French prudential authorities.

As far as the corporate sector is concerned, their 21 per cent level of ownership is not surprising since, as will be seen in the chapter on the regulation of defensive measures in France, cross shareholdings are an integral feature of French listed companies. Individuals are the third most important category of owners. It should be noted in this respect that the French government has successfully attempted to increase individuals' stake in listed companies, by introducing strong tax subsidies and by carrying out large-scale privatisations. Indeed, one of the goals of the privatisations between 1986-1988 was to promote 'people's capitalism',

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[356] Y. Guyon, 'Les Investisseurs Institutionnels en Droit Français' in T. Baums, R. M. Buxbaum, and K. J. Hopt (eds), *Institutional Investors and Corporate Governance* (Berlin: W. de Gruyter, 1994), p. 388.
[357] J. P. Charkham (1994), supra n 352, pp. 145-146.
[358] A. Goldstein (1996), supra n 355, p. 476.
[359] Ibid, p. 477, Table 5.
[360] J. P. Charkham (1994), supra n 352, pp. 126-128.

and these contributed to increasing the number of French shareholders from 1.7 million in 1982 to 6.2 million in 1987[361]. However, the initial dispersion of shares has been reduced considerably by subsequent trading. Indeed, the holdings of individuals have reduced from 37.6 per cent in 1990 to 11.1 per cent in 1998[362]. Furthermore, as in the UK, individual ownership is declining in favour of indirect ownership through the institutions[363].

As far as the State is concerned, the French State sees itself as having a protective role, and its influence is by no means restricted to cases which 'endanger public order, health or national defence'. Indeed, '*the French administration, from Sully to Colbert, from Laffemas to Turgot and Necker, has always been interventionist*' [364]. In particular after the Second World War, there was widespread support for a corporatist system in which the government would play a strong direct role in the affairs of large business firms, with a view to avoiding the deficiencies of the market[365]. The Constitution of 1946 reflected the latter view by allowing the State to take over companies where doing so would promote the interests of the national community. Following the Second World War, more than 300 companies were taken over by the State under the latter provision[366]. The state ownership has been reduced, however, when Jacques Chirac came to power in 1986[367]. Indeed, his conservative government disposed of the State's holdings in a number of large banks and non-financial enterprises. Under his two-year premiership, 31 banks and financial and non-financial enterprises have been privatised[368]. These included Agence Havas, Cie Générale d'Electricité, Cie de Saint-Gobain, Société Matra, Société Générale, Cie financière du CCF, Cie financière Paribas, Cie financière de Suez[369].

[361] A. Goldstein (1996), supra n 355, p. 463.
[362] A. E. Murphy (2004), supra n 306, p. 33.
[363] Y. Guyon (1994), supra n 356, p. 386.
[364] A. Hamdouch, *L'Etat d'Influence, Nationalisations et Privatisations en France* (Presses du CNRS, 1989), pp. 31-32.
[365] H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 Geo. L. J. 439, p. 446.
[366] The preamble of the 1946 Constitution was subsequently incorporated into the current Constitution; see B. Mojuyé, 'French Corporate Governance in the New Millenium: Who Watches the Board in Corporate France?' (2000) 6 Col. J. Eur. L. 73, p. 81.
[367] The Privatisation Law No. 86-912 of August 6, 1986.
[368] A. Goldstein (1996), supra n 355, p. 463.
[369] D. Lacoue-Labarthe, *Les Banques en France: Privatisation, Restructuration, Consolidation* (Paris: Economica, 2001), pp. 60-61, Table 2.5.

Following the electoral victory of the socialists in 1988, all the remaining privatisations from the Chirac's list were halted, though the government of François Mitterrand did not renationalise formerly divested firms during its period in office between 1988-1993. Beginning in 1993, when the centre-right party returned to power, the government of Edouard Balladur has embarked on a second major privatisation program[370]. In three years, 9 major state-owned enterprises have been at least partially sold[371]. Following the 1997 election, the socialists returned to power. Although they had campaigned against the sale of state assets, the globalisation of the economy led the leftist government of Lionel Jospin to subscribe to a new program of privatisation[372], which in the end generated an amount surpassing the total amount generated under both Balladur and Juppé governments from 1993 to 1997[373]. In particular, the Jospin government launched the two largest French privatisations ever, namely the $7.1 billion France Telecom IPO in October 1997 and the subsequent $10.5 billion seasoned France Telecom issue in November 1998[374]. However, the above privatisations did not bring about a radical marketisation of the French system along British lines[375]. For, despite these privatisations, the French government still retains control in several key sectors, either through golden shares or through the *noyaux durs*. Furthermore, as will be seen below, it continues to object to bids which might prejudice the French national interest. As Charkham (1994) puts it, '*Colbert's ghost survives and will not be easily exorcised*'[376].

[370] Indeed, 21 companies were privatised under the governments of Balladur and Juppé, including Crédit Local de France, BNP, Rhône-Poulenc, Elf-Aquitaine, UAP, SEITA, Bull, Usinor-Sacilor, Péchiney.
[371] A. Goldstein (1996), supra n 355, p. 455.
[372] B. Mojuyé (2000), supra n 366, pp. 90-91. The privatised companies included CIC, Thomson CSF, Thomson Multimédia, Crédit Foncier, Crédit Lyonnais.
[373] M. O'Sullivan, 'The Stock Market and the Corporate Economy in France' (2002), p. 16, available at http://www.intech.unu.edu/research/current-research/designing/bartzokas/2000-138/october-2002/osullivan-2.pdf.
[374] W. L. Megginson and J. M. Netter, 'From State to Market: A Survey of Empirical Studies on Privatization' (2001), p. 4, available at SSRN.
[375] H. J. Yeo, C. Pochet and A. Alcouffe, 'CEO Reciprocal Interlocks in French Corporations' (2003) 7 Journal of Management and Governance 87, p. 90.
[376] J. P. Charkham (1994), supra n 352, p. 154.

2.2.3 Operation of the Market for Corporate Control

As far as the market for corporate control is concerned, the prospects of a bidder successfully conducting a hostile bid in France is limited in practice. Indeed, for the entire decade from 1991 to 2000, French companies were involved in 19 hostile bids only[377]. The low level of hostile bids in France is also evidenced by the fact that, according to a study by KPMG, in the first half of 2000, whilst the value of acquisitions of French companies was $19 billion, the value of foreign acquisitions by French companies was $113 billion[378]. The rationale behind the difficulty of conducting hostile bids in France are two-fold: First, control is often retained by powerful controlling families and non-financial companies. As a result, control changes usually occur as a result of private negotiations, rather than by way of transactions in the market. The ensuing mandatory bid is just a formality to withdraw the company from the exchange rather than as a device to change control. This may not be obvious, for the French statistics classify under the same heading the price guarantee procedures, which are mandated after a shareholder has acquired full legal control as a consequence of his purchase of a controlling block from another shareholder. The frequency of these block transactions, and hence of the price guarantee procedure, confirms that, according to French tradition, company restructuring takes place by voluntary measures rather than via the market[379].

Secondly, the influence of the State makes hostile takeovers, and in particular those by foreign bidders, more difficult. This can be illustrated by the recent takeover attempt by Sanofi-Synthélabo - the French drug firm – for its bigger Franco-German rival Aventis. During this battle, Aventis called for a Swiss white knight – Novartis - , which was opposed by the French government. Indeed, the French prime minister told Novartis to leave the battle, on the grounds that the ability of France to counter bio-terrorism had required national ownership of a vaccine producer. The prime minister further told Aventis to stop resisting the

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377 M. O'Sullivan (2002), supra n 373, p. 39.
378 Ibid, p. 29.
379 E. Wymeersch (1998), supra n 237, p. 1193.

Sanofi bid[380]. Similarly, Generali of Italy's attempt in 1997 to take over AGF, France's second-largest insurer, constitutes another example of the French State's involvement in foreign hostile bids. Unsuccessful in its search for a French ally against the Italian bidder, AGF turned to its German rival, Allianz AG, which promised to preserve a substantial degree of autonomy for AGF. In the meantime, the French Minister of Economy made maximum use of its three-month review period under the French Insurance Code to frustrate Generali's hostile bid. Frustrated by the government's delay in providing insurance regulatory approval for its bid, Generali conceded victory to Allianz. On the other hand, because of the Ministry's concern about the state interests likely to be affected by foreign ownership of AGF, Allianz agreed to maintain AGF's headquarters in Paris and to appoint only a minority of the AGF's directors. This example illustrates well the ability of French administrative bodies to delay a non-French bid until a friendly white knight appears, in cases where their prior approval is necessary to acquire control of an offeree company.

It should be noted, however, that a number of changes are occurring in France, which are likely to increase the likelihood of hostile takeovers. First and foremost, the French government has outlawed a number of specific control techniques by companies. In particular, shares held by a subsidiary in the capital of its parent have been restricted. Furthermore, since the publication in 1995 of the Viénot Report, listed companies are in a continuous process of unwinding their cross shareholdings. Indeed, there has been a decline in non-financial companies' stakes in the 25 largest companies. Over just one-year period between 1998 and 1999, the corporate sector's stake in listed companies reduced from 33.5 per cent to 30.2 per cent[381]. The rationale behind this phenomenon is the increasing competition in the market for goods and services, which induces companies to refocus on their core activities in order to rein in their unit cost[382].

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380 'Patent Nonsense', *The Economist*, March 27, 2004.

381 J. C. Coffee, 'Convergence and its Critics: What are the Preconditions to the Separation of Ownership and Control?', in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 88, Table 4.1.

382 Ibid, p. 44.

Secondly, the use of golden shares by the French government has been rendered difficult by the ECJ's landmark judgment, which found the French government's golden share in Société Elf-Aquitaine illegal[383]. The share in question had allowed the Minister of Economy to veto the acquisition of more than ten per cent of the shares in the company, as well as the sale of the majority of the capital of the parent's subsidiaries. Although the ECJ held that the objective sought after by the French government – namely to ensure the security of the supplies of petroleum products – was deemed to be a legitimate public interest, it concluded that the French regulation manifestly went beyond what was necessary to reach the objective invoked. This is because the regulation did not provide for specific and objective circumstances where such powers could be used. This was held to create uncertainty, as the investors could not identify the extent of their rights and duties. As a result of the ECJ's decision, the Minister of Economy eradicated the State's golden share in Elf-Aquitaine.

Finally, the increasing percentage of capital held by foreign institutions, coupled with their more active role, are also likely to be favourable to the conduct of hostile bids in France[384]. Until recently, no investment in a French company was big enough to deter foreign institutional investors from selling their shares and place their funds elsewhere. Indeed, according to a study conducted in 1995[385] by the law firm Burson-Marsteller Eurocorporate with Anglo-Saxon institutional investors, only 12 per cent of the latter stated that they vote against the managers of French companies where they are shareholders whilst 60 per cent stated that they sell their shares in case of disagreement with the management[386]. This situation is changing, however. Indeed, foreign institutions in France no longer divest when they disagree with the management. Like in the UK, they play a more active role. This is illustrated by CalPERS's proxy fight in 1995, along with CREF[387], against Elf Aquitaine, with a view to rejecting a resolution designed to

[383] ECJ, 4 June 2002, No. C-483/99, *Commission CE c/République française* (2002) Bull. Joly Bourse 411, pp. 430-435.
[384] 'Pourquoi les Entreprises Françaises Sont-Elles Opéables?', CDC Marché, Flash, February 23, 1998.
[385] 'Corporate Governance Seen by Anglo-Saxon Institutional Investors', 364 *Option Finance*, July 17, 1995, p. 12.
[386] *Les Critères d'Investissement* (1998), supra n 329, p. 23.
[387] This is the pension fund of US lecturers.

limit shareholders' voting rights[388]. The increasing interest of CalPERS in French listed companies is also evidenced by the application, since 1994, of its proxy voting guidelines to France. Indeed, CalPERS particularly urges French listed companies to comply with the 'one share, one vote' principle, to eradicate their cross shareholdings, and to render their boards of directors more independent[389].

It should be noted in this respect that French institutional shareholders have also increased their voice. As an example, the French Asset Management Association[390] stated that it is not generally in favour of anti-takeover measures[391]. In its recommendations, the AFG recommends the progressive relinquishment of shares with double voting rights and of shares with a loyalty premium. The increased role of French institutional investors is partly due to the fact that fund management companies have been subjected to a number of rules of conduct, such as the obligation to act honestly and fairly in the best interests of their clients[392]. More importantly, they have been recently compelled to account of their voting practices relating to the securities they manage, pursuant to conditions which will be determined by the General Regulation of the AMF. In particular, if they fail to exercise the voting rights attaching to the securities they manage, they will have to explain the reasons of their abstention to the UCITS' shareholders[393]. This requirement falls short, however, of compelling fund managers to vote[394].

The impact of the increased role of both foreign and French institutions upon listed companies' policies has already produced its results. As will be seen in more detail in the chapter on the regulation of defensive measures in France, a

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388 C. Girard, 'Une Typologie de l'Activisme des Actionnaires Minoritaires en France' (2001), p. 2, available at http://ungaro.u-bourgogne.fr/WP/1010101.pdf.
389 *Activisme des Actionnaires: Le Cas Particulier des Fonds de Pension*, Bull. COB, No. 354 (February, 2001), p. 27, available at AMF website.
390 i. e. the Association Française de la Gestion Financière (hereafter the AFG). The latter is intended to improve accountability to shareholders and/or maximise shareholder value.
391 *Recommendations on Corporate Governance*, AFG-ASFFI (June, 1998), cl. C.4, available at AFG-ASFFI website.
392 Code monétaire et financier, art. L. 533-4(1).
393 Code monétaire et financier, art. L. 533-4(8).
394 Note that article 58 of the Law No. 96/597 of 2 July 1996 had required pension funds to exercise the voting rights attaching to the shares they hold in investee companies effectively. The Law No. 2003/736 of 1 August 2003 has repelled the latter article, however, and the new provisions relating to the rules of conduct no longer contain such requirement; see Code monétaire et financier, art. L. 533-40.

number of listed companies have already eliminated their double voting rights in order to comply with the 'one share, one vote' principle. Thus, the boards of French listed companies are becoming aware of the necessity to eradicate some of their pre-bid defences in order to avoid being subsequently challenged by the institutions. They are further becoming aware that they can no longer introduce whatever pre-bid defence suits them. This is evidenced by the fact that, according to a survey of 408 general meetings of listed companies in France, the rate of resolutions passed at less than 96 per cent has increased since 1992. Resolutions designed to retain authority to increase capital during the course of an offer are challenged the most. Indeed, they constitute 18 per cent of the totality of the resolutions passed at less than 96 per cent[395]. This shows that the respect of the establishment is no longer a priority for institutional investors[396] and that a culture of shareholder activism is developing in France, albeit timidly[397]. All the above developments are likely to change the traditional ownership pattern in French listed companies and thus facilitate hostile takeovers.

Conclusion

The foregoing indicates that the degree of concentration of share ownership and the identity of shareholders, as well as the operation of the market for corporate control, vary quite markedly in the UK and France. Indeed, unlike in the UK, listed firms in France present a more concentrated ownership structure. This, as well as other factors such as the widespread use of intercorporate holdings and the influence of the State, make the mounting of hostile bids more difficult in France than in the UK. However, as noted above, the pre-eminence in France of conflicts between the controlling shareholders and their minority counterparts over conflicts between the offeree management and the shareholders minimises the need to have recourse to hostile bids as a constraint on managerial behaviour. Indeed, the existence of large blocks of shares avoids the problem of separation of ownership and control, which is prevailing in Anglo-Saxon jurisdictions. But the

[395] *Activisme des Actionnaires* (2001), supra n 389, p. 27.
[396] 'Les Entreprises Redécouvrent les OPA Hostiles', 468 *Option Finance* September 29, 1997, p. 14.
[397] *Activisme des Actionnaires* (2001), supra n 389, p. 27.

concentration of ownership and control has its own problems: the development of a stock exchange calls for new minority shareholders, and these shareholders must be assured that their interests, and not only those of the block-holders, are taken into account[398]. As will be seen in the following chapters, the French takeover regime contains a number of mechanisms to solve the conflicts of interests as between the controlling shareholders and their minority counterparts. These include the price guarantee procedure, the *abus de majorité*, and the judicial recognition of a duty of loyalty by the controlling shareholders *vis-à-vis* the minority.

In contrast, shareholdings in the UK are often widely dispersed and quoted on a public exchange, which provides a liquid market for those who wish to trade in such securities[399]. This in turn makes the conflict of interests as between the management and the offeree shareholders predominant in the UK. As a result, unlike in France, firms in the UK rely more heavily on the market for corporate control as a means of influencing or displacing managers[400]. This is logical because the major differences in the operation of the market for corporate control emerge not from public policy differences, but from differences in corporate ownership and control[401].

Despite the foregoing, it should be noted that the French model of corporate governance seems to be edging closer to its UK counterpart in recent years. This convergence is brought about by a number of important forces: First, there is an increase in the number of listed companies in France. This demonstrates that French firms are relying less on bank financing and more on market financing[402]. As a result, the French economy is beginning to operate in the same way as the UK economy and is distancing itself from the German and Japanese models of

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398 J. M. Garrido and A. Rojo, 'Institutional Investors and Corporate Governance: Solution or Problem?', in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 433.
399 P. L. Davies, 'Institutional Investors as Corporate Monitors in the UK' in Hopt and Wymeersch (eds), *Comparative Corporate Governance: Essays and Materials* (Berlin ; New York : Walter de Gruyer, 1997), p. 48.
400 E. R. Gedajlovic and D. M. Shapiro, 'Management and Ownership Effects: Evidence From Five Countries' (1998) 19 Strateg. Manage. J. 533, pp. 538-539.
401 Ibid, p. 538.
402 E. Bertero (1994), supra n 307, p. 76.

capitalism which had, to some extent, previously prevailed[403]. Secondly, there is an increase in the number of individuals owning equity via collective investment vehicles[404]. Indeed, there is a greater institutionalisation of savings, channelled through pension funds and unit and investment trusts. The rationale behind this phenomenon is that institutional saving offers some risk pooling, as individual investment is collectively invested with that of others under the direction of specialist managers.[405]. It should be added that the recent reform in France on funded pensions will likely result in a greater investment by pension funds in the French stock market. The increasing control of the stock exchange by the institutions will likely change the traditional ownership pattern in the French stock exchange, and prevent French listed companies from adopting pre-bid defences which are value decreasing. Finally, since the late 1990s, the increasing competition for stock exchange listings[406] are driving French companies towards a different style of governance[407], which places emphasis on 'creating shareholder value'. The latter demonstrate that the corporate world's drive for the cheapest capital is likely to level all sorts of playing fields[408].

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[403] F. Morin (2000), supra n 305, p. 37.
[404] J. Armour, B. R. Cheffins and D. A. Skeel (2002), supra n 269, p. 8.
[405] S. Griffith-Jones and J. Cailloux, *Encouraging the Long-Term: Institutional Investors and Emerging Markets* (NY: UN Development Programme, Office of Development Studies, 1998), DP No. 16, pp. 3-5.
[406] Note that French companies are increasingly seeking listing on foreign exchanges, and in particular on US exchanges. Indeed, at the end of 2000, a total of 18 French companies had ADRs listed on the NYSE, and a further 14 had ADRs listed on the Nasdaq.
[407] H. Sherman (1997), supra n 332, p. 345.
[408] 'From Slow Start to Relentless Build-Up', *The Financial Times*, January 11, 2000.

Chapter 3 The Regulation of Defensive Measures in the UK

Introduction

Hostile bids are often unwelcome to the board of an offeree company. This is because a successful bid usually results in the loss by directors of their control of the company and the benefits that flow from it. There is thus a potential for conflicts of interest as between the offeree board and the shareholders in the context of hostile bids. Because of the latter conflict, most MS in the EU have taken a negative approach towards post-bid defensive measures. This is particularly the case in the UK, where the divergence of interests between the management and the offeree shareholders is solved in favour of the latter once a takeover bid is imminent. Indeed, the imposes a duty upon the offeree directors not to take steps to frustrate a bona fide offer without the approval of the shareholders in general meeting. By significantly reducing the offeree board's discretion to engage in post-bid defensive actions that keep the offer away from the shareholders, the Code thus promotes shareholder decision-making. However, the offeree management is relatively free to take pre-bid defences, as the latter are not regulated by the Code. Pre-bid defences are nevertheless subject to general company law and to the stock exchange rules, which will be described below[409].

This chapter analyses the defensive measures – both pre-bid and post-bid - likely to be taken by companies listed in the UK. Section I describes the principles governing directors' actions, both prior to and during a bid. Section II gives an overview of the permissible pre-bid defences. Section III examines the meaning and rationale of the provisions governing post-bid defences. Finally Section IV describes the permissible post-bid defences in the UK. Before proceeding, it should be noted that this chapter does not deal with the various types of pre-bid and post-bid defences which are available in other jurisdictions but which are not permissible in the UK.

[409] In particular the Listing Rules.

3.1 Principles Governing Directors' Actions

On the one hand, directors must be free to operate the company in the risky commercial world, but on the other there must be some supervision on the exercise of their powers[410]. As a result, the law requires minimum standards of behaviour from directors, with potentially severe penalties in the event of breach[411]. Some of these standards are embodied in statutes and/or in stock exchange regulations, which will be considered whilst dealing with individual pre-bid defences. Others are judge-made rules. The latter consist of the duty of care and the fiduciary duties. Common law fiduciary duties constitute the major weapon by which the law regulates company management, and in particular their pre-bid actions. As a result, it is worth mentioning the different components of these duties.

Before reviewing the common law fiduciary duties, it should be noted, however, that the UK government is currently carrying out a major revision of UK company law, which will result in a new Companies Act. Part of this revision concerns directors' fiduciary duties, which have been reformulated and incorporated in statute[412]. Following the introduction of the new Act, the existing common law fiduciary rules will be replaced by statutory fiduciary duties, though the courts will be allowed to develop the existing rules by reference to particular cases[413]. It is noteworthy, however, that the proposed Act does not contain any specific reference to the duties of directors in the context of takeovers.

There are several facets of directors' fiduciary duties. These are the duty of loyalty, the duty to exercise their powers for a proper purpose[414], the duty not to fetter their future discretion, and the duty not to place themselves in a position in which there would be a conflict between their duties to the company and their

[410] T. Paton, 'Codification of Corporate Law in the UK and European Union: The Need for the Australian Approach' (2000) I.C.C.L.R. 309, p. 310.
[411] J. H. Farrar, *Farrar's Company Law* (London: Butterworths, 4th ed., 1998), p. 377.
[412] *Modernising Company Law* (2002), supra n 296, Schedule 2.
[413] *Modern Company Law for a Competitive Economy: Completing the Structure*, URN 00/1335 (November, 2000), p. 45, available at DTI website.
[414] Hereafter the proper purpose duty.

personal interests[415]. The most important of these for our purposes are that a director must '*exercise his powers in the way he believes in good faith is best calculated in the circumstances [...] to promote the success of the company for the benefit of its members as a whole*'[416], and that a director must use his powers for the purposes for which they were conferred upon him. These two duties are frequently referred to by UK courts whilst dealing with directors' pre-bid actions.

As far as the duty to act bona fide is concerned, the test is a subjective one in that the court must consider whether the director believed he was acting for the benefit of the members as a whole[417]. As far as the proper purpose duty is concerned, this must be ascertained largely by reference to the company's articles of association and, relevantly, any affecting legislation[418]. However, it is not possible to determine in advance the limits beyond which directors cannot pass in exercising a particular power. As a result, every case depends upon a scrutiny of its own relevant facts, though the nature of the power in question affects the intensity with which a court reviews directors' acts. For instance, directors' power to acquire or sell assets are not as easily challenged by the courts as, say, their power to issue shares[419]. Indeed, Prichard J held in a New Zealand case that '*in the case of [...] the power to issue shares [...] the broad line is comparatively narrow: the purpose for which such power is intended is well defined and it is restricted in scope*'[420].

It should be emphasised that the proper purpose test is a different and additional test from the bona fide test. This is often overlooked by the courts, however, which either refer to these two tests interchangeably or give pre-eminence to one

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415 e.g. the duty not to use for their own profit the company's assets, opportunities or information.
416 Note that, in its Final Report, the CLR removed the ambiguities generated by the previous reference to 'the interests of the company' in the common law formulation by replacing it with the words 'for the benefit of the members as a whole'. By recognising the 'legitimate interests of stakeholders', the CLR has thus opted for the enlightened shareholder value approach of the company, which offers something to both the shareholder value and the stakeholder camps; see P. L. Davies (2003), supra n 239, p. 269.
417 S. Griffin, *Company Law - Fundamental Principles* (London: Longman, 3rd ed., 1994), pp. 248-249.
418 B. S. Butcher, *Directors' Duties: A New Millennium, a New Approach?* (Boston: Kluwer Law International, 2000), p. 114.
419 P. Little, *Law of Company Takeovers* (North Ryde, NSW: LBC Information Services, 1997), p. 528.
420 *Baigent v DMcL Wallace Ltd* [1984] NZ CLC 96-011.

of them. For instance, in *Punt v Symons & Co Ltd*[421], where the directors issued shares to create a sufficient majority to enable them to pass a special resolution depriving some shareholders of special rights conferred on them by the company's articles of association, Byrne J gave pre-eminence to the bona fide test. He held

> '*A limited issue of shares to persons who obviously meant and intended to secure the necessary statutory majority in a particular interest was not a fair and bona fide exercise of the power to issue shares*'.

By contrast, in *Hogg v Cramphorn*[422], where the directors of a company faced with a takeover established a trust and issued to the trustees sufficient shares to defeat the takeover[423], Buckley J gave pre-eminence to the proper purpose test. Indeed, he stated that, if exercised for an improper motive - namely to maintain the directors in control - the issue could be set aside for breach of fiduciary duty. He further held that the directors' honest belief that their command of the majority of the votes in general meeting would benefit the company could not justify the issue.

Subsequently, in *Bamford v Bamford*[424], the court once again relied on the bona fide test. In this case, the directors of a company issued 500,000 shares to one of the principal distributors of the company's products. They did so primarily for the purpose of forestalling a takeover bid, though by virtue of a power vested in them by the articles of association. Harman LJ held that the issue was made in breach of directors' duty to act bona fide in the interests of the company. In his words, the directors made the issue '*with an eye primarily on the exigencies of the takeover war and not with a single eye to the benefit of the company*'. Thus, this case, along with the above-mentioned Punt v Symons, considers that directors

[421] [1903] 2 Ch. 506.
[422] [1967] Ch. 254.
[423] Note that the Code was not adopted yet at the time of this case. As a result, although the case involved a post-bid defence, the validity of the latter was judged upon by the courts, by reference to the common law.
[424] [1970] Ch. 212, CA.

will be deemed to have exercised their powers validly so long as they exercise them honestly[425].

In *Howard Smith Ltd v Ampol Petroleum Ltd*[426], the Privy Council seized the opportunity to review the whole question. In this case, directors of a company threatened with a takeover issued a large number of shares to a shareholder, with a view to rendering the bidders a minority in the company. The directors did so by virtue of a power to issue shares '*to such persons on such terms and conditions [...] as the directors might think fit*', vested in them by the articles of association. Lord Wilberforce laid down the correct approach as follows:

> '*It is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. In doing so, it will necessarily give credit to the bona fide opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls*'.

The above ruling is noteworthy in two respects: First, it clearly distinguishes the bona fide and the proper purpose tests, and gives pre-eminence to the proper purpose test[427]. The latter has the advantage of allowing the courts to review directors' acts upon a more objective basis. This, in turn, offers UK courts of a more interventionist disposition an opportunity to consider the decision itself rather than simply the decision-making process, and thus gives rise to the review of business judgments, long considered anathema to the UK judiciary[428].

However, a case decided following Howard Smith cast doubt on the pre-eminence of the proper purpose test in UK courts. Indeed, in *Cayne v Global Natural Resources plc*[429], Megarry V-C held

[425] R. C. Nolan, 'The Proper Purpose Doctrine and Company Directors', in B. A. K. Rider (ed.), *The Realm of Company Law* (Kluwer Law International, 1998), p. 7.
[426] [1974] 1 All E.R. 1126.
[427] It should be noted that, even following *Howard Smith v Ampol Petroleum*, the bona fide test continued to outweigh in some Commonwealth jurisdictions. See *Pine Vale Investments Ltd v McDonnell* [1983] 1 ACLC 1, 294; and *Baigent v DMcL Wallace Ltd* [1984] NZ CLC 96-011 (High Court of New Zealand).
[428] B. S. Butcher (2000), supra n 418, p. 119.
[429] 12.8.82, unreported.

'In Hogg v Cramphorn, it was held that the honest belief did not prevent the motive for issuing the shares from being an improper motive. [...] This principle must not be carried too far. If company A and Company B are in business competition, and Company A acquires a large holding of shares in company B with the object of running company B down so as to lessen its competition, [...] the directors of company B might well come to the honest conclusion that it was contrary to the best interests of company B to allow company A to effect its purpose. If, then, the directors issue further shares in company B in order to maintain their control of company B for the purpose of defeating company A's plans [...] I cannot see why that should not be a perfectly proper exercise of the fiduciary powers of the directors of company B. The object is not to retain control as such, but to prevent company B from being reduced to impotence and beggary, and the only means available to the directors for achieving this purpose is to retain control'.

A subsequent decision by UK courts seemed emphatic as to the dominance of the proper purpose test over the bona fide test[430]. In this case, the incumbent directors entered into a long-term management agreement with a third party knowing that the shareholders were proposing to exercise their rights to appoint new directors. Dillon J held

'The crucial question is whether it was within the directors' powers at all to commit the company to the management agreement, however much they may have thought it in that company's best interests to thwart the intention of the shareholders'.

However, a more recent case indicates that the UK courts might back away from the ruling in Howard Smith is *Criterion Properties plc v Stratford UK Properties LLC*[431]. In this case, Oaktree, a US company, and Criterion, a UK plc, were parties to a joint venture for investment in real property in the UK. The terms of their partnership were subsequently changed, with a view to protecting Criterion against a possible takeover and change of management[432]. The CA upheld the High Court of Justice's[433] decision that the agreement was outside the powers of the directors of Criterion, on the grounds that the agreement went far beyond anything which could be justified for the purpose of deterring an unwelcome predator[434]. At the same time, however, the CA held

'Had the agreement been so drafted as to be confined to the purpose of seeing off a particular predator, the present dispute would not have arisen'.

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430 *Lee Panavision v Lee Lighting Ltd* [1992] B.C.L.C. 22 (CA).
431 [2003] BCC 50.
432 Indeed, Oaktree was given the right to have its interest in the joint venture to be bought out, on very favourable terms, in the event of another party gaining control of Criterion.
433 [2003] BCC 50.
434 Indeed, the buy-back right could be triggered not only upon a hostile bid, but even upon the departure of the chairman of Criterion due to death or misconduct.

This shows that the CA was ready to accept a narrower version of the measure in question which, although having an anti-takeover effect, nevertheless had a commercial purpose. Thus, the ruling in Criterion goes some way towards supporting a restriction on the scope of Howard Smith.

The second noteworthiness of the ruling in Howard Smith is that it lays down a second test within the proper purpose test, namely the substantial purpose test. Indeed, the Privy Council further held in that case that, although the company would benefit from the capital raised from the issue to Howard Smith, the dominant purpose behind such issue was an improper one, namely the manipulation of voting control in favour of Howard Smith. It should be noted in this respect that both the substantial purpose test and the judgment in Cayne & Anr and Criterion, which reduce the strictness of Howard Smith by relying on the bona fide test, suggest a weakness of the proper purpose test to prevent pre-bid defences in the UK[435].

It should be noted that fiduciary duties are, as a general rule, owed to the company, not to the shareholders individually. This is the much-criticized doctrine of *Percival v Wright*[436]. In this case, the shareholders of a company offered to sell their shares to the chairman of the board and two other directors, who agreed to buy them at £12.50 per share. After completion of the sale of their shares, the shareholders discovered that, at the time, the board had been negotiating the sale of the company, at a price which represented well over £12.50 per share, and that this information had not been disclosed to them. The shareholders claimed that the directors stood in a fiduciary relationship towards them, and sought to reverse the sale of their shares on the ground of non-disclosure. Swinfen Eady J thought, however, that the purchasing directors were under no obligation to disclose the negotiations[437] to their vendor shareholders. He held

[435] P. L. Davies, 'The Board of Directors: Composition, Structure, Duties and Powers', Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends (2000), pp. 10-11, available at OECD website.
[436] [1902] 2 Ch 421 (Ch.). Note that the Percival doctrine has been incorporated into the new Companies Bill; see the Companies Bill, Part 2, Ch. 2, 19(2).
[437] Note that in the event these ultimately proved abortive.

'The contrary view would place directors in a most invidious position, as they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company'.

This view was later upheld in *Dawson International Plc v Coats Paton Plc*[438], where Lord Cullen held that the '*directors have but one master, the company*'.

The rationale behind the Percival doctrine is that, as a general rule, it is important for the well being of a company that the directors are not overexposed to the risk of multiple legal actions by dissenting minority shareholders. This doctrine has, however, been subject to significant judicial and academic critical comment, which resulted in the recognition that directors may in particular circumstances owe fiduciary duties to the shareholders individually[439]. In this respect, it is worth mentioning a case of the New Zealand CA, where Woodhouse J described these particular circumstances in the following terms

'The standard of conduct required from a director in relation to dealings with a shareholder will differ depending upon [...] the nature of the responsibility which [...] the director has assumed towards the shareholders [...] Factors that will usually have an influence [...] include dependence upon information and advice, the existence of a relationship of confidence, [and] the significance of some particular transaction for the parties' [440].

An example where shareholders were found to depend on the directors for information and advice is provided by the case of *Briess v Woolley*[441]. In this case, the managing director of an offeree company was authorised by the shareholders to negotiate the sale of their shares to a potential offeror. Meantime, he purchased offeree shares, knowing that the offeror was proposing to increase its offer but hiding that fact from the shareholders. That director was held by the House of Lords to stand in a fiduciary relationship towards the offeree shareholders. Another example where directors were found to be in direct and close contact with the shareholders in a manner capable of generating fiduciary duties is provided by the case of *Peskin v Anderson*[442]. In this case, the motoring services business of the Royal Automobile Club was sold following its de-

[438] [1988] 4 B.C.C. 305.

[439] Circumstances where directors' conduct of a company's affairs will be regarded as placing them in a fiduciary position towards shareholders usually occur in the context of takeovers; see P. L. Davies, *Introduction to Company Law* (Clarendon Law Series, 2002), p. 232.

[440] *Coleman v Myers* [1977] 2 N.Z.L.R. 225.

[441] [1954] 1 All E.R. 909.

[442] [2001] 1 B.C.L.C.

mutualisation by scheme of arrangement. All members received a payment of £34,131 for their interest in the business. Former members of the Club, who had withdrawn their membership prior to the de-mutualisation, brought an action for damages against the directors, on the grounds that the latter breached their fiduciary duty to disclose the plans relating to the de-mutualisation[443]. It should be noted, however, that, despite the above examples, the courts in the UK are unlikely to accept that directors owe a fiduciary duty to the shareholders in the case of takeovers of listed companies. Instead, they are more likely to hold that directors owe a duty of care to shareholders, in particular where the offeree directors give advice to offeree shareholders about a takeover bid[444]. Indeed, in *Hedley Byrne & Co. Ltd v Heller & Partners Ltd*[445], the House of Lords held that a duty of care is owed by a person possessed of special skill who provides information or advice to another whom he knows, or ought to know, will rely on his skill and judgment. Thus, an offeree shareholder who relies on a directors' circular which is misleading may have a cause of action for damages against the offeree directors on the basis of negligent misrepresentation.

3.2 Permissible Pre-Bid Defences

Companies that have not received an offer but that are potentially at risk of receiving one may resort to pre-bid defences. In doing so, the actions of the directors are not restricted by the Code, since the latter applies only once a bid is imminent. Directors' actions are however restricted by the fiduciary duties described above. Because of the above-mentioned weakness of the proper purpose test, however, directors of listed companies may seem to have a significant discretion under the UK law to undertake pre-bid actions so as to make their firms '*takeover-proof*'. However, as will be seen below, directors' pre-bid actions are further subject to the statutory company law and the regulations laid down by the Stock Exchange. It should be noted from the outset that the following gives an

[443] See also *Re Chez Nico (Restaurants) Ltd* [1991] B.C.C. 736, p. 750, where the directors were held to be under a fiduciary duty of disclosure to the shareholders.
[444] In particular in documents issued by them in relation to the takeover; see S. Deakin, R. Hobbs, D. Nash and G. Slinger, 'Implicit Contracts, Takeovers, and Corporate Governance: In the Shadow of the City Code' (2002), available at http://www.cbr.cam.ac.uk/pdf/WP254.pdf (2002), p. 10.
[445] [1964] AC 465 (HL 1963).

overview of only those pre-bid defences whose use is constrained by the statutes and regulations. It should also be borne in mind that the following pre-bid defences may also be deployed during the course of a bid, provided they are approved by shareholders. This would, however, provide little or no protection to management, as the outcome would be left in the hands of offeree shareholders.

3.2.1 Disclosure

The disclosure requirements embodied in the statutes and regulations may act as a pre-bid defence. For instance, the statutory requirement to disclose beneficial ownership of the voting shares when a threshold of three per cent of the share capital has been reached, or when the level of interest in the shares has changed by an integral percentage point, whilst above the three per cent threshold[446], serves to alert companies about potential offerors. Likewise, the SARs requirement that share acquisitions which result in the holding of fifteen per cent of the voting rights be notified to the company and to the stock exchange also serves to alert potential offeree companies[447].

3.2.2 Non-Voting Preference Shares, Voting Caps, and Shares with Double Voting Rights

Companies in the UK may issue common or preferred shares with enhanced, restricted[448], or non-voting rights. The latter serve to limit the ability of an offeror to control the passing of shareholder resolutions. The rationale for allowing the issue of such shares in the UK is two-fold: First, such shares serve to effect a desired allocation of control in important companies, which thus remain in UK hands[449]. Secondly, it was thought that the imposition of a 'one-share-one-vote' principle would be unduly restrictive[450]. Even the CLR has suggested that the freedom of companies to issue shares with multiple votes, or none, should not be

[446] CA 1985, ss.198-199, as amended by the 1989 Act.
[447] SARs, r.3.
[448] These limit the number of votes to which a shareholder is entitled, irrespective of his stake in the capital of the company.
[449] G. O. Barboutis, 'Takeover Defence Tactics Part II: Specific Defensive Devices' (1999) 20 Co. Law. 40, p. 45.
[450] Jenkins Report, para 136. For the background to this Report, see subsection 3.3.2(ii) below.

restricted by statute and that any limit on their use should be for market regulation, not company law[451].

Companies are also allowed to list such shares, though the London Stock Exchange strongly disapproves of them. To do so, companies must include in their particulars a summary of the rights attaching to the shares for which application is made, and '*in particular the extent of the voting rights* [...] *and any other special rights*'[452]. It should be noted, however, that differential voting structures have become less common in listed companies, as market sentiment has turned against them[453]. Indeed, many companies with separate voting and non-voting share classes, such as Great Universal Stores or WH Smith[454], have unified their capital structure by agreement to a one-share-one-vote structure[455]. It should be noted in this respect that the proposed Fifth Directive[456], if ultimately adopted, would likely put an end to such shares, given its requirement that all companies endorse the one-share-one-vote principle.

3.2.3 Issue of Authorised but Unissued Shares

The issue of shares is normally intended to raise capital. However, directors often issue new shares to preserve their own control or to ward off a potential takeover bid. This is usually done by issuing shares to a friendly shareholder, to another company with which the potential offeree company has a close commercial relationship, or to a pension fund. The effectiveness of the latter lies in the fact that the trustees of a company's pension fund are generally either employees of the company or persons appointed by the directors and will generally be only too willing to please the directors[457]. There are, however, a number of requirements

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451 *Modern Company Law for a Competitive Economy: Completing the Structure* (2000), supra n 413, p. 87.
452 Listing Rules, Ch. 6, r. 6.B.7.
453 *Modern Company Law for a Competitive Economy: Developing the Framework* (March, 2000), p. 140, available at DTI website.
454 'John Laing Gives Shareholders the Vote', *The Financial Times*, March 24, 2000.
455 G. McCormack, 'Institutional Shareholders and the Promotion of Good Corporate Governance' in B. A. K. Rider (ed.), *The Realm of Company Law* (Kluwer Law International, 1998), p.155.
456 Second Amendment to the proposal for a Fifth Council Directive concerning the structure of public limited companies, COM (90) 629 final – SYN 3, OJ C 7/4, 11/1/91, art. 33.
457 M. A. Weinberg and M V. Blank, *Weinberg and Blank on Take-overs and Mergers* (London: Sweet and Maxwell, 4th ed., 1979), p. 584. Note, however, that the trustees may be sued by the

that the directors must comply with in order to resort to this defence: First, the law requires the board of directors to either be expressly authorised by the articles of association or obtain shareholder authorisation in general meeting[458]. Secondly, where the shares are issued for cash, they must first be offered to the existing shareholders on a pro rata basis, pursuant to their statutory pre-emption rights[459]. The latter have '*an important effect on under-performing management by limiting their access to equity*'[460].

Listed companies may, however, dis-apply pre-emption rights by passing a special resolution each year[461], and routinely do so for a rolling five year period[462]. The rationale behind allowing companies to do so is that pre-emption rights deny companies access to alternative investors with a greater growth orientation who might therefore put a higher value on longer-term higher-risk growth opportunities[463]. However, a Pre-emption Group[464], which was founded following opposition by institutional shareholders to the dis-application of pre-emption rights[465], issued guidelines which further restrict listed companies' ability to dis-apply pre-emption rights. Indeed, under the guidelines, the issue size is restricted to five per cent of the ordinary share capital in any one-year and to 7.5 per cent cumulatively in any three-year period. In addition, the issue discount is restricted to five per cent of the mid-price between the best bid and offer prices[466].

The above guidelines protect the existing shareholders from the dilution of their financial position in the company. Indeed, in the case of discounted non-preemptive issues, the cost of the discount is borne by the existing

beneficiaries of the fund or trust for damages for improper administration of the trust, where they reject a bid unwelcome to the directors and the share price plunges, or where they accept the lower of two bids.

458 s.80. This requirement goes back to the Jenkins Report; see para 122(h).

459 s.89(1) and Listing Rules, Ch. 9, r. 9.18.

460 *Modern Company Law: Developing the Framework* (2000), supra n 453, p. 144.

461 Listing Rules, Ch. 9, r. 9.20.

462 *Modern Company Law for a Competitive Economy: Developing the Framework* (2000), supra n 453, p. 144.

463 *Underwriting Services for Share Offers*, Competition Commission, Cm. 4168 (February, 1999), p. 21, available at Competition Commission website.

464 This was established in 1987 and was made up of the representatives of the Investment Committees of the trade associations of the traditional institutions, the Stock Exchange, and the corporate sector.

465 G. McCormack (1998), supra n 455, p. 155.

466 *Underwriting Services for Share Offers* (1999), supra n 463, p. 55.

shareholders[467]. At the same time, however, the restriction of the issue discount makes it difficult for the management to pursue a strategy of issuing deeply discounted shares to new friendly investors as part of an implicit bargain whereby the new investors would support the incumbent management.

Boards of listed companies in the UK may also legally put in place poison pills. These are shareholder rights plans which entitle their holders to special rights and privileges if the issuing firm becomes the subject of a takeover bid[468]. These are likely to make a company less attractive to potential offerors. For the existence of such rights makes it more difficult for potential offerors to establish the relative value of each class of share capital. More importantly, they make it prohibitively expensive for a hostile offeror to take over a company, unless the issuing firm's board of directors redeems the pills[469]. However, the rules on pre-emption rights[470]; the requirement for shareholder approval for transactions involving more than twenty-five per cent of a company's asset value[471]; and the directors' proper purpose duty all mean that a board in the UK is hard pressed to craft a pill sufficiently poisonous to deter an offeror without shareholders' approval[472]. For instance, in *Criterion Properties*, the adoption of a poison pill with a view to deterring a particular bidder was held by the CA to constitute an abuse by the directors of their powers[473]. It should further be noted that shareholders in UK companies have shown no enthusiasm generally to encourage such pills[474].

[467] P. L. Davies (2003), supra n 239, p. 279.
[468] P. H. Malatesta and R. A. Walkling, 'Poison Pill Securities: Stockholder Wealth, Profitability, and Ownership Structure' (1988) 20 J. Fin. Econ. 347, p. 347.
[469] For these will have the effect of considerably expanding the equity which the offeror must acquire.
[470] CA, ss.89-95.
[471] Listing Rules, Chs.10 and 11.
[472] J. Armour, S. Deakin and S. Konzelmann, 'A Post-Stakeholder World? Reflections on the Recent Evolution and Future Trajectory of UK Corporate Governance', 3CL/CBR Conference, Faculty of Law, University of Cambridge, *Using Law to Promote Competitiveness and Enterprise: Will Corporate Law Deliver?*, 4 July 2002, p. 6.
[473] [2003] B.C.C. 50, CA.
[474] A. Paul, 'Corporate Governance in the Context of Takeovers of UK Public Companies', in D. D. Prentice and P. R. J. Holland (eds), *Contemporary Issues in Corporate Governance*, (Oxford, 1993), p. 140. Even in the US, the overwhelming majority of proposals sponsored by institutional investors concern rescission of poison pills; see R. Romano, 'Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance' (2001) 18 Yale Journal on Regulation 174, p. 196

3.2.4 Share Buy-Backs

Offeree boards in the UK may carry out share buy-backs if authorised to do so by the articles of association or upon shareholder authorisation in general meeting. This defence serves to increase the company's share price and thus to deter shareholders from selling their shares to a potential offeror[475]. However, such authorisation cannot exceed a period of more than eighteen months[476]. Furthermore, only purchases of less than fifteen per cent of any class of the equity shares may be made through the market, and this, only if the price to be paid is no more than five per cent above the average of the market values of such shares for the five business days before the purchase is made[477]. By contrast, purchases of fifteen per cent or more of the equity shares must be made by way of either a tender or a partial offer to all shareholders of that class on the same terms[478]. Listed companies must further comply with the informal guidelines issued by institutional investors' trade associations, if they wish to avoid infuriating the institutions. These guidelines contain stricter requirements than the statutes and the stock exchange regulations. For instance, the ABI guidelines require listed companies to seek authority from the general meeting every twelve months and to limit their repurchase to a maximum of ten per cent of their issued capital per year. The ABI guidelines are designed to protect the interests of shareholders by putting a limit on the increase in gearing which occurs as a result of any share buy-back. Notwithstanding the above restrictions, only in 1995-1996, £1.4 billion worth of share buy-backs were conducted in the UK market by listed companies[479], and seeking permission from the shareholders at a company's AGM has become a routine practice even if there is no immediate intention to use it.

It should be noted that, until recently, companies were required to cancel the shares repurchased. However, a reform in 2003 gave companies power to hold

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[475] *Création de Valeur Actionnariale* (2000), supra n 354, p. 6.
[476] ss.159ff.
[477] Listing Rules, Ch.15, r.15.6.
[478] Listing Rules, Ch.15, r.15.7.
[479] B. Pettet, 'Share Buy-Backs', in B. A. K. Rider (ed.), *The Corporate Dimension: An Exploration of Developing Areas of Company and Commercial Law* (Bristol: Jordans, 1998), p. 243.

such shares in treasury for resale at some later date[480]. This represents a significant shift from the old regime. Thus, companies in need of fresh capital may henceforth sell shares from treasury[481] in small lots, as and when it suits them, without the costs of a new issue of shares[482]. This in turn gives companies greater flexibility in managing their share capital and helps them reduce their overall cost of capital[483]. Allowing companies to hold treasury shares is particularly useful for companies with substantial cash. For such companies are likely to be subject to a bid from a raider willing to strip the company out of its assets. Such companies may thus purchase their own shares and subsequently resell them to friendly third parties without resorting to shareholder approval. By doing so, they may dilute a potential offeror's stake in the company and thus alter the balance of power within the company. However, the aggregate nominal value of treasury shares cannot at any time exceed ten per cent of the nominal value of the issued share capital of the company. If that maximum is exceeded at any time, the excess shall be automatically cancelled. Furthermore, companies holding treasury shares cannot exercise any rights in respect of treasury shares, including the right to attend and vote at general meetings[484]. Moreover, companies holding treasury shares cannot pay any dividend in respect of treasury shares[485].

It should further be noted that share buy-backs might have the effect of increasing one's stake in the company so as to trigger the Code's mandatory bid rule. In such circumstances, that controlling shareholder usually seeks a waiver from the mandatory bid requirement. The PIRC[486]'s Shareholder Voting Guidelines advise, however, that waivers should not be approved if there is the potential that a controlling shareholder's stake could increase beyond fifty per cent[487]. Guidelines issued by such institutional investors as PIRC should not be underestimated. It

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480 The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003, SI 2003/1116. Note, however, that, as under the old regime, companies may cancel the repurchased shares and return cash to their shareholders. Furthermore, they may use such shares to launch a counter-offer on the offeree company.

481 Note that the law prohibits the sale of treasury shares whilst a company is subject to a takeover bid.

482 K. Birkett, 'Treasury Shares: Worth the Wait?' (2003) 14 P.L.C. 10, p. 10.

483 *Treasury Shares*, A Consultative Document (September, 2001), p. 2, available at DTI website.

484 Ibid, p. 6.

485 Ibid, p. 7.

486 This is a UK body which advises institutional shareholders on matters of corporate governance. It was established in 1986 by a consortium of UK local-authority pension funds.

487 Part 5, p. 15.

does not necessarily follow, however, that all shareholders will inevitably follow these guidelines. Indeed, shareholders of Colt Telecom were called upon in 2001 to vote at an extraordinary meeting on a waiver of the mandatory bid rule to allow Fidelity's holding to rise above fifty per cent without making a mandatory bid for Colt. PIRC was opposed to the deal and accordingly advised opposition to the waiver of the mandatory bid rule, on the ground that Fidelity would achieve majority control of Colt without paying a premium to the existing shareholders. Nevertheless, most Colt shareholders voted in favour of the resolution, given that the company needed the extra cash to support its business plan and there was no alternative fundraising option on the table[488].

3.2.5 Cross Shareholdings

This technique, whereby a company has an interest in another company which, in turn, has an interest in the former, allows companies to form strategic alliances with others. Such shareholdings may be used by companies to internalise their transactions with the providers of a critical input in circumstances where there are high asset specificity and transaction frequency[489]. They may also be used to make it more difficult for an offeror to buy a controlling stake in a company. Despite the latter risk, the law does not regulate this defence on the grounds that many cross-holdings are advantageous for all the shareholders concerned and that it would not be right to prohibit them all[490]. In addition, any provision would necessarily be complex and arbitrary[491]. Furthermore, companies would easily ward off bids by pre-emptively acquiring shares in potential predators, which would render them immune from takeovers[492]. Moreover, it is believed that, as a result of the compulsory disclosure requirements, investors and prospective

[488] L. Vaughan-Adams, 'Colt Telecom May Face Opposition from Shareholders Over Fundraising Plan', *The Independent*, November 19, 2001.
[489] S. Thomsen and T. Pedersen, 'Ownership Structure and Economic Performance in the Largest European Companies' (2000) 21 Strateg. Manage. J. 689, pp. 693-694.
[490] Jenkins Report, para 153.
[491] In particular, there would be considerable problems of definition if, for instance, two companies simultaneously were to obtain holdings of, say, 20 per cent in each other. Indeed, it is difficult to determine in such a case which company should lose its voting rights; see ibid.
[492] R. Nolan, 'The Veil Intact' (1995) 16 Co. Law. 180, p. 180.

investors become aware of the existence of cross and circular holdings[493]. As a result of the latter rationales, UK companies can resort to cross shareholdings without shareholder approval.

However, the law prohibits a company from being a member of its holding company[494]. The weakness of this prohibition lies, however, in the fact that it does not prohibit company B, which already holds a non-controlling interest in company A, from continuing to hold shares in company A following the acquisition by company A of a controlling interest in company B. In other words, if company B owns shares in company A and company A buys all the shares in company B and turns it into a subsidiary, company B may continue to hold shares in its parent. This issue can be illustrated by the case of *Acatos & Hutcheson plc v Watson*[495], where Acatos & Hutcheson plc wished to acquire all the issued share capital of a company called Acatos Ltd, whose only asset was a 29.4 per cent shareholding in the acquiring company itself. Lightman J held that the proposed transaction was not contrary to s.23, on the grounds that s.23 does not prohibit a company – in the present case Acatos Ltd - from acquiring shares in another company – in the present case Acatos & Hutcheson plc - which subsequently becomes its holding company, and the company which is now a subsidiary[496] may continue to hold shares in its parent.

3.2.6 Other Permissible Pre-Bid Defences

Other pre-bid defences commonly used in the UK include the distribution of exceptional dividends; the conclusion of shareholder agreements[497]; the

[493] If such holdings are used by the directors to pursue policies which are oppressive, the outside shareholders may resort to the 'unfair prejudice' remedy embodied in s.459 of the CA 1985; see ibid.
[494] s.23.
[495] [1995] BCC 446.
[496] i. e. Acatos Ltd.
[497] Most recently, Paul Reichman, the founder and 8.9 per cent shareholder of the property company Canary Wharf concluded a pact with Brascan, a 9 per cent shareholder, with a view to thwarting the bid made by a consortium for the shares of Canary Wharf. The pact consisted of backing the other's bid, and if both fail, of not selling their shares to 'certain types of transactions' until a certain date; see 'Canary Bid Pact Facing Takeover Panel Threat', *The Evening Standard*, December 30, 2003.

introduction of change of control clauses[498] in documents; the granting of large termination compensation packages to senior executives[499]; and the disposal of strategic assets to make the offeree company less attractive. Since the object of an offer is to gain control over the assets of a company, the latter defence is likely to deter potential offerors from making an offer[500]. However, boards of listed companies must seek prior approval of their shareholders in general meeting where such disposals classify as 'significant transactions'[501]. A disposal will be classified as such where its size relative to that of the listed company proposing to make it presents a percentage ratio of twenty-five per cent or more. It should be noted, however, that such a transaction may be characterised by the courts as an improper use by directors' of their powers[502].

3.2.7 Structural Factors

Structural factors likely to deter hostile bids are relatively unimportant in the UK. Nevertheless, it is worth mentioning the presence of golden shares in some large UK companies. These shares allow the State to preserve control over the management of privatised companies, by way of conferring on the State power to either restrict shareholdings or veto the disposal of material assets. However, this pre-bid defence is not as widely used in the UK as in France. Indeed, the number of golden shares held by the UK government in privatised companies has reduced over the years[503]. There are currently 24 companies with golden shares, including BAE systems, Rolls-Royce, British Energy plc[504]. It should be noted in this respect that the UK government's golden share in BAA[505], which conferred on the Secretary of State for Transport power to veto the acquisition of more than fifteen per cent of the voting shares, has been ruled illegal by the ECJ[506]. This is because the share in question restricted the free movement of capital. However,

[498] Such clauses allow the co-contractor to terminate the contract upon a change of control. These are usually found in contracts with strong *intuitus personae*, such as loan agreements, which would discourage a potential offeror where the amount of the loan is significant.
[499] These are likely to reduce the offeree board's hostility to an unsolicited takeover.
[500] M. A. Weinberg and M. V. Blank (1979), supra n 457, p. 600.
[501] These are principally acquisitions and disposals; see Listing Rules, Ch.10.
[502] See e. g. below the *Land Securities Investment Company/Savoy Hotel Company* case.
[503] 'Golden Shares', ECJ Press release No. 24, July 3, 2001, available at europa website.
[504] J. Morris 'Golden Shares: Getting Tarnished?' (2003) 14 P.L.C. 14, p. 14.
[505] i. e. the airport operator.
[506] *Commission of the European Communities v United Kingdom* [2003] 2 C. M. L. Rev. 19.

the share in question restricted the free movement of capital. However, the latter ruling by no means amounts to a complete ban on all forms of golden shares. Indeed, the UK remains free to adopt such shares provided that they are limited in time and scope, and that they relate to industries of national interest. It should be added that, these shares do not contravene the Listing Rules' requirement that a company seeking a listing provide in its articles that its shares are freely transferable[507]. For third-party approvals to share transfers are admitted in the UK when such approvals are contemplated by the law, as in the case of golden shares[508].

The foregoing demonstrates that directors of listed companies have a wide range of devices at their disposal to deter takeover bids, and the general company law is not particularly effective to reduce directors' discretion in this area. However, the Listing Rules and the UK institutions' policies on such issues as pre-emption rights, non-voting shares, and share buy-backs have all served to limit the use of pre-bid defences in the UK.

3.3 Regulation of Post-Bid Defences

As far as post-bid defences are concerned, the present policy in the UK is to sideline the incumbent management in the takeover process. This policy is embodied in General Principle 7[509] of the Code, which is referred to as the ' no frustrating action' rule. The latter reads

> *'At no time after a bona fide offer has been communicated to the board of the offeree company, or after the board of the offeree company has reason to believe that a bona fide offer might be imminent, may any action be taken by the board of the offeree company in relation to the affairs of the company, without the approval of the shareholders in general meeting, which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits'*[510].

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[507] Listing Rules, Ch. 3, r. 3.15.
[508] G. A. Ferrarini, 'Share Ownership, Takeover Law and the Contestability of Corporate Control', Company Law Reform in OECD Countries - A Comparative Outlook of Current Trends (2001), p. 8, available at SSRN website.
[509] Hereafter GP 7.
[510] This rule was first laid down in 1968 and it was subject to minor amendments in the subsequent editions of the Code. For instance, in 1969, the expression '*shall any action be taken by the board of the offeree company*' had been replaced by the expression '*shall any action be taken by the board of the offeree company in relation to the affairs of the company*'. The rationale behind such amendment was that the fact that the wording of the original rule had also covered market purchases undertaken

It should be emphasised that the fact that the Code applies *ex post* does not mean that post-bid defences will no longer be subject to the common law fiduciary rules. However, given that the Code contains stronger rules, there is rarely a need in the UK to resort to the common law to restrain post-bid defences[511]. Furthermore, a minority shareholder might find it difficult to pursue litigation during a takeover bid. This is because litigation is expensive and an uncertain way of monitoring boards[512]. Moreover, the courts are reluctant to interfere with the takeover process, as they think that litigation is not an appropriate mechanism for resolving disputes within companies which are subject to public markets[513]. Without prejudice to the latter remarks, however, if the offeree directors take, for instance, one of the post-bid defensive measures mentioned in Rule 21 without resorting to shareholder approval, they may be sued on the ground of improper purpose, in addition to being subject to the Code's sanctions[514].

3.3.1 Meaning of the 'No Frustrating Action' Rule

GP 7 prohibits action by the offeree board which is capable of frustrating an offer, unless shareholders in general meeting approve such action. Thus, the Code views the offeree shareholders as the ultimate persons to determine the success of a bid independently of management[515]. In other words, the Code's approach toward post-bid defences is permeated by the notion of shareholder sovereignty. The rationale underlying the latter approach is two-fold: First, shareholders are the owners of the company, and accordingly, they must decide the company's ultimate fate. Secondly, given the potential for conflict of interest, it is risky to allow the offeree management to interpose itself between the offeror and the shareholders of the offeree company. The latter rationale demonstrates that the Code is very sceptical about deferring decisions about the ultimate best interests

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by a director was considered to go beyond the purpose of the Code. Subsequently, in 1976, the word '*is imminent*' was replaced by the word '*might be imminent*'.

[511] P. L. Davies, 'Defensive Measures: The Anglo-American Approach', in K. J. Hopt and E. Wymeersch (eds), *European Takeovers: Law and Practice* (London, 1992), p. 209.

[512] P. L. Davies (2000), supra n 435, p. 10.

[513] C. Bradley, 'Corporate Control: Markets and Rules' (1990) 53 Modern L. Rev. 170, p. 179.

[514] Compliance with the shareholder approval requirement will, however, prevent a post-bid action from being in breach of the fiduciary rules.

[515] T. Ogowewo, 'The Underlying Themes of Tender Offer Regulation in the United Kingdom and the United States of America' (1996) J. Bus. L. 463, p. 478.

of the offeree company and its shareholders to management. It should be noted in this respect that GP is an effect-based rule. As a result, whether the purpose or intention of the offeree directors was to frustrate the offer is irrelevant. Indeed, the Panel stated that the essential test to evaluate a post-bid action is whether the action taken by the board '*could effectively result in [...] any [...] offer being frustrated*'[516].

GP 7 is supplemented by a number of rules which expressly prohibit the use of some defences which would render the offeree company less attractive or less vulnerable, unless they are approved by offeree shareholders. The most important of these is Rule 21, which presents a list of defences which can only be deployed upon shareholder approval. These include the sale or acquisition of assets; the issue of authorised but unissued shares; the transfer or sale of treasury shares; and the conclusion of contracts otherwise than in the ordinary course of business. Another rule supplementing GP 7 is Rule 37.3, which prohibits the offeree company from redeeming or purchasing its own shares without shareholder approval[517].

It should be noted the list in Rule 21 is in no way exhaustive[518]. In other words, the 'no frustrating action' rule covers any possible defensive tactic which could have the effect of frustrating an ongoing bona fide offer. Thus, for instance, the offeree board cannot pay an abnormal interim dividend, except with the Panel's consent, if such payment amounts to a disposal of assets of a material amount[519]. This is intended to preclude the offeree board from depleting cash, which would result in the offeror paying too high a price for the remaining assets. This technique is illustrated by *Charter Consolidated*'s hostile bid for *Anderson Strathclyde*. This bid was at a price which included the payment of dividend. Anderson's defence strategy included plans to pay a second interim dividend. However, the Panel refused to allow Anderson to pay the latter type of dividend, on the grounds that the effect would have been to take the amount of the dividend

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[516] Panel Statement of May 9, 1989 on *Consolidated Gold Fields*, p.12.
[517] Code, r.21(1)(a).
[518] *Consolidated Gold Field plc.*, supra n 515, p.6.
[519] Note that the term '*material amount*' is defined as equating to 10 per cent or more of the value of the company's gross assets; see Note 2 on r.21 of the Code.

out of Anderson and to frustrate Charter's bid. Another post-bid action likely to be viewed as frustrating action is the increase of directors' emoluments to a level which would be regarded as abnormal[520].

A number of criticisms deserve to be made, however, against the formulation of Rule 21: First, it is difficult to determine when an offer will be deemed to be 'imminent'. Secondly, the definition of what constitutes 'the ordinary course of business' is problematic. Much will depend on the nature of the business considered. The latter problem is evidenced by *Burton Group*'s bid for the shares of *Debenhams plc*. In this case, Burton appealed against the Panel Executive's ruling, which found that the variations introduced by Debenhams into its contracts with a number of 'shop-in-shop' concessionaires during the course of Burton's offer did not constitute a breach of Rule 21 of the Code. Following Burton's appeal, the full Panel held that the extent and timing of the contract variations in question were affected by the existence of the pre-bid speculation and of the offer itself, and that they could not therefore be held without qualification to have been made in the ordinary course of business[521].

In support of the 'no frustrating action' rule, the Code places further restrictions upon the directors faced with a bid. First and foremost, as seen above, the directors are required to circulate their views on the offer[522] and to provide shareholders with all the necessary information upon which an adequate decision can be made[523]. Secondly, the Code requires directors to act only in their capacity as directors[524]. However, directors can have regard to their personal shareholdings where there are competing offers for the offeree company. This is illustrated by *Re a Company (N° 008699 of 1985)*[525]. In this case, competing bids were made for

[520] Code, Note 6 on r.21(1).
[521] Panel Statement of July 25, 1985. In the event, the Panel concluded that the variations were not so material to the offer as to constitute a breach of the Code.
[522] Code, r.25(1) and 25(2). The Code's requirement that the offeree board must recommend either acceptance or rejection of a bid seems to come into conflict with the American federal law, which confer directors a legal right to express no opinion, so long as they provide reasons for their position; see Y. F. Danziger, 'Directors and Takeovers: The Right of Target Companies' Directors to Stay Silent Upon a Bid' (1984) 5 Co. Law. 213, p. 213.
[523] Code, GP 4, r.3(1), and r.23.
[524] Code, GP 9.
[525] [1986] B.C.L.C. 382 (Ch.).

a company[526] and its directors proposed to exercise their rights as shareholders to accept the lower bid. Hoffman J held

> '*Fairness cannot require more of the directors than to give the shareholders sufficient information and advice to enable them to reach a properly informed decision*'.

3.3.2 Rationale of the 'No Frustrating Action' Rule

The Code differs sharply from US state takeover law on managerial defensive tactics, where offeree boards can use an array of post-bid defences without resorting to shareholder approval. It is far from certain what the policy reasons were behind the adoption of the 'no frustrating action' rule in the UK. Some of the features of the bids preceding the adoption of the Code no doubt contributed to the adoption of this rule. It is suggested below that a number of other factors might also have contributed to the Code's policy in relation to post-bid defences. These include the then industrial policy; the composition of the City working party; and the Report of the Jenkins Committee.

i) Features of the bids preceding the adoption of the Code

Examples of attempts to thwart unsolicited bids date back to the 1950s. The leading example is provided by the case of *Land Securities Investment Company/Savoy Hotel Company*[527]. In this case, Land Securities made a hostile bid to acquire Savoy Hotel. The bidder's aim was to get possession of the Berkeley Hotel, which was owned by the Savoy Hotel, and to use the site for offices. The board of the Savoy Hotel transferred the Berkeley Hotel to a new company they set up for the occasion. Effective voting control of the new company was vested in the trustees of the Savoy Hotel's staff, and the trustees included the chairman of the Savoy Hotel board. The new company leased back the Berkeley Hotel to the Savoy Hotel, with a condition that the former could not be used otherwise than as a hotel without the new company's consent. Mr

[526] Note that the company in question was a private company.
[527] Note that, although this case involved a post-bid action, the validity of the latter was judged upon by the courts, by reference to directors' fiduciary duties. For the Code was not adopted yet at the time of this case.

Holland, Q.C. reported that, although the directors of the Savoy Hotel exercised their power to dispose of the Berkeley Hotel in the bona fide belief that the alternative use planned by the bidder would not be in the company's interest, the powers had been exercised '*in order to render irrevocable for all time the policy view of the present board*', so that never after could the shareholders '*alter the decision of their present board as to the present or future use of the property of the company*'[528]. Similarly, in 1958, in the case of *Reynolds Metal and Tube Investments Inc./British Aluminium*, the board of British Aluminium, which was subject to Reynolds Metal's bid, issued Alcoa, a friendly third-party, one-third of British Aluminium's then outstanding shares[529]. In so doing, the offeree board did not obtain the approval of its existing shareholders and thus provoked hostile opposition from merchant banks and securities professionals. The above cases constituted examples of contests for corporate control, where the offeree boards deployed post-bid measures which had undesirable effects.

ii) Report of the Company Law Committee

In 1959, the then President of the Board of Trade appointed a Committee, under the chairmanship of Lord Jenkins[530], to, *inter alia*, '*consider in the light of modern conditions and practices, including the practice of takeover bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable*'. The Committee produced a Report[531] in 1962, which recommended, *inter alia*, that directors should not be allowed to issue shares or to dispose of the whole, or substantially the whole, of the assets of the company without the approval of shareholders[532]. In particular, the Report admitted that takeovers were '*an essential feature of economic growth and development*', and its drafters therefore '*tried to avoid, as far as possible, placing obstacles in the way of honest and fairly conducted takeover*

528 L. C. B. Gower, 'Corporate Control: The Battle for Berkeley' (1955) 68 Harv. L. Rev. 1176, p. 1185.
529 Note that these cases took place before the Companies Act required shareholder approval for the issue of shares.
530 Hereafter the Jenkins Committee.
531 Report of the Company Law Committee (London: H.M.S.O., 1962) (hereafter the Jenkins Report).
532 Jenkins Report, paras 122(h) and (e), respectively. Note, however, that such recommendations were made independently of the existence of an on-going takeover bid.

transactions'[533]. Since defensive measures constitute obstacles to the fulfilment of takeover bids, it is fair to assume that the Committee was not in favour of post-bid defensive tactics. In turn, it is believed that the drafters of the Code were influenced by the recommendations embodied in this Report in drafting the neutrality rule.

iii) Industrial policy

Another factor which might have led to the adoption of the 'no frustrating action' rule is the then Labour government's policy to encourage the reorganisation of the British industrial structure through mergers and takeovers. Indeed, the view was widespread that UK firms suffered a handicap of inadequate size to compete effectively on world markets[534]. To promote its policy, the government set up in 1966 the Industrial Reorganisation Corporation[535]. The latter was intended to encourage mergers in industries it determined to be too fragmented[536]. To this end, it was empowered to do almost anything '*calculated to facilitate the discharge of its functions*'. Its powers included, *inter alia*, the acquisition, holding and disposal of securities, and the making of loans and giving guarantees. As a result of this policy, the period between 1960-70 was a period of great activity in the field of mergers and takeovers. Indeed, there had been between 600 and 1000 acquisitions by listed companies each year during that period. The IRC had a decisive role in some of the largest acquisitions of the period, including the merger of *GEC* first with *AEI* in 1967, and subsequently with *English Electric* in 1968.

It should be noted, however, that the government's policy inevitably tended to create monopolistic conditions in a number of domestic British markets. What was surprising is that, although the government had the power to prohibit a merger under the then Monopolies and Mergers Act of 1965, that power was seldom used. Indeed, between July 1965 and April 1969, only 10 of the 350 mergers falling within the scope of the merger legislation had been referred to the

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[533] Ibid, para 265.
[534] Note that only as late as 1969 did Britain have an electrical manufacturing company large enough to compete with the then electrical giants of Germany or the US.
[535] Hereafter the IRC.
[536] For this purpose, £150m was made available to the IRC to help suitable firms to merge.

then Monopolies and Mergers Commission. For instance, following its decision not to refer the GEC-AEI merger to the latter Commission, the Board of Trade stated that the merger would provide *'real benefits to UK's international competitiveness'*. This demonstrates that, despite the creation of monopolistic conditions, the government was intended to give pre-eminence to its policy of 'rationalisation' of the UK industry. As a result, it is suggested that the then industrial policy in the UK might have been instrumental in shaping the neutrality rule. For the government might have thought that such rule would serve to speed up the process of restructuration of UK companies.

iv) Composition of the City Working Party

In the summer of 1967, the Governor of the Bank of England reconvened the City Working Party that had drawn up the *Notes* and the *Revised Notes*[537], and entrusted them with the drafting of the Code. The Working Party organised a drafting committee, which did most of the work. This committee consisted of personalities who had all been involved in takeover battles. For instance, one of them was a partner in Rothschilds, a family bank which was the controversial advisers of *Richard Thomas & Baldwins* for their bid on the shares of *Whitehead Iron & Steel*[538]. Another worked for Morgan Grenfell, which had stood behind *Aberdare* in its battle for *Metal Industries*[539]. Another member of this committee worked as a solicitor at a prominent law firm, where he thoroughly dealt with takeover tactics, in particular through his involvement in the *GEC/AEI* bid[540]. Thus, all members of this committee were previously involved in takeover battles and they frequently stood on the side of the bidder. As a result, they had to cope with various defensive tactics deployed by offeree boards, in order to pave the way for their clients' success. It is therefore suggested that, in drafting the neutrality rule, these men might have been influenced by their previous involvement in fiercely fought takeover battles.

[537] The participating bodies were the Issuing Houses Association, the Accepting Houses Committee, the Association of Investment Trusts, the British Insurance Association, the Committee of London Clearing Bankers, the NAPF, and the London Stock Exchange. Note, however, that the CBI was represented for the first time.
[538] [1963].
[539] [1968].
[540] [1967].

It is true that these men were not free from interference. The draft they prepared was subsequently scrutinised by the full working party. It is suggested, however, that the very bodies composing the full Working Party were also in favour of the neutrality rule. Indeed, Bebchuk and Ferrell (1999) argue that the reasons why the Code went in such a different direction than the US lies in the fact that those responsible for the Code gave less weight to managerial interests because of the close connection at least some of them had with the interests of shareholders[541]. This holds true for a great number of organisations which made up the full Working Party. For instance, the NAPF, which is eager to increase the return on their clients' investment. It is suggested that even the Confederation of British Industry must have been, at the time, in favour of the neutrality rule, bearing in mind the then desire of the British industry to acquire large scale, in order to cope with the potential effects of the EC upon competition.

3.3.3 Permissible Post-Bid Defences

The following is an overview of the permissible post-bid defences. As we shall see below, the 'no frustrating action' rule considerably reduces the number of defences available to offeree boards faced with a bid.

i) Post-bid defences explicitly permitted by the Code to be taken without shareholder approval

The Code authorises actions referred to in Rule 21 to be taken without shareholder approval where they are conducted in pursuance of a contract entered into earlier[542]. This refers to obligations undertaken by the company towards third parties and aims at ensuring the certainty of law in contractual relations[543]. Thus, a contract entered into prior to the bid, and which organises defensive measures, is binding for the offeree company and the offeree board must execute its terms[544]. This can be illustrated by the case of *John Crowther Group plc*. In this case, options to subscribe for new Crowther shares were granted by the board to two of

[541] L. A Bebchuk and A Ferrell, 'Federalism and Corporate Law: The Race to Protect Managers from Takeovers' (1999) 99 Col. L. Rev. 1168, p. 1193.
[542] Code, r.21.
[543] G. O Barboutis (1999), supra n 449, p. 42.
[544] Ibid, p. 49.

its directors two days before the announcement that the company was in talks which might lead to an offer. The Panel held that this should not be regarded as a breach of Rule 21, on the grounds that the directors became entitled to the options under the terms of their employment contracts[545]. It should be noted that the Panel may consent to an action taken without shareholder approval even in circumstances where a formal contract has not been entered into, provided there is an obligation or other special circumstance, or where this is acceptable to the offeror[546].

ii) Disclosure of favourable information of a financial nature

Offeree directors who are faced with a bid may disclose favourable information of a financial nature. Indeed, the financial argument is statistically the most common and the most successful tool[547]. To this end, offeree directors may point out that they anticipate increased sales and profits in case the takeover attempt fails. In doing so, however, they must use every endeavour to prevent the creation of a false market in the shares of the offeree company[548]. This is because the disclosure of false favourable information may cause the market price of the offeree's shares to rise, and accordingly, convince the offeree shareholders to retain their shares. Thus, market transparency constitutes a fundamental protection for shareholders and others who deal in the UK securities markets[549].

A widely used defence strategy of a financial nature consists of issuing profit forecasts. The issue of a profit forecast considerably in excess of the profits for the previous year may convince the offeree shareholders that their company is worth much more than the offer, and they may thus reject the offer. Or forecasts may result in an increased offer being made by the offeror. The same holds true of a revaluation of assets, which is effected when the early-published value of the offeree's assets is not adequately stated[550]. The Code sets out, very stringent

[545] Panel Statement of May 24, 1988.
[546] Code, Note 1 on r.21.
[547] A. Paul (1993), supra n 474, p. 142.
[548] Code, GP 6.
[549] Panel Statement of July 17, 2003 on *Cordiant Communications Group plc.*
[550] Note that, in the early 1970s, it was common for assets to be stated at depreciated cost in financial accounts. Over the years, however, many companies have decided to review their asset

requirements in relation to both profit forecasts and asset valuations, given the latter's critical bearing on a bid's outcome. As far as asset valuations are concerned, the Code requires that the latter be supported by an independent valuer and that the basis of valuation be clearly stated[551]. As far as profit forecasts are concerned, the Code requires them to present the highest standards of accuracy, and to include the assumptions[552] upon which the directors have based them[553]. The latter assumptions are intended to help shareholders to form a view as to the reasonableness and reliability of the forecast. However, in practice it is unusual for the assumptions to cause be particularly informative[554]. It should further be noted in this respect the directors have sole responsibility for making the forecast. This is logical since the directors are in a best position to determine the likely profits. However, since the forecasts depends upon subjective judgments, the Listing Rules require them to be reported on by the auditors and by the sponsor, as to whether the profit forecast has been compiled by the directors after due and careful enquiry[555]. For instance, in *The Morgan Crucible Company Plc v Hill Samuel Bank Limited and Others*, the bidder, Morgan Crucible, claimed that the profit forecast put forward by the offeree company, First Castle Electronics plc, and on which the merchant bank, Hill Samuel, had commented was misleading and inaccurate[556].

Another widely used defence strategy of a financial nature is the payment of increased dividends[557]. This technique was for instance used in 1982 by *Croda International* against the hostile bid by *Burmah Oil*. The latter eventually lost the battle following an over-generous dividend policy taken up by the offeree company to defend itself against Burmah's bid[558].

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values periodically and incorporate them in the balance sheet; see T. E. Cooke, *Mergers and Acquisitions* (Basil Blackwell, 1986), pp. 233-234.

[551] Code, r.29. Note that the basis of valuation depends on the type of asset.

[552] Note that these must be readily understandable by investors, and be specific and precise; see Listing Rules, Ch. 12, r.12(27).

[553] Code, r.28(1) and (2), respectively.

[554] Especially when they say e. g. that there will be no change in current inflation or in exchange rates; see B. Morgan, 'Profit Forecasts and Asset Valuations', in (eds) M. Button and S. Bolton, *A Practitioner's Guide to the City Code on Takeovers and Mergers*' (Woking: City and Financial Publishing, 1997), p. 185.

[555] Listing Rules, Ch. 2, 2(19) and Ch. 12, r.12(24).

[556] [1991] 1 All E.R. 148.

[557] Code, Note 3 on r.21(1).

[558] 'Croda Goes 37% Down in the Face', *Evening Standard*, March 31, 1992.

iii) Criticism of the offer or the offeror

Once faced with a bid, offeree directors must obtain competent and independent financial advice on the merits of the offer, which they must subsequently circulate to the shareholders with their own recommendation[559]. The latter need not be favourable and the offeree directors may for instance argue that the consideration offered is worth less than it appears to be[560]. Indeed, the offeree directors may warn their shareholders that the value of the offeror's securities is likely to be depressed, if the bid succeeds, by the action of former offeree shareholders wishing to dispose of the offeror's securities they have received[561]. It should be noted, however, that the directors must prepare their recommendation with the highest standards of care and accuracy, as if it were a prospectus[562]. The effectiveness of this defence is limited, however. For the offeree directors may find themselves forced to recommend the bid, if the offeror produces a more attractive offer by either revising it or introducing a cash alternative. Offeree directors may also try to persuade their shareholders that the offeror is unsuitable to manage the offeree's business more effectively than the incumbent management. In this regard, they may point out to the poor past performance results of the offeror, if there are any, in operating its own business, or to the inexperience of the offeror in the type of business activities that the offeree company is involved in.

iv) Search for a white knight

This defence consists of soliciting a competing bid from an alternative offeror. The offeree company's desire to seek a white knight may be based on two grounds, these being the possibility that an auction would ensure that control of the company is transferred to the highest bidder, and the possibility that the competing offeror's plans for the offeree company offer a better outcome for the 'stakeholders'. Although the Code does not expressly regulate this defence, the

[559] Code, GP 4.
[560] Note, however, that this argument can only be put forward in the context of a share-exchange offer.
[561] M. A. Weinberg and M. V. Blank (1979), supra n 457, p. 610.
[562] Code, GP 5 and Code, r.19(1).

requirement that all offers be kept open for a minimum of twenty-one days after their initial posting[563] demonstrates that the Code encourages auctions by giving potential bidders time to assess the offeree company and launch their bids.

The problem with such defence is that there may not be another offeror willing to make an offer for the offeree company. Furthermore, the offeree directors may claim to be initiating an auction to the benefit of shareholders when, in fact, they are using this defence to protect their own position. Indeed, the white knight may have promised to retain the management or to present it with some other personal benefits[564]. Such outcome is likely to be mitigated, however, by a number of market-related factors. The first such factor is that, if the offeree directors agree to be taken by a friendly predator rather than the unwelcome original offeror, they will have to justify to their shareholders why they prefer the white knight's offer to the original offeror's offer. Another such factor is that shareholders will probably accept the offer of the white knight only if the latter is willing to pay a higher premium than the original offeror. It should be added that the Code's requirement that directors furnish any information given to a preferred offeror equally and as promptly to a less welcome potential offeror also serves to mitigate the above outcome[565].

Before turning to the next type of post-bid defensive measure, it should be emphasised that, all the permissible post-bid defences that we have described thus far are permitted precisely because they do not take the ultimate decision out of the hands of offeree shareholders.

v) Reference to the regulatory authorities

This defence consists of lobbying anti-trust or similar authorities with a view to convincing the latter to block the bid. Referrals to such authorities are not, as a rule, considered as frustrating actions. For instance, the offeree directors may encourage the Office of Fair Trading to refer a bid to the Competition

[563] Code, r.31(1).
[564] L. A. Bebchuk (1982), supra n 5, p. 1055.
[565] Code, r.20(2).

Commission, where the offer creates a merger situation qualifying for investigation according to the provisions of the Fair Trading Act of 1973. Since the Competition Commission usually reports within six months following the referral of a bid, the offeror may well withdraw its offer in the meantime. Similarly, the offeree directors may apply to the European Commission where the offer leads to a dominant position, which is sanctioned by the competition rules embodied in the EC Treaty[566].

It should be noted, however, that a referral to the anti-trust authorities would not necessarily deter an offeror from pursuing its bid. For the Panel normally grants consent to the making of a new offer in less than twelve months where the previous offer lapses as a result of a reference to such regulatory bodies[567]. Furthermore, GP 7 and Rule 21 continue to operate during the reference[568], which facilitates the offeror's activity. This can be illustrated by the case of *GKN Ltd/Miles Druce&Co. Ltd*[569]. In this case, following referral of the bid to the European Commission and the latter's decision not to initiate proceedings, GKN decided to renew its offer. At the same time, GKN requested the Panel that it prevents the board of Miles Druce from challenging the decision of the Commission before the ECJ without the approval of its shareholders in general meeting, on the grounds that this could effectively result in the frustration of GKN's offer.

Another regulatory authority which may be relevant in the context of takeover bids, and which may be referred to by the offeree directors, is the insurance regulatory bodies. This can be illustrated by the case of *Hoylake/BAT Industries plc*[570]. In this case, Hoylake made an offer for the shares of BAT Industries, which indirectly owned Farmers Inc. The offer was conditional upon the offeror obtaining all necessary regulatory approvals which, because of Farmers, included approval by the insurance regulatory bodies in some nine States of the US where

566 Consolidated Version of the Treaty Establishing the European Community, 24/12/2002, OJ C 325/33, art. 82. See also Draft Treaty Establishing a Constitution for Europe, 18/07/2003, OJ C 169/36, s.5, art. III-51.
567 Code, r.35(1).
568 Note 1 on r.12 of the Code.
569 Panel Statement of March 26, 1974 on *Guest, Keen and Nettlefolds Ltd/Miles Druce&Co. Ltd.*
570 Panel Statement of September 15, 1989 on *BAT Industries.*

Farmers was authorised to carry on business. The offeree company participated in the public regulatory process and in litigation initiated by the offeror to challenge the validity of that process. Hoylake submitted that the board of BAT sought to frustrate the offer, *inter alia*, by intervening in Hoylake's legal action against the insurance regulatory bodies. The Panel rejected Hoylake's argument, and held that it would be '*slow to characterise conduct in regulatory proceedings as frustrating action*'[571].

vi) Other permissible post-bid defences

Other post-bid defences include the appeal to offeree shareholders to consider the loyal service of offeree managers and employees in making their decision. This defence is of limited value, however. For it is unlikely that the offeree shareholders will forego the takeover premium on the grounds that the offer negatively impacts upon other constituencies. Another post-bid defence consists of encouraging friendly third parties to sell part of their shares in the offeror, with a view to depressing the market price of the offeror's shares. This defence is particularly useful in the event of a share-exchange bid. Moreover, the offeree board may encourage friendly investors to purchase offeree shares in the market[572]. Indeed, from the perspective of the offeror, a material holding by persons hostile to its offer could seriously jeopardise the success of its offer, as this would reduce the number of shares held by 'willing sellers' that it might otherwise purchase. Such persons must, however, be cautious not to cross the thirty per cent threshold, which would compel them to make a cash offer[573]. The only way by which the offeror could counteract such defensive market purchases would be to buy in the market itself. However, if the offer is a share-exchange offer, then such defensive market purchases would oblige the offeror to make a cash offer.

[571] Note, however, that the Panel further held that, in an appropriate case, involvement in a regulatory process could amount to 'frustrating action'; see ibid., p. 13.
[572] Note, however, that the offeree company cannot provide financial assistance for the acquisition of its shares; see CA 1985, s.151.
[573] Code, r.37(1). Furthermore, they must disclose their dealings pursuant to Rule 8 of the Code if they fall within the definition of 'associates'; see Code, Definitions.

Conclusion

The foregoing indicates that the UK regulatory framework is very restrictive toward post-bid defensive measures. Indeed, offeree companies in the UK can take only a limited number of post-bid measures. The only real defence seems to be to win the argument on value. However, the fact that the latter is no impossible task has been evidenced by the initial attempt by Blue Circle Industries, the UK cement-maker, to defeat a £3 billion hostile bid from French rival Lafarge in 2000[574]. In this case, the offeree board convinced shareholders that the offer price was inadequate; that it undervalued the offeree company; and that Lafarge had not yet arranged financing for the deal. Another example is provided by the resistance by Wolverhampton & Dudley Breweries against a £457 million hostile bid from Pubmistress in 2001, whereby the offeree board convinced the offeree shareholders to reject the bid in return for a share buyback supported by a loan from Barclays.

It should further be noted that, despite the Code's rigorous approach toward post-bid measures, market research indicates that, as a general guide, medium to large companies spend approximately one per cent of their market capitalisation to defend a hostile bid, and that advisory expenses can reach up to five per cent of the value of a hostile bid[575]. To reduce such expenses, some companies are even taking out hostile takeover insurance. It is by no means suggested, however, that the post-bid defences permissible in the UK are not worth their cost. On the contrary, the use of such defences results in the dissemination of a great deal of information about the offeree company, which benefits the offeree shareholders. It is nevertheless suggested that the Code should perhaps set a limit to advisory expenses and regulate the use by offeree companies of hostile takeover insurances.

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[574] 'Lafarge's Bid for Blue Circle Rejected', *Cement Americas*, March 2000, available at Lexis-Nexis Executive. At the same time, the offeree company made an early announcement of its 1999 results, which were higher than the forecast at the time of its profits warning in October 1999; see 'BCI Builds Foundation for its Defence: Cement Maker Kicks off Fight Against Lafarge with Early Results', *The Financial Times*, February 22, 2000. Note, however, that Lafarge, who was left with a substantial shareholding, was subsequently able to negotiate a recommended offer.

[575] J. Hayes, 'Hostile Takeovers: Planning for Defence Costs' (2003) 14 P.L.C. 6, p. 6.

In contrast to post-bid defences, companies in the UK seem to have a large number of pre-bid defences at their disposal. However, such defences are also subject to restrictions. The latter are mainly to be found in general company law. However, as seen above, in particular the common law is rather weak to prevent the use of detrimental pre-bid defences. This does not mean, however, that any pre-bid defence may accordingly be used in the UK. This is because such defences are further subject to the stock exchange rules, which contain additional restrictions designed to protect the shareholders. More importantly, as seen in the chapter on the ownership structure of listed companies and the market for corporate control in the UK and France, pre-bid defences are increasingly subject to the scrutiny of institutional investors.

Chapter 4 The Regulation of Defensive Measures in France

Introduction

Potential offeree companies in France have a large number of pre-bid defences at their disposal. In contrast, they have little room for manoeuvre during the currency of an offer. Indeed, the offeree board is severely constrained in adopting defensive measures following the filing of an offer. Indeed, other than the reform in 1989, which allowed the offeree board to issue shares during the course of an offer, no major reform has occurred with a view to facilitating the recourse by companies to post-bid defensive measures. It has therefore been argued that, whilst the company law requires the directors to run the company, the regulation of takeovers confines them to a role of provisional administrator[576].

This chapter provides an overview of the defence mechanisms available to companies listed in France. Section I examines the principles governing directors' actions both prior to and during a bid. Section II describes the permissible pre-bid defences. Finally, Section III describes the rules governing post-bid defences and the permissible post-bid defences.

4.1 Principles Governing Directors' Actions

This Section first describes the general company law provisions governing both pre-bid and post-bid defences. This author has focused in the chapter on the regulation of defensive measures in the UK on the bona fide and proper purpose tests, which form part of directors' common law fiduciary duties. In France, the company law does not impose fiduciary duties upon the directors. The absence in France of a legal fiduciary duty may seem odd, since the French usually pride themselves *'for relying on principles and leaving it to English purists to look for regulations'*[577]. Wymeersch (2003) argues that the rationale behind the absence of

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[576] A. Viandier, 'Réglementation des Offres Publiques et Droit des Sociétés: L'Expérience Française' (1993) Bull. Joly Bourse 7, p. 13.
[577] A. Tunc, 'The Fiduciary Duties of a Dominant Shareholder' in C. M. Schmitthoff and F. Wooldridge (eds), *Groups of Companies* (London: Sweet & Maxwell, 1991), p. 3.

a legal fiduciary duty in France may be that, until recently, there was less sensitivity in France, as well as in other European continental jurisdictions, to issues of personal conflict of interest, due to the predominance of controlling, especially family holdings in many listed companies[578].

However, the French legal writing often mentions the existence of such duties. For instance, Schmidt (2000) refers to directors' fiduciary duty when speaking of directors' conflicts of interests. He describes the latter as encompassing every situation where a director chooses to exercise his powers in contravention of the collective interest, to either satisfy a personal interest which is external to the company, or concede himself an advantage in the company to the detriment of the shareholders. He argues that such conflict can be resolved in favour of the proper functioning of the company, if and only if the director places his fiduciary duty before any other consideration[579]. Other scholars also recognise the existence of a fiduciary duty, though they recognise such duty to exist as between the shareholders of the company rather than as a duty of the directors towards the shareholders[580]. On the other hand, the French Supreme Court held in a number of cases that directors owe a duty of loyalty to the company. For instance, in one case, the director of a company, who resigned with a view to creating a rival company, was held liable by the Supreme Court on the grounds that he was bound by a duty of loyalty to his company[581]. More importantly for our purposes, the Court held in another case that the directors owe a duty of loyalty to the shareholders[582]. In that case, the director of a company was negotiating the sale of the company with an outsider. Meantime, a minority shareholder asked the director to find a purchaser for his shares. The director agreed to buy the minority's shares himself. However, the director paid a low price to the minority and subsequently resold the purchased shares to the outsider at a significantly higher price. The Supreme Court held the director liable on the basis of his duty of loyalty to the shareholder.

[578] E. Wymeersch (2003), supra n 44, p. 583.
[579] D. Schmidt, 'Les Conflits d'Intérêts dans la Société Anonyme: Prolégomènes' (2000) Bull. Joly Soc. 9, p. 24.
[580] See e.g. E. Wymeersch (2003), supra n 44, p. 581.
[581] Cass. Com. 24 February 1998 (1998) Bull. Joly, p. 813.
[582] Cass. Com., 27 February 1996, *Vilgrain c/ Mme Alary* (1996) JCP éd. E., 22664, p. 838, note Ghestin.

Despite the absence of a legal fiduciary duty, the latter defences are subject to numerous statutory rules. Indeed, there are several legal rules that directors must comply with in the performance of their duties, such as the rule requiring directors to refrain from taking any action which would be contrary to the best interests of the company[583]. Indeed, the company's interest is a fundamental concept of French company law and is omnipresent in the Code of Commerce[584]. However, this concept has not been clearly defined either by the legislators or the courts. Attempts to define it have been made by a number of scholars, such as Faugérolas (2003) who defines it as the collective interest of the shareholders in the proper functioning of the company[585]. The application of this concept in the context of pre-bid defences can be exemplified as follows: if, for instance, the purpose of a non-preemptive share issue is found to be to introduce into the share capital of a company a shareholder friendly to the incumbent management, rather than to obtain financial aid, it is obvious that the real purpose of such issue is different from that sought for. In such a case, the decision to issue shares will likely be against the interests of the company and it will be possible to invoke the concept of the *abus de majorité* to nullify such decision. According to a well-known formula of the French Supreme Court, there is *abus de majorité* whenever a resolution '*is taken contrary to the general interest and with the sole view to favour the members of the majority at the expense of the minority*'[586]. This can be illustrated by the case of *Marret v. SA Champagne Giesler et autres*[587]. In this case, the French Supreme Court nullified the transfer by a parent company of the shares it held in its subsidiary to a SCA, on the grounds that the resolution was taken against the interests of the company, with the sole aim to favour the members of the majority at the expense of the minority. This is because the *commandité* of the SCA was the controlling shareholder of the parent company

[583] This concept is to be found in art. 1848 of the Civil Code, which states that the director can take all acts of management in the interests of the company.
[584] L. Faugérolas, 'Impact of Take-overs and their Regulation on French Company Law and Practice' in K. J. Hopt and E. Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 328.
[585] Ibid, p. 328.
[586] Cass. com., 18 April 1961, *Sté des Anciens Etablissements Piquard Frères et Durey Sohy réunis c/Schumann et autres* (1961) D., p. 661.
[587] Cass. com., 24 January 1995, No. 185 P (1995) Bull. Joly 321.

and the interposition of the SCA between the parent company and its subsidiary turned the latter into an 'empty shell'[588].

There are other legal rules which deal with the directors' conflicts of interest, such as the rules mandating the disclosure of conflicts of interest and specific approval procedures involving the disinterested directors [589], or the rule prohibiting directors from taking loans out of company funds[590]. The latter is referred to as the *abus de crédit* or *abus de biens sociaux*[591]. For instance, large severance payments are considered in France as being at odds with the directors' obligation to act in the interests of the company, and may therefore constitute an *abus de biens sociaux*. It is further suggested that the broader concept of the *abus de pouvoirs*, which is embodied in the Code of Commerce [592], probably encompasses the UK bona fide and proper purpose doctrines. In other words, this author believes that the concept of the *abus de pouvoir* performs the same function in France as the bona fide and proper purpose tests in the UK.

Non-compliance with the above rules will likely give rise to directors' civil liability. Action for such liability may be brought by the company or its shareholders acting derivatively[593]. Derivative actions are rare, however, given that any benefit from such actions accrues solely to the company[594]. Shareholders may further sue the directors directly where they consider they have suffered a personal prejudice[595]. More importantly, some offences give rise to directors' criminal liability. For instance, the *abus de biens sociaux* represents the most frequently invoked and effectively enforced criminal offence in French company law.

[588] Note that this defence was also used in the *Mutuelle du Mans Assurance-Vie et autres c/Sté OCP* case, where the main assets of a listed company – OCP – were transferred to two SCAs, which were the subsidiaries of OCP; see supra n 216.
[589] Code of Commerce, arts L. 225-38 to L. 225-43.
[590] Code of Commerce, art. L. 225-43.
[591] i.e. the use by a manager of the credit or the assets of the company for his personal purposes; see Code of Commerce, art. L. 242-6(3).
[592] Code of Commerce, art. L. 242-6(4).
[593] Derivative actions are regulated by art. 1843-5 of the Civil Code.
[594] M. Cozian, A. Viandier and F. Deboissy, *Droit des Sociétés* (Paris: Litec, 2002), p. 168.
[595] J. P. Le Gall and P. Morel, *French Company Law* (1992), p. 144.

4.2 Permissible Pre-Bid Defences

The following describes only the pre-bid defences whose use is restricted by statutory and/or stock exchange rules, or by judicial decisions.

4.2.1 Disclosure

The disclosure requirements embodied in the law may act as a pre-bid defence. Indeed, the French law imposes a number of disclosure requirements upon crossing certain thresholds[596]. Non-compliance with the latter results in the automatic deprivation of the voting rights of the undisclosed shares for a period of two years following their notification[597]. In addition, voting rights may be totally or partially suspended for up to five years by the commercial court if, upon request of the company, its shareholders or the AMF, the circumstances are shown to have warranted such penalty[598]. Companies may further stipulate in their articles of association an obligation for shareholders to transform their bearer shares into registered shares[599] where they cross a certain percentage of the capital[600]. More importantly, companies may opt for the so-called system of 'identifiable bearer securities'[601], which allows companies to find out the identities of the holders of bearer securities as well as the number of securities held by each of them, by making a request to the institution authorised to keep the list of shareholders. This system is particularly useful since most companies listed in France use bearer shares. The TPI regime combines the speed with which negotiations are carried out, which is associated with bearer securities and the communication between the shareholders and the issuer, which is associated with registered securities[602]. It should be noted, however, that the TPI regime has two

[596] e.g. Code of Commerce, art. L. 233-7 and Cob Regs, r.17. Note that the thresholds are determined by reference to the voting rights where the number of voting rights does not correspond to the number of shares.
[597] Code of Commerce, art. L. 233-14.
[598] D. Berger, 'Guidelines for Mergers and Acquisitions in France' (1991) 11 Nw. J. Int'l L. & Bus. 484, p. 515.
[599] Note that, since 1984, securities issued in France are no longer evidenced by paper certificates.
[600] T. Vassogne, 'Défenses Anti-OPA' (1998) 57 Banque et Droit 27, p. 27.
[601] i. e. titres à porteur identifiables (hereafter the TPI). This regime was introduced by the Law No. 87-416 of 17 June 1987, and is now regulated by art. L. 228-2 of the Code of Commerce.
[602] Note that the Law of 2001 (Law No. 2001-420 of 15 March 2001, JO 16 May, p. 7776) has supplemented the above regime by allowing issuers to require any holder of registered securities that

major shortcomings: First, it can only prove effective if it is being used in a permanent fashion. However, its cost is likely to induce the issuer to limit its research to shareholders holding over a certain percentage of the shares or voting rights[603]. Secondly, this regime removes the anonymous nature of the *société anonyme* by turning it into a *société relativement anonyme*[604].

4.2.2 Non-Voting Preference Shares, Voting Caps, Investment and Voting Certificates, and Shares with Double Voting Rights

In principle, French law is dominated by the 'one share, one vote' principle[605]. However, the law allows companies to deviate from the latter in a number of ways: First, a company may issue non-voting [606] preference shares [607] to shareholders who have no affiliation with the management and who are therefore likely to sell their shares to whomever is willing to pay a control premium. These shares thus serve to raise equity without diluting the voting rights. Non-voting preference shares may indeed be financially attractive to shareholders without management affiliation, as such shares have priority in terms of receiving dividends over the ordinary shares, and they involve minimum dividend streams[608]. By providing such shareholders with non-voting preference shares, a company may deprive potential offerors of the support of the shareholders most likely to accept their offer [609]. However, only companies that have made distributable profits during the two fiscal years preceding the date of the proposed issue are allowed to issue non-voting preference shares[610] and the number of such

they believe is a mere intermediary to disclose the identities of the beneficial owners; see Code of Commerce, art. L. 228-2.

[603] T. Bonneau and L. Faugérolas, *Les Offres Publiques* (Paris: EFE, 1999), p. 94.

[604] D. Bureau, 'La Loi Relative aux Nouvelles Régulations Economiques: Aspects de Droit des Sociétés' (2001) Bull. Joly Soc. 553, p. 585.

[605] Code of Commerce, art. L. 225-122.

[606] Code of Commerce, art. L. 228-12.

[607] Code of Commerce, art. L. 225-126.

[608] Indeed, the dividend cannot be lower than the first dividend. Nor can it be lower than 7,5 per cent of the paid amount of the capital represented by the non-voting preference shares; see Code of Commerce, art. L. 228-13.

[609] K. Byttebier, 'Protective and Defensive Measures Against Hostile Takeovers' in E. Wymeersch (ed.), *Further Perspectives in Financial Integration in Europe* (Berlin: Walter de Gruyter, 1994), p. 186.

[610] Code of Commerce, art. L. 225-126.

shares cannot exceed one-fourth of the capital[611]. Furthermore, if the holders of such shares do not receive a dividend over three consecutive years, then they regain their voting rights until the close of the first fiscal year during which their dividend is paid[612].

Secondly, a company may provide in its articles for voting caps. As early as 1989, the AMF proposed that companies should include in their articles a standard clause which would automatically invalidate the cap if the offeror receives acceptances for more than fifty per cent of the shares[613]. This proposal is reminiscent of the breakthrough rule embodied in the Directive on takeover bids, which will be examined in the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids. An alternative proposal was made by Schmidt (1994), who suggested that the offeror should be allowed to make an offer conditional upon the removal of the voting cap by a resolution of shareholders in general meeting. Pursuant to his proposal, the shareholders would vote in favour of the removal only if they wish to accept the offer[614]. Another proposal was put forward by Bonneau and Faugérolas (1999) who suggested that the minority shareholders of a company which provides for a voting cap should be allowed to exercise their sell-out rights, given that the cap involves a substantial modification to the company's articles of association[615]. The latter scholars also noted, however, that it was questionable whether the AMF could trace any controlling shareholder(s) on whom to impose a buy-out offer, given that companies which adopt such caps do not usually have a controlling shareholder(s)[616].

In spite of the above-mentioned alternative proposals, most companies have in practice complied with the AMF's proposal, though they set a higher threshold to remove the cap than that proposed by the AMF. For instance, in 1992, BSN Danone provided in its articles for a voting cap, which limited the voting rights of

[611] Code of Commerce, art. L. 228-12.
[612] Code of Commerce, art. L. 228-14..
[613] Annual Report COB 1989, p. 124 and Annual Report COB 1993, p. 51.
[614] D. Schmidt, 'Plafonnement du droit de vote et OPA' (1994) 44 RD bancaire et bourse 151, p. 152.
[615] T. Bonneau and L. Faugérolas (1999), supra n 603, p. 106.
[616] Ibid, p. 106.

shareholders to six per cent[617]. Such cap was to become ineffective, however, if the offeror received at least ninety per cent of the shares. The latter figure was judged to be too high by the AMF. As a result, BSN Danone lowered it so that the cap would become ineffective upon receipt of two-thirds of the offeree's voting rights.

Thirdly, a company may split shares into investment and voting certificates[618]. This technique is peculiar to France and serves to keep voting control in the hands of the *noyau dur*, in an attempt to deny foreign acquirers to have a say in the running of French listed companies. The ICs represent the pecuniary rights, are transferable[619], and are entirely deprived of the *affectio societatis*. The VCs, on the other hand, represent the other rights attaching to shares, and are transferable only to the holder of an IC or if accompanied by an IC[620]. It should be noted, however, that such certificates cannot represent more than one-fourth of the issuer's share capital.

A final defence which deviates from the 'one-share-one-vote' principle, and which is commonly used in France, is the provision of double voting rights to loyal shareholders[621]. An analysis of 156 companies in 1999 showed that 68 per cent of them had a regime of double voting rights[622]. However, to qualify for double voting rights, the shares must be fully paid up and be registered for at least two years in the name of the same holder[623]. Companies may provide in their articles for a period longer than two years in order for the shares to qualify for double voting rights, though listed companies are not allowed to provide for periods longer than four years[624]. Double voting shares are likely to render the acquisition of control in a company longer, given that the offeror will need to either hold shares for at least two years until they qualify for double voting

[617] Note that the ceiling was raised to 12 per cent in the event of double voting rights; see ibid, p. 104.
[618] Code of Commerce, art. L. 228-30 to L. 228-35. Hereafter the IC and the VC, respectively.
[619] Code of Commerce, art. L. 228-30.
[620] Code of Commerce, art. L. 228-30.
[621] Code of Commerce, art. L. 225-123.
[622] C. Van der Elst (2000), supra n 311, p. 30.
[623] Code of Commerce, art. L. 225-123.
[624] J-J. Daigre, D. Bompoint and F. Basdevant, 'La Prise de Contrôle Rampante' (2000) 6 Cahiers dr. entrepr. 1, p. 8.

rights[625]. This is because the transfer of double voting shares results in the loss of the double voting rights. It should be added that this technique might even be resorted to at the last minute, in case of imminent threat, by way of a general meeting decision. This is because the period of two years, which is necessary for the shares to qualify for double voting rights, is calculated by reference to the date when a person registers in the company's share registry and not by reference to the date when the general meeting takes a decision in this direction[626].

It should be noted, however, that market forces seem to induce French companies to eliminate double voting rights. Indeed, a number of companies such as Vivendi have recently eliminated a long-standing policy of double voting rights. This was prompted by the objections of both French and international investors to a shareholder resolution in 2000, which permitted Vivendi to make the voting power of blocks above two per cent contingent on the level of voting turnout. Given Vivendi's historical thirty per cent voting turnout, such resolution would prevent blockholders from exercising influence on the company. Opposition to double voting shares is also echoed by the French Commission on Corporate Governance, which takes the view that companies should eradicate such shares, which can be used in a manner contrary to the spirit of responsible corporate governance[627].

The foregoing indicates that, by issuing shares with double voting rights to a core of loyal shareholders, and at the same time by reinforcing the company's equity by issuing non-voting preference shares and/or investment certificates, the management of a company may well entrench itself.

4.2.3 Issue of Authorised but Unissued Shares

French companies may also issue securities to a core of friendly shareholders. Such securities can take the form of securities which over time lead to the

[625] J. Charbit, 'France' in J. C. F. Lufkin and D. Gallagher (eds), *International Corporate Governance* (Euromoney Books, 1990), p. 103.
[626] R. Vatinet, 'Les Défenses Anti-OPA' (1987) 105 Rev. Soc. 539, p. 555.
[627] *Recommendations on Corporate Governance* (1998), supra n 391, p. 6.

ownership of shares or voting rights by their holders, with the understanding that they will not come into play unless a hostile bid is declared[628]. The latter type of securities constitute an effective defence for the issuer, as they allow their holders to convert them into equity subsequent to a hostile bid[629]. Such conversion would dilute the offeror's stake and increase the costs of its offer. The issue of such securities necessitates, however, that the existing shareholders waive their pre-emption rights in favour of the holders of such securities[630]. It should be noted in this respect that this technique will not necessarily guarantee the loyalty of the core of friendly shareholders. For the latter may be tempted to sell their shares to a hostile offeror. To remedy this risk, companies usually combine this technique with the use of shareholder agreements.

4.2.4 Share Buy-Backs

Another pre-bid defence at the disposal of French listed companies consists of purchasing their own shares. Until recently, as a general rule, the purchase by a company of its own shares was prohibited, except under limited circumstances and under very strict conditions[631]. This was due to the perception in France of the share capital as a guarantee of the company's creditors.

However, in 1998, the Esambert Report[632] suggested to reform this area of company law, on the grounds that the above perception had become obsolete and that the exceptions under the old regime were insufficient for a dynamic financial market. The Report further noted that this defence is frequently used in the US. The Report advised, however, that the reform should be made within a legislative and regulatory framework which would dissipate the dangers of a sheer liberalisation[633]. Following the reform[634], the emphasis changed from that of

[628] Code of Commerce, art. L. 228-91 to L. 228-97.
[629] It should be noted, however, that the rules on capital formation embodied in the Second Company Law Directive make it difficult to issue securities at a discount so as to dilute the capital of the offeror; see G. A. Ferrarini (2001), supra n 508, pp. 13-14.
[630] Code of Commerce, art. L. 228-92.
[631] Law of 1966, art. 217.
[632] *Rapport Esambert sur le Rachat par les Sociétés de leurs Propres Actions* (January, 1998), available at AMF website.
[633] J. J. Daigre 'Le Rachat par les Sociétés de leurs Propres Actions: Présentation et Commentaire du Rapport de M. Esambert' (1998) 65 RD bancaire et bourse 3, p. 3.

prohibition to that of authorisation. The essence of the reform consists of allowing companies to carry out share buy-backs for economic and financial management purposes[635], which as a result allows companies to hold shares in treasury. This permits companies to take out their 'dormant funds' and to increase the latter's profitability, with a view to protecting themselves against the risk of hostile takeovers[636].

Share buy-backs must, however, meet certain requirements: First and foremost, the ordinary general meeting must authorise the board to carry out such purchases[637] and the duration of the period for which the authorisation is given cannot exceed eighteen months[638]. In addition, such purchases cannot exceed ten per cent of the capital[639]. When determining whether the company has crossed the ten per cent threshold, not only the shares held directly by the company but also the shares held by third parties acting on behalf of the company and the shares held by the subsidiaries are to be taken into account. Furthermore, the shares so purchased must be held in registered form, and the company must file a prospectus with the AMF[640]. Moreover, the company must set up a reserve, other than the legal reserve, of an amount at least equal to the value of the shares held by the company, and the purchase cannot result in the amount of the company's equity becoming less than the amount of its share capital, increased by any non distributable reserves[641]. It should further be noted that the shares so purchased lose their voting rights, their right to dividend, and their pre-emption rights[642]. The 1998 reform has been successful and listed companies increasingly carry out share buy-backs. There have been seven since January 2003, against two in 2002 and six in 1998[643].

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[634] Law No. 98-546 of 2 July 1998, JO of 3 July 1998, p. 10127.
[635] Code of Commerce, L.225- 209.
[636] H. Vauplane, M. Germain and J. P. Bornet (2001), supra n 129, p. 817.
[637] The shares purchased may be sold, exchanged or cancelled.
[638] Code of Commerce, L.225- 209.
[639] Code of Commerce, L.225- 209.
[640] Code of Commerce, L.225- 210.
[641] Code of Commerce, L.225- 210.
[642] Code of Commerce, L.225- 210.
[643] 'A Paris, les Sociétés Cotées Prennent la Clef des Champs', *La Tribune*, August 6, 2003.

An alternative defence to share buy-backs consists of the purchase by a subsidiary of shares in its parent company, at the request of the latter[644]. This technique allows a company to indirectly become its own shareholder by holding its shares through its subsidiaries. Prior to the Law of 1989, such shares were allowed to be voted up to a limit of ten per cent of the votes of all shareholders present or represented at the general meeting[645]. This, in turn, enabled the management of prospective offeree companies to effectively lock up a portion of their capital[646]. The Law of 1989 deprived, however, these shares from their voting rights[647] and thus rendered it more difficult to lock up a listed company for the benefit of the incumbent management. Henceforth, the only benefit arising out of this pre-bid defence is to have a smaller number of outstanding capital that the hostile bidder may acquire. At the same time, however, the holding by a subsidiary of shares in its parent may facilitate the acquisition by the offeror of control of the parent, given that the threshold to acquire control of the latter will be reduced[648].

It should be noted that the AMF does not support the practice of companies holding shares in the capital of their parents, on the grounds that this results in having an imaginary capital and superficial general meetings. Furthermore, in the AMF's view, this practice serves to protect the management team in place[649]. The latter criticisms should not be of great concern, however, since very few French companies currently resort to this practice[650]. For instance, Suez owns 8 per cent of its shares through its subsidiaries Société Générale de Belgique and Groupe Victoire.

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[644] This defence is referred to in France as the 'auto-contrôle'.
[645] Law of 1966, art. 359-1.
[646] A. Marquardt, 'Tender Offers in France: The New Rules' (1990) I.F.L.Rev. 35, p. 36.
[647] Code of Commerce, art. L. 233-31.
[648] 'Mesures Anti-OPA: De la Panoplie à la Mise en Œuvre', 541 *Option Finance* 31, March 29, 1999, p. 32.
[649] Annual Report COB 1989, p. 88.
[650] B. Mojuyé (2000), supra n 366, p. 84.

4.2.5 Cross Shareholdings

Cross-shareholdings in large groups serve to perpetuate control within the corporate sector[651]. Such shareholdings have always been an attribute of the French takeover regime. The rationale behind their creation was to prevent foreign companies holding large stakes in French companies which were privatised in 1986. However, a study conducted in 2001 on ten privatised companies shows that this technique has not been able to really prevent the increase of foreign presence in French capitalism[652]. This is because, over the past decade or so, companies have been unwinding their traditional cross-shareholdings. As a result, directors of many large listed companies can no longer rely on the support of a hard core of stable French shareholders. Furthermore, the Commission on Corporate Governance has stated that this practice '*runs counter to openness and independent decision-making*', except in cases where cross shareholdings are the result of strategic alliances[653].

Under the French law, a company cannot own more than ten per cent of the capital of another company if the latter holds more than ten per cent of the capital of the former[654]. If a company holds more than ten per cent of the capital of another company, which in turn holds more than ten per cent of the capital of the former, one of the two must agree to sell its interest in the other company. In case of disagreement, the company holding the smaller interest must sell its shareholding within one year following the notification made by the other company[655]. The ten per cent threshold is likely to induce a potential offeree company to purchase as quickly as possible a stake of more than ten per cent in the capital of a potential offeror in order to subsequently invoke to its own benefit the rule on cross shareholdings. If the interconnected interests are equal, each company must reduce its interest in the capital of the other to, at most, ten per cent[656]. Pending such reduction, shares in excess of the ten per cent threshold are

[651] J. Franks and C. Mayer (1997), supra n 235, p. 295.
[652] L. Bloch and E. Kremp (2001), supra n 138, p. 106.
[653] *Recommendations on Corporate Governance* (1998), supra n 390, p. 9.
[654] Code of Commerce, art. L. 233-29.
[655] Code of Commerce, art. L. 233-29.
[656] Code of Commerce, art. L. 233-29.

deprived of their voting rights[657]. It should be noted, however, that the rule only concerns direct cross shareholdings and does not apply to indirect shareholdings in the subsidiaries of friendly companies. Thus, company A and company B may hold only nine per cent in the capital of each other, but each of them may hold a greater percentage of shareholding in the subsidiary of the other[658].

Another pre-bid defence which is closely associated with cross shareholdings is the pacman defence[659]. It is still questionable, however, whether an offeree company may legally resort to this defence in France. This is because the rule on cross shareholdings should prevent the offeree company from launching a counter-bid on the original bidder where the latter already holds more than ten per cent in the capital of the offeree company[660]. This defence has nevertheless been used in 1999 by Société Elf Aquitaine, in its battle against TotalFina. In this case, TotalFina's offer had closed before Elf made a counter-bid. However, at the time Elf filed its counter bid, it was still unclear how many shareholders had tendered their shares in favour of TotalFina's offer and thus whether TotalFina's offer could result in TotalFina owning more than ten per cent of Elf. Subsequently, the parties settled, and the AMF did not have to judge upon the validity of this defence in France.

Legal scholars have continued the debate, however, as to the validity of the pacman defence in France. Some interpret the rule on cross shareholdings as prohibiting any acquisition whatsoever of shares in excess of the ten per cent threshold. This view is held by Viandier, who anticipates that, if the pacman defence is used again in the future, the courts are likely to invalidate it on the grounds that it falls foul of the rule on cross shareholdings[661]. Others interpret the rule on cross shareholdings as not prohibiting any acquisition *per se* but rather as requiring the immediate disposal of the shares in excess of the ten per cent

[657] Code of Commerce, art. L. 233-29.
[658] R. Vatinet (1987), supra n 626, p. 550.
[659] i.e. when the offeree company launches a counter offer over the offeror company.
[660] Also note that there may be circumstances where the pacman defence can simply not be implemented legally. This is particularly the case where the offeror cannot be taken over simply because it is a *société en commandite par actions*; see D. Carreau and J. Y. Martin, 'Les Moyens de Défense Anti-OPA en France-2[e] partie' (1990) 510 Banque 1032, p. 1033.
[661] I am indebted to Professor Alain Viandier at the University of Paris V for his valuable comments on this point during my interview with him in January 2003.

threshold. This view is held by Daigre, who argues that requiring the company holding the smaller interest to regularise its situation within one year renders the pacman defence consistent with the rule on cross shareholdings[662]. He further argues that the AMF has no authority to judge upon the validity of this defence in France and therefore supports the AMF for not having done so during the TotalFina/Elf battle. In his view, the AMF would have committed an *abus de pouvoir* had it acted otherwise during the latter battle. For, his argument goes, this is a matter for company law and therefore falls outside the scope of the AMF's activities.

4.2.6 Sociétés en Commandite par Actions

Another pre-bid defence, which is peculiar to France and which has no equivalent in the UK, concerns the use of *sociétés en commandite par actions*[663]. Since the early 1980s, SCAs[664] have been enjoying a revival in France. This is because this technique allows a considerable amount of outside capital to be raised while keeping the running of the company in the hands of a few members[665]. Indeed, in a SCA, there are two types of members. On the one hand, there are the *commanditaires* whose liability for the debts is limited to the amount of their contributions, whose shares are freely transferable as in a public limited company[666], but who are deprived of the management powers[667]. On the other hand, there are the *commandités* who are individually liable for the whole of the debts without limitation, whose shares are transferable only with the consent of all the other *commandités*, and who have the exclusive power to manage the SCA. Thus, an offeror who acquires the majority of the capital in a SCA cannot acquire the right to control the latter. As a result, transforming a public limited company into a SCA may be an effective means to prevent hostile offers. For the prospect of becoming a *commanditaire* without a say in the running of the SCA is likely to

[662] I am indebted to Professor Jean-Jacques Daigre at the University of Paris I for his valuable comments on this point during my interview with him in January 2003.
[663] Hereafter the SCA.
[664] Code of Commerce, art. L. 226-1 to 226-14.
[665] J. P. Le Gall and P. Morel (1992), supra n 595, p. 22.
[666] Hereafter the SA.
[667] A. Perrier and R. Scacchi, *Stratégies Anti-OPA* (Paris: Economica, 1995), p. 43.

be unattractive for potential offerors[668]. It should be added in this respect that such transformation requires a two-thirds majority of the votes at the shareholders' extraordinary meeeting, with the unanimous consent of the prospective *commandités*.

It should be noted, however, that although the AMF does not oppose the listing of an already existing SCA provided shareholders are adequately informed that they will have reduced rights in comparison with those in a public limited company, it is more reluctant to approve the transformation of a public limited company into a SCA[669]. The authorities have become less reticent, however, following the reform of 1989, which introduced the right of the minority to exercise their sell-out rights upon transformation of a public limited company into a SCA[670]. This right has been conferred on the minority on the grounds that such transformation alters the original articles of association to a significant extent[671]. It should further be added that such transformation may be characterised as an *abus de majorité* by the courts, which would then nullify the resolution taken to that effect[672]. For instance, the Paris Tribunal of Commerce nullified the transformation of Sidef Conforama into a SCA, on the grounds that this constituted an *abus de majorité* on the part of the designated *commandité*.

4.2.7 Other Permissible Pre-Bid Defences

Other widely used pre-bid defences in France include the distribution of exceptional dividends and the payment by a company to its loyal shareholders of so-called *loyalty premium dividends*[673]. In order to receive the latter, shares must have been registered for at least two years in the name of the same holder. In addition, shareholders in extraordinary general meeting must approve a resolution taken to that effect. However, the number of shares eligible for the increased

[668] Ch. Gavalda, 'Commentaire de la Loi du 2 Août 1989 Concernant l'Amélioration de la Transparence et de la Sécurité du Marché Financier' (1990) Rev. Soc. 1, p. 19.
[669] T. Bonneau and L. Faugérolas (1999), supra n 603, p. 108.
[670] CMF regs, r.5-6-5.
[671] Annual Report COB, 1988, p. 18.
[672] T. com. Paris, 29 June 1981; see (1982) Rev. Soc., p. 791.
[673] Code of Commerce, art. L. 232-14. Note that the Commission on Corporate Governance is also against 'loyalty premium' dividend payments; see *Recommendations on Corporate Governance* (1998), supra n 390, p. 7.

dividend cannot exceed, for the same shareholder, 0.5 per cent of the company's share capital. The use of loyalty premium dividends may act as a deterrent for potential offerors, for the transfer of shares eligible for the increased dividend results in the loss of the right to a premium. However, the 0.5 per cent ceiling threshold is likely to discourage shareholders owning more than 0.5 per cent of the capital, since they will only be partially rewarded.

Another widely used pre-bid defence by French listed companies is the creation of a hard core through shareholder agreements. The latter are very common in French listed companies and often have a significant influence on the outcome of an offer[674]. This is because such agreements usually involve the granting by offeree shareholders of pre-emption rights to each other, which restricts the free transferability of their shares. The French law requires any clause of such agreement which includes preferential conditions for the sale or acquisition of shares, such as pre-emption rights, or put and call options, and which concerns at least 0.5 per cent of the share capital or voting rights of the issuer to be notified to the AMF[675]. The choice of 0.5 per cent as a threshold results from the legislator's desire to publicise a maximum number of shareholder agreements, and at the same time to exclude those which do not affect the course of offers[676]. The 0.5 per cent threshold is also in line with the minimum disclosure threshold that French listed companies may stipulate pursuant to the Code of Commerce[677]. Non-compliance with the obligation to disclose results in the suspension of the clause and the release of the parties to the agreement from their commitment during the course of an offer. The latter sanction, which has been provided by the Law of 2001, has caused furore amongst legal practitioners. For, in the latter's view, this sanction ignores the French principle pursuant to which '*le contrat est la loi des parties*'[678].

[674] V. Médail and P. Vergnole, 'La Réforme des Offres Publiques par la Loi sur les NRE' (2001) Bull. Joly soc. 766, p. 767.
[675] Code of Commerce, art. L. 233-11. Note that agreements which are outside the scope of this rule need nevertheless be disclosed if they may have an incidence on the outcome of an offer; see COB regs, r.4.
[676] V. Médail and P. Vergnole (2001), supra n 674, p. 767.
[677] Code of Commerce, art. L. 233-7.
[678] I am indebted to Ms Anne Maréchal at the law firm Auguste & Debouzy for her valuable comments on this point.

4.2.8 Structural Factors

Unlike in the UK, there are a great number of structural factors in France, which may act as a deterrent to hostile offerors. For instance, most listed companies in France resort to pyramid structures, which result in very low liquidity for all the companies involved[679]. Indeed, a study in 1997 shows that the number of groups have exploded in France, from 1,300 in 1980 to 6,700 in 1995[680]. More important, the French State is traditionally heavily involved in the ownership and management of large public companies through golden shares[681]. The latter were first introduced in the wake of the privatisations in 1986[682], with a view to protecting the national interests in newly privatised companies operating in strategic sectors. The Law of 1993 further extended the prerogatives attaching to such shares, by conferring on the Minister of Economy power to appoint representatives to the board of directors; to veto the sale of assets or their granting as a guarantee; and to approve the crossing of certain thresholds of the capital or the voting rights. Although the latter power constitutes a departure from the stock exchange rule which prohibits transfer clauses[683], it has been justified in view of the objectives pursued by the issuance of such shares[684]. It should be noted, however, that, as seen in the chapter on the ownership structure of listed companies and the market for corporate control in the UK and France, the use of golden shares by the French government has been rendered more difficult by the

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679 J. G. Garcia, 'Freeing Europe's Corporates from Minority Control' (2002) 21 I.F.L.Rev., p. 13. A pyramid can be defined as a group structure characterized by a more or less long chain of control using several holding companies. The ultimate shareholders control each company in the chain by majority or controlling minority interests, leaving minority shareholders at each level. The result is that the ultimate shareholders may control the whole chain up to and including the company at the bottom on the basis of a small total investment; see *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* (November, 2002), p. 98, available at europa website.

680 L. Bloch and E. Kremp (2001), supra n 138, p. 106.

681 These were issued following the introduction of the Privatisation Law No. 86-912 of 6 August 1986, as amended by the Law No. 93-923 of 19 July 1993.

682 Law of 1986, art. 10, as modified by the Law of 1993.

683 COB regs, r.4. See also article P 1-1-17 of Book II: Specific Rules Applicable to the French Regulated Markets. Note that Book II contains non-harmonised market rules and will soon be replaced by Book I, which contains harmonised market rules. Chapter 6 of Book I will contain rules for the listing of securities.

684 L. Richer and A. Viandier, 'La loi de Privatisation' (1993) 281 JCP, éd. E, I 445, pp. 450-451.

ECJ's landmark judgment on the French government's golden share in Société Elf-Aquitaine[685].

It should be added that French companies have at their disposal another tool, which is closely associated with the golden shares. This consists of the creation of a *noyau dur* within the privatised companies, by selling the formerly state-owned shares to investors chosen by the State. The idea behind this tool is, as in the case of golden shares, to keep privatised companies nationally 'anchored'[686]. This defence was initially created in view of the fact that, under the Law of 1986, golden shares used to automatically transform into ordinary shares after a period of five years following their issuance[687]. According to data during the privatisations of 1993, participants to the hard core were compelled to retain all of the shares issued for a period of at least three months. At the end of this period, they were compelled to keep eighty per cent of the shares issued for a period of at least twenty-one months (BNP) or fifteen months (Rhône-Poulenc) and, at the end of the latter period, agree to a mutual pre-emption right for the subsequent three years (BNP et Rhône-Poulenc). As a result, participants to the hard core were allowed to freely dispose of their shares only after five years following the date of issuance[688].

Another barrier difficult to surmount by foreign bidders relates to the power of chairmans/CEOs[689] in French listed public sector companies. Most of these PDGs have been educated in two elite state schools, namely the Ecole Nationale d'Administration and the Ecole Polytechnique. Indeed, graduates of the latter schools represent fifty per cent of the management of the 200 most important national companies[690]. Furthermore, according to a survey conducted in 1997, more than one out of two managers of CAC40 companies is *énarque* or

685 *Commission CE c/République française*, supra n 383, pp. 430-435.
686 K. Lannoo, 'A European Perspective on Corporate Governance' (1999) 37 JCMC 269, p. 291.
687 As seen above, this is no longer the case since the Law of 1993.
688 D. Carreau and R. Treuhold, 'Privatisations, Droit Boursier, et Pratiques des Marchés' (1994) 1 Rev. Soc. 1, p. 9.
689 Referred to in France as Présidents-Directeurs Généraux (hereafter the PDGs).
690 23 per cent for Ena and 27 per cent for Polytechnique; see G. Carminatti-Marchand and M. Paquerot, 'The Elite and their Boards of Directors' (2001), p. 9, available at SSRN.

polytechnicien[691]. The particularity of these graduates is that, because they are appointed by the State and removable only by the State, they do not see themselves as accountable to the shareholders but rather to the State[692]. In other words, they think more of national progress than of shareholder profit maximisation[693]. As a result, it is very difficult for a foreign bidder to take over a listed public sector company where the PDG opposes its bid, even if shareholders would gain more from such bid. The cumulative effect of these structural factors is that relatively few listed companies in France are vulnerable to hostile bids[694].

As the foregoing indicates, French listed companies may use various mechanisms to deter an offer. Indeed, UK-US funds are mostly worried about the double voting rights, the cross shareholdings, the *noyaux durs*, the golden shares, and the strong power of the PDG s[695]. After the offer commences, however, French directors'margin of manoeuvre reduces to a significant extent.

4.3 Regulation of Post-Bid Defences

The following gives an overview of the rules governing post-bid defensive measures and the permissible post-bid defences.

4.3.1 Rules Governing Post-Bid Defences

Principles governing post-bid defences are to be found primarily in the COB's Regulation No. 2002-04. In particular, Rule 4 of the latter reads

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[691] 'Gouvernement d'Entreprise: le CAC 40 Fait de la Résistance' (1997) 468 Option Finance 17, p. 17.

[692] See e. g. the $4 billion loss incurred by the state-owned bank Crédit Lyonnais. Indeed, the then PDG of the bank, who was appointed by the socialist government, had not disclosed the tactics the bank undertook in the real estate market throughout Europe. However, nobody checked his management, as he was a former member of the socialist government; see B. Mojuyé (2000), supra n 366, pp. 90-91.

[693] M. J. Roe (2002), supra n 308, p. 125.

[694] J. Epstein, J. Swank and S. Deparis-Maze, 'France' (1992) I.F.L.Rev., p. 2.

[695] *Les Critères d'Investissement* (1998), supra n 329, p. 24.

'During the course of an offer, every person must act in accordance with the fair game of bids and overbids, the equality of treatment and of information of the holders of securities of the companies concerned, the transparency and the integrity of the market, the honesty in the transactions and the competition'.

Thus, the rule enumerates a number of principles that the offeree company must observe during the course of an offer. The rule further contains an obligation of notification imposed upon the offeree company, in the following terms:

'If the offeree company decides to take non-routine managerial actions other than those explicitly authorised by the general meeting of shareholders conveyed during the course of the offer, the offeree directors must notify the AMF with a view to allowing the latter to ensure the information of the public and to make known its reservations, if there are any'.

For the purpose of clarity, it is suggested to examine the two parts of the rule separately.

i) Principles enumerated in Rule 4

Two remarks deserve to be made as regards the first part of the Rule: First, there is no judicial decision in France illustrating the scope of the principles enumerated in Rule 4[696]. Secondly, the list is not exhaustive. Indeed, another principle that the offeree company must observe in the course of an offer is that the offeree board must act in conformity with the interests of the company. The latter principle was expressly mentioned in the previous COB's Regulation, but has been subsequently removed. This is because the concept of the corporate interest belongs to company law and therefore has no place within the stock exchange regulation. The removal of the concept of the corporate interest was further viewed by some commentators as satisfactory due to the difficulty to define such concept[697]. Indeed, the French company law has long denied equating the interests of the company with those of the shareholders. It has instead endorsed an institutional approach of the company and viewed the interests of the latter as transcending those of the shareholders. In *Fruehauf*, the Court of Appeal held that the interests of the company cannot be identified with those of its

[696] I am indebted to Professor Alain Viandier for his valuable comments on this point during my interview with him in January 2003.
[697] 'Offre Publique-Réglement COB' (2002) 83 Banque et Droit 31, p. 32. On the difficulties to define this concept, see the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids.

shareholders, and the Court even employed the term 'general interest' to designate the interests of the company[698]. The lack of a clear definition of what constitutes the interests of the company may be seen as a loophole, which could be exploited by offeree companies to ward off hostile bids. However, as far as the legal doctrine is concerned, Viandier (2000) argues that the interests of the company and those of the offeree shareholders should be regarded as being the same in the context of post-bid defences. For, in his view, control belongs to offeree shareholders and the latter have the right to sell it[699].

In spite of its removal from the COB's Regulation, offeree directors must still comply with the principle of corporate interest whilst taking post-bid defences[700]. Thus, if an action taken by the offeree board during the course of an offer is contrary to the interests of the company, then that action will be contrary to company law. As a result, such action will likely be invalidated by the courts, even if it has been notified to the AMF by the offeree directors[701]. Furthermore, the offeree directors may be held liable for *abus de pouvoir*[702] or for *abus de biens sociaux*[703].

ii) Obligation of notification embodied in Rule 4

As seen above, the second part of Rule 4 of the COB's Regulation 2002-04 imposes an obligation of notification upon the offeree company in cases where it decides to take non-routine managerial actions other than those explicitly authorised by the general meeting of shareholders. Such actions have been defined by the doctrine and the courts as actions which significantly modify the

[698] CA, Paris, *Fruehauf*, 22 May 1965 (1968) D., p. 147.
[699] A. Viandier, 'Le Droit des Sociétés à l'Epreuve des Offres Publiques' (2000) Rev. JP comm. 243, pp. 251-252.
[700] S. Nonorgue 'L'Apport Partiel d'Actif, Technique de Défense Anti-OPA' (2002) Bull. Joly Bourse 397, p. 407.
[701] I am indebted to Professor Alain Viandier for his valuable comments on this point during my interview with him in January 2003.
[702] 'OPA: Quels Droits Pour la Société Cible?', 474 *Option Finance*, November 10, 1997, p. 28.
[703] e.g. Cass. Crim., 10 July 1995, 4 JCP éd. G, p. 47, where the French Supreme Court confirmed a decision by the Court of Appeal, which held the PDG of a company liable for *abus de biens sociaux* and for *abus de pouvoirs*, on the grounds that he used his powers to organize a merger which was contrary to the interests of the company and advantageous for himself and the companies in which he had interests.

composition of the balance sheet of the company, which fall within the powers of the board of directors, and which have an exceptional and non-repetitive nature.

At first sight, Rule 4 does not seem to prohibit acts other than those of ordinary management which have not been approved by shareholders in general meeting. Instead, it seems to stipulate a mere obligation to inform the AMF of such acts[704]. Thus, unlike GP 7 of the UK Code, Rule 4 does not contain a clear-cut 'no frustrating action' rule. Nor does the COB's Regulation offer a list of defences whose use is prohibited during the course of an offer. All Rule 4 does is to impose an obligation of notification. This author suggests that, the reason behind the absence of a clear-cut 'no frustrating action' rule in France probably lies in the fact that the French experience is short of hostile takeovers. In addition, given that conflicts of interests in France mostly arise as between controlling and non-controlling shareholders, the regulators may not have felt the need to place much emphasis on the regulation of post-bid defences.

In spite of the absence of a clear-cut 'no frustrating action' rule, the interpretation of Rule 4 is quite different for two reasons: First, the offeree directors must at all times observe the principles enumerated in Rule 4, as well as other principles such as the principle of the interests of the company. Indeed, Daigre argues that if, for instance, an offeree company rushes to dispose of a major or a strategic asset in the face of a bid, this would be regarded as contrary to the interests of the company[705]. This can be illustrated by the *Bénédictine* case of 1998. In this case, the offeree company was willing to trigger a clause which conferred on a third party an option on the most advantageous assets of the company in the event of a change of majority holding. The AMF held that '*this type of clause was designed to impede tender offers and therefore the normal operation of the market*'[706].

Secondly, although the AMF has no power to force the offeree company to renounce to its proposed action[707], it has power to issue reservations where it

[704] L. Faugérolas (2003), supra n 584, p. 332.
[705] I am indebted to Professor Jean-Jacques Daigre for his valuable comments on this point during my interview with him in January 2003.
[706] L. Faugérolas (2003), supra n 584, pp. 336-337.
[707] H. Vauplane, M. Germain and J. P. Bornet (2001), supra n 129, p. 743.

believes that the action jeopardises the course of the offer[708]. The AMF's reservations have a powerful effect, as the offeree company would fear the impact of such reservations upon its share price. Furthermore, in the unlikely event that the offeree company would ignore the AMF's reservations and would proceed with its proposed action, there are a number of devices at the AMF's disposal which are likely to deter the offeree company from doing so. Indeed, the AMF has power to issue injunctions and/or order pecuniary sanctions, though the pecuniary sanctions are minor and thus unlikely to deter offeree companies. The AMF has also power to request the courts to issue an injunction. Furthermore, the courts may nullify the disputed action and incur the civil and/or criminal liability of the offeree directors, at the request of a shareholder, who would claim that the offeree company has acted in breach of company law[709], or at the request of the offeror who would claim that the offeree company has acted in breach of the principle of fair competition embodied in Rule 4 of the COB's Regulation.

As a result of the above-mentioned reasons, Rule 4 is seen as tantamount to prohibiting the offeree board from performing any acts that go beyond ordinary management if such acts have not been approved by shareholders in general meeting[710]. Indeed, Rule 4 has always been interpreted by the offeree directors as prohibiting post-bid defences other than those authorised by shareholders in general meeting[711]. It is noteworthy in this respect that the early discussions leading to the reform of the COB's Regulation considered, albeit unsuccessfully, to reinforce this restrictive approach, in that the new rule would read

> '*Where the managers of the companies concerned decide to take non-routine managerial actions, they must inform the AMF, with a view to allowing the latter to ensure that the proposed actions do not jeopardise the general principles governing tender offers and to guarantee the information of the public*'.

The above version of Rule 4 would oblige the offeree board to obtain a 'nothing hinders' from the AMF before adopting any non-routine post-bid managerial

708 For an illustration of such reservations, see below the AMF's recent reservation about Aventis' notification to issue share warrants during the course of Sanofi's hostile takeover bid.
709 The plaintiff may e. g. claim that the company has breached the principle of the interests of the company.
710 L. Faugérolas (2003), supra n 584, p. 332.
711 A. Viandier (1990), supra n 95, p. 299.

action, and would allow the AMF to veto any action that would violate the principles contained in this rule[712].

It should be noted that, by not requiring notification for actions authorised by the general meeting, Rule 4 confirms the sovereignty of the general meeting and demonstrates that the AMF refuses to impede measures decided by the general meeting. It should be noted in this respect that the ability of the general meeting to take defensive measures in the face of a bid has been facilitated by the Law of 1997[713], which has increased the offer period[714]. Such increase arose out of the desire of the then President of the Republic to render French companies less vulnerable to takeovers[715]. Indeed, the unofficial commentaries accompanying this reform stated that the purpose of the reform was to allow companies more time to organise their defence[716]. Prior to this reform, it was almost impossible for companies to convene a general meeting during the course of an offer and their situation was held by the then market authorities to be too disadvantageous in comparison with other European jurisdictions. Henceforth, offeree companies have more time to establish a dialogue with their shareholders with a view to proposing them a defence plan.

It should finally be noted that, despite the rigorous interpretation by legal scholars of Rule 4 and the fact that offeree companies in France abide by such interpretation, as evidenced by the absence of regulatory and/or judicial decisions pointing to the contrary view, it is suggested that 'theoretically'[717] there is room in France for offeree companies to take post-bid defences without shareholder approval. This suggestion is based on Rule 5-2-9 of the CMF's Regulation. The latter authorises the offeror to renounce to its offer, *inter alia*, where the offeree company takes measures which are likely to change its substance. Most legal scholars view this rule as no more than a faculty conferred on the offeror in exchange for the faculty conferred on the offeree board to resort to the general meeting during the course of an offer. It is suggested, however, that, this rule

[712] A. Viandier (2000), supra n 699, p. 249.
[713] Order of 27 March 1997.
[714] 'OPA: Quels Droits Pour la Société Cible?', supra n 701, p. 28.
[715] A. Viandier, 'La Réforme du Droit des Offres Publiques' (1997) 6 RJDA 499, p. 499.
[716] Ibid, p. 501.
[717] This is because no use of Rule 5-2-9 has been made thus far in the context of defensive measures.

provides offeree directors with a way round the application of Rule 4 of the COB's Regulation[718]. This is because Rule 5-2-9 does not explicitly refer to decisions taken by the general meeting whilst describing the circumstances which would allow the offeror to withdraw its offer. Instead, the rule simply refers to decisions taken by 'the offeree company'. It should be emphasised in this respect that it is not suggested that Rule 5-2-9 contradicts Rule 4. Instead, it is suggested that Rule 5-2-9 theoretically allows an offeree company to take post-bid actions without shareholder approval, even if the proposed action has been notified to the AMF and even if the latter has issued reservations. It is true that, as noted above, it would be unwise for an offeree company not to take the AMF's reservations into account and to proceed with its proposed action. For such course of action would not only be badly received by the market but would also possibly trigger the AMF's above-mentioned powers. It is suggested that the AMF's new General Regulation should either amend Rule 5-2-9 with a view to making it clear that the term 'offeree company' does indeed refer to the general meeting of shareholders, or at least establish a linkage between Rule 5-2-9 and Rule 4 of the COB's Regulation.

4.3.2 Permissible Post-Bid Defences

i) Post-bid defences expressly permitted by Rule 4

Rule 4 explicitly allows an offeree board to issue shares during the course of an offer. This measure would allow the offeree board to potentially increase the costs of an unsolicited offer, by increasing the number of shares outstanding. For the offeror may not have enough resources to pay for the additional shares resulting from the issue. To do so, however, the offeree board must be expressly authorised by a resolution of the extraordinary meeting, for a term not exceeding one year, to make use, after a takeover has been made, of a delegation of authority to increase the capital[719].

[718] Although most scholars fiercely oppose this view, a small number of them support it; see e. g. A. Viandier (2000), supra n 699, p. 250, where he makes a *a contrario* interpretation of Rule 5-2-9 to come to this conclusion.
[719] Code of Commerce, art. L. 225-129.

The effectiveness of this defence is limited, however. For on the one hand the issue must take into account shareholders' pre-emption rights[720]. As a result, the rule does not allow the offeree board to use its delegated power in favour of a 'white knight'[721]. Furthermore, even if shareholders do not invoke their pre-emption rights by individually waiving them[722], there is a risk that the issue will open up even wider share acquisition possibilities to the offeror. Indeed, individual shareholders may well transfer their pre-emption rights for the benefit of the assailant rather than for the benefit of the white knight. It should be added that institutional investors are not in favour of the use of a delegated authority to issue shares. Indeed, the new French corporate governance principles recommend that companies cease in future to submit to the extraordinary meeting a resolution expressly permitting the use of delegations of authority to increase the capital after a takeover offer has been made[723]. Moreover, nothing guarantees that friendly third parties will subscribe to newly issued shares.

Another post-bid defence explicitly allowed by Rule 4, and which also requires prior authorisation, is share buy-backs[724]. However, the AMF allows the latter only if the offer is a cash offer and the buy-backs are in connection with an existing share repurchase programme, which has already been put into effect. Thus, the offeree board cannot avail itself of a prior authorisation if the share buy-back has not been partly enforced yet.

[720] Any clause otherwise stipulated will be deemed null and void; see Code of Commerce, art. L. 225-132.
[721] See below for this defence.
[722] Code of Commerce, art. L. 225-132.
[723] *Principes de Gouvernement d'Entreprise* (2004), Consolidation des Rapports Conjoints des Rapports Viénot I (1995), Viénot II (1999), et Bouton (2002), p. 8, available at http://www.paris-europlace.net.
[724] Such course of action was implicitly prohibited under the old COB's Regulation No. 89-03, which prohibited offeree companies from increasing their treasury shares or the shares held by their subsidiaries in their capital during the currency of an offer.

ii) Search for a white knight

The AMF has several times declared that it favours takeovers being fought out on the market, if necessary by having white knights come in and offer better prices[725]. The courts share the AMF's view and state that

> *'If it is legitimate for a company to defend itself against an unwelcome bid, it has to do so openly, by respecting the interests of the shareholders as soon as the offer period starts. If the offeree company wishes to impede the hostile offer, it has to make a counter offer and cannot engage in illegal acts which would jeopardise the interests of all shareholders'* [726].

The white knight defence is subject to certain requirements, however. Indeed, where the original offer is a cash offer, the AMF requires the competing offer to represent a price at least two per cent higher than that of the original offer[727]. Where the original offer is a share exchange offer, the AMF requires the competing offer to propose changes which significantly improve the original offer. The competing offer may have the same price as the original offer, however, if the AMF feels that the minimum level set by the initial offeror is inappropriately high[728] and the competing offer omits such condition[729]. In spite of the latter requirements, the competing offeror's chances of success are high in France. This is because tenders filed by shareholders in response to the initial offer are automatically cancelled upon the announcement of a competing offer[730]. By rendering the position of the previous offeror precarious, this provision not only allows the offeree shareholders to accept the superior terms of a competing offer but also removes the potential for coercion by the original offeror.

The effectiveness of the white knight defence is limited, however, in two respects: First, as seen above, the offeree company cannot issue additional shares or sell the shares held by its subsidiary in its capital in favour of a white knight in the course

[725] E. Wymeersch, 'Problems of the Regulation of Takeover Bids in Western Europe: A Comparative Survey' in K. J. Hopt and E. Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), p. 127.
[726] CA, Paris 10 March 1992, *Perrier* (1992) Rev. Soc., p. 345.
[727] CMF regs, r.5-2-6.
[728] Note that, since the Law of 2001, the offeror who conditions its offer to the obtaining of a minimum percentage of shares is henceforth bound by this threshold and thus cannot renounce to such threshold in view of the results.
[729] CMF regs, r.5-2-6.
[730] CMF regs, r.5-2-7.

of an offer. This prohibition resulted from the *Perrier* case[731], where during the course of a hostile offer by Nestlé on the shares of Exor, a French holding company that owned 28.8 per cent of Perrier, SPG – a strategic asset of Exor and a wholly owned subsidiary of Perrier– decided to sell to Saint-Louis the shares it held in the capital of Perrier. The Paris Tribunal of Commerce held that any operation on the shares of Perrier must be assimilated to an operation on the shares of Exor, and that the sale, which was realised during the course of Nestlé's offer, could not be regarded as a routine managerial action. This is because such sale would re-activate, in favour of Saint-Louis, the voting rights attaching to the shares held by SPG in the capital of Perrier. The problem was further exacerbated by the fact that Saint-Louis had declared acting in concert with Exor. As a result, the Tribunal held that the sale by an offeree company of the shares held by its subsidiary in its capital in favour of another company during the course of an offer does not constitute a routine managerial action and that such sale would therefore be nullified, on the grounds that it constitutes a blatant breach of the letter and the spirit of the takeover regulation[732].

It is noteworthy in this respect that the Tribunal based its decision on Rule 3 of the old COB's Regulation No. 89-03[733]. The latter merely prohibited the increase by a subsidiary of the shares it held in the capital of its parent during the course of an offer and did not expressly prohibit the sale of such shares. However, the Tribunal made an extensive interpretation of this provision, by relying on an earlier ruling of the president of the Paris Tribunal of Commerce[734], whereby it was held that the sale of such shares to third parties during the course of a hostile bid would modify the situation which existed at the beginning of the hostile bid and would seem linked to the immediate preoccupations of the directors. Thus, in the Perrier case, the Paris Tribunal of Commerce relied on the spirit of the takeover regulation.

[731] T. com. Paris, 16 March 1992, *SA Démilac et autre c/ SPG et Saint-Louis* (1992) Bull. Joly soc. 526. Hereafter the Perrier case.
[732] Note, however, that the shares held by subsidiaries in the capital of their parents may be tendered to the initial offeror or to a competing offeror.
[733] Now Rule 4 of the new COB's Regulation.
[734] T. com. Paris, 30 August 1989, *Cie Financière de Suez/Cie Industrielle* (1990) JCP, éd. E. 15677.

Secondly, the regulations require the equal treatment of competing offerors[735], which constitutes another limit to the effectiveness of the white knight defence. This can be illustrated by the *Mutuelle du Mans v. OCP* case[736]. In this case, Gehe made a hostile bid on the shares of OCP, a public limited company whose principal assets were situated in two SCAs, which were wholly-owned subsidiaries of OCP. Since a bid on the shares of OCP would not allow the offeror to control the subsidiaries[737], the *commandités* of the subsidiaries undertook to sell to the offeror the majority of their shares. Following the admissibility of Gehe's offer, an offeree shareholder challenged the AMF's admissibility decision, on the grounds that the above undertakings conferred on the offeror a decisive advantage over any competing offeror and thus breached the principle of equal treatment of competing offerors. The Paris Court of Appeal quashed the AMF's admissibility decision on the grounds that, although the undertakings were necessary for the success of the offer on the shares of OCP, they had the effect of preventing the operation of the principle of competition[738].

Similarly, in the Sanofi-Synthélabo/Aventis/Novartis battle, Aventis notified the AMF, in the course of Sanofi's bid, of its intention to issue share warrants to all its shareholders[739], as insurance against the risk of Sanofi losing its US patent protection on Plavix, which is Sanofi's second-biggest selling drug. In the view of Aventis, the loss of such patent would significantly reduce the value of the offeror company, which in turn would adversely affect the shareholders of Aventis. Indeed, it was thought that the urgency of Sanofi's hostile bid reflected its desire to use its highly valued securities to obtain control of Aventis before the forthcoming court challenge over its patent on Plavix[740]. The AMF viewed the issue of share warrants as an indirect means to unilaterally increase the offer price,

735 CMF regs, r.5-1-1 and COB Regs, r.4.
736 CA, Paris, 27 April 1993 (1993) Rev. JP comm., p. 204; note Goyet.
737 This is because the subsidiaries were structured as SCAs.
738 Note, however, that, in CA, Paris, 27 Octobre 1993, *Balland* (Sucrerie-Raffinerie de Chalon-sur Saône), the Paris Court of Appeal held, in relation to an irrevocable covenant which related to a mere 10 per cent of the capital, that it was not of a nature to make the acquisition of control of the offeree company impossible by a competing offeror; see *Les Echos*, December 30, 1993.
739 Note that Aventis was ready to do so by resorting to its shareholders' approval in general meeting.
740 'Sanofi is in a Hurry to Take Over Aventis', *The Financial Times*, January 27, 2004.

something which jeopardises the offeror's freedom to decide whether or not increase the offer price[741]. As a result, the AMF held

> *'Although we acknowledge that offeree shareholders are free to take post-bid defensive measures, we cannot accept clauses which are designed to privilege one of the competing offerors, at the expense of the other'*[742].

The principle of equal treatment of competing offerors does not prejudice, however, the execution of agreements which were entered into prior to the commencing of an offer and which are likely to render the offeree company less attractive. This is evidenced by a decision of the Paris Tribunal of Commerce[743], whereby the competing bidder applied to the courts for the nullification of the option to buy the assets of the offeree company, which was conferred on the initial bidder before the takeover was launched. The Tribunal held

> *'Under the present stock exchange regulations, the exchange authorities have rightly considered that the publication of [...] a competing bid, does not affect irrevocable covenants subscribed before the takeover was launched'*.

The rationale underlying the above decision is that the offeree board takes no action when the beneficiary of the call option exercises his right[744]. It should be noted, however, that such agreements will be valid if and only if the beneficiary pays an equitable price, the public is duly informed, the agreement is not entered into with a desire to impede a hostile bid, and the option does not in practice prevent the operation of the principle of competition[745].

It should finally be added that, until recently, the AMF rendered offeree companies' search for a white knight more difficult, by restricting offerors' ability to subject their offer to the receipt of satisfactory approvals by the competition authorities. This had the effect of reducing the class of potential offerors. However, as will be seen below, offerors are no longer prevented from conditioning their offer on the receipt of such approvals.

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741 Note that the AMF decided so even though Aventis had informed the AMF that the issue would become null and void should a rival bid occur.
742 AMF's Press Release, April 23, 2004, available on AMF website.
743 T. com. Paris, 28 July 1986 (1987) Rev. Soc., p. 58, note J. J. Daigre.
744 E. Wymeersch, 'Les Défenses Anti-OPA Après la Treizième Directive' (2000), p. 15, available at http://www.law.ugent.be/fli/WP/WP2000-pdf/WP2000-01*.pdf.
745 T. Bonneau and L. Faugérolas (1999), supra n 603, pp. 109-110.

iii) Other permissible post-bid defences

The offeree board may always try 'to win the argument'. It may do so in its motivated opinion on the merits or demerits of the offer for the offeree company and its shareholders that the regulations require it to issue[746]. In doing so, however, the offeree board must exercise 'particular prudence'[747].

The offeree board may also encourage friendly investors to purchase offeree shares on the market. However, shareholders holding at least five per cent of the shares or voting rights must report to Euronext-Paris SA any transaction carried out in the shares or voting rights of the offeree company[748]. The same requirement applies to any person acquiring shares representing 0.5 per cent or more of the shares or voting rights of the offeree company following the filing of the offer[749].

The offeree board may also refer a bid to antitrust authorities. It should be noted, in this regard, that until recently the French regulations did not permit the offeror to condition its offer to the receipt of satisfactory approvals by the competition authorities, on the grounds that this was contrary to the principle of irrevocability of offers. Thus, an offeror whose offer was referred to such authorities could pursue its offer and continue to acquire the offeree shares. The only restriction imposed upon the offeror was the deprivation of its voting rights[750]. This approach caused significant problems, in particular in cases where the competition authorities ruled against the offer subsequent to the announcement of the results of the offer by the AMF. This was evidenced by the cases of Schneider/Legrand and TetraLaval/Sidel, following which the AMF introduced a new exception[751] to the principle of irrevocability of offers[752]. Henceforth, the offeror may condition its offer to the publication of a positive finding by the end

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[746] COB regs, r.12.
[747] COB regs, r.7.
[748] COB regs,r.17.
[749] COB regs, r.17.
[750] Even then, the offeror would keep its voting rights provided voting was necessary to save the value of its investment and provided it obtained the AMF's consent.
[751] CMF regs, r.5-1-4.
[752] The other exceptions to the irrevocability principle are the vote of the general meeting, and linked offers; see CMF regs, r.5-1-5, and r.5-1-3-2, respectively.

of the Phase I review[753]. For instance, in 2003, the Canadian aluminium group Alcan made an offer for the shares of French aluminium company Péchiney conditional upon approval at the end of phase I investigation by the competition authorities in the EU and in the US[754]. On the other hand, the offer will automatically lapse if either the French Minister of Economy refers the matter to the French Competition Council[755], or if the European Commission decides to launch a Phase II investigation, or if the antitrust authorities of the US or a MS of the EU decide to launch the equivalent to a Phase II review.

Finally, the offeree board may appeal to the courts in order to delay the bid and thus in the meantime convince the offeree shareholders about the merits of their own strategy. This defence has recently been used by Aventis in its attempt to thwart the hostile bid by its rival Sanofi. Indeed, Aventis filed an appeal against the AMF's approval of Sanofi's bid, arguing that the latter breached the principle of equality, as well as the principle of transparency and integrity of the market. It should be noted, however, that the French courts have only overruled two bid approvals so far, once for Gehe's purchase of OCP in 1993, and a second time for Schneider's takeover approach for Legrand in 2001[756].

Conclusion

As the foregoing indicates, offeree boards in France must remain neutral in the face of a bid and they can only take actions provided they obtain shareholders' authorisation during the course of the bid. This, however, results from the market practice, and not from a clear-cut prohibition. As a result, it is difficult to determine which post-bid actions are prohibited and which are not. The problem is further exacerbated by the fact that there are no judicial decisions on this subject. Due to the absence of a clear-cut prohibition, some companies have even attempted to get round Rule 4 of the COB's Regulation. For instance, when Casino became subject to a hostile bid by Promodès, it proceeded to the

[753] CMF regs, r.5-1-3-3.
[754] 'Alcan Confiant dans le Feu Vert de Bruxelles', *Le Figaro*, July 23, 2003.
[755] This is the equivalent to a Phase II investigation.
[756] 'Sanofi Confident Despite Aventis Appeal', *The Financial Times*, February 23, 2004.

acquisition of a number of companies soon after Promodès filed its offer with the AMF[757]. It should further be added that, France has thus far not experienced a significant hostile takeover from a foreign company, such as the $175 billion-worth takeover of Mannesmann by Vodaphone. It is indeed suggested that a takeover along the latter lines could create panic on the part of the AMF and/or the courts, which may loosen their hitherto rigorous stance *vis-à-vis* post-bid defensive measures.

On the other hand, there are a number of definitional problems which are likely to give rise to ambiguities in the area of post-bid defences. For instance, offeree directors faced with a bid must comply with the principle of the interests of the company. However, the absence of a clear definition of what constitutes the interests of the company constitutes a loophole, which may be exploited by offeree boards to defeat hostile bids. Another ambiguity relates to whether the concept of 'non-routine managerial actions', which have only been defined by the doctrine and the courts, mean the same as the concept of 'acts which are likely to modify the substance of the offeree company', which are referred to in Rule 5-2-9 of the CMF's General Regulation.

It should be noted, however, that the issue of post-bid defences is not as relevant in France as in the UK. This is because the French experience is short of hostile takeovers. This is mainly due to the fact that most French companies, like their counterparts elsewhere in the Continent, rely upon a variety of pre-bid defences. Indeed, listed companies in France have a wide array of pre-bid defences at their disposal.

[757] H. de Vauplane, 'Chronique Financière et Boursière' (1997) 56 Banque et Droit 29, p. 29.

Chapter 5 The Principle Of Equality of Shareholders and the Protection of the Minority Under the UK Takeover Regime

Introduction

The principle of equality of shareholders, in its broadest sense, would mean that offers should be made to no fewer than all of the offeree's shares; that all shareholders who tender their shares to the offeror be paid the same price; that the offeror be precluded from dealing in the shares of the offeree company if there are special favourable conditions attached which are not made available to all shareholders; that the offeror be precluded from buying shares outside the offer at above the offer price; that all non-tendering shareholders be subsequently permitted to sell their shares to the offeror at the offer price; and that shareholders should have the right to exit the company if control of the company changes.

The Code comes very close to achieving this form of equality[758]. Indeed, General Principle 1[759] of the Code requires all shareholders of the same class of an offeree company to be treated similarly by the offeror. This principle is the cornerstone of the Code and '*runs through and covers the whole Code*'[760]. GP 1 is supplemented by rules which regulate numerous situations which might otherwise result in an unequal treatment of offeree shareholders. By its strong emphasis on equality, the Code substantially differs from the regulation in the US, where there is greater scope for unequal treatment of shareholders[761]. The rationale behind the Code's strict regulation of the offeror lies in the Code's neutrality requirement[762]. Indeed, as we have already seen, the latter requirement precludes offeree boards of UK listed companies from implementing US-style post bid defensive measures, which are *inter alia* intended to drive the offer price. By strictly regulating the offeror, the Code substitutes the rules on equality for the inability of offeree boards in the

[758] D. A. DeMott (1983), supra n 51, p. 983.
[759] Hereafter GP 1.
[760] Panel Statement of 2 April 1971 on *Adepton Ltd. and William Hudson Ltd.*
[761] On the scope of the equality principle in the US, see R. Sappideen (1986), supra n 23.
[762] C. Kirchner and R. W. Painter, 'European Takeover Law-Towards a European Modified Business Judgment Rule for Takeover Law' (2000) 1 EBOR 353, p. 387.

UK to act on behalf of shareholders to improve the terms of an offer[763]. In other words, the Code's rules on equality act as substitutes for US-style post-bid defences in order to increase shareholder value.

This chapter examines the provisions of the Code which are designed to ensure equal treatment of offeree shareholders. Section I describes the circumstances where the principle of equality operates. Section II describes the concepts which increase the potential for achieving equality. Section III identifies the rationales underlying the principle of equality.

5.1 Scope of the Operation of the Equality Principle

The following examines the operation of the principle of equality within the offer; as between accepting shareholders and shareholders who sell outside the offer; and in circumstances where control is either acquired in the market or transferred from an already existing controlling shareholder.

5.1.1 Operation of the Principle Within the Offer

The Code contains numerous provisions designed to ensure that shareholders are treated equally within an offer. First and foremost, the Code reflects a general dislike of offerors gaining control without giving all shareholders an exit possibility. This is evidenced by the fact that the Code requires a bid to be made for all the shares of an offeree company. The Code does allow partial bids[764], however, albeit with prior consent of the Panel[765]. It should be noted in this respect that the first edition of the Code had stated that partial offers were undesirable[766]. This negative approach toward partial offers was based on the idea that effective control of a company is a matter for decision by all shareholders [767].

[763] G. A. Ferrarini (2001), supra n 508, p. 20.
[764] i.e. offers for less than 100 per cent of the voting rights in the offeree company not already held by the offeror.
[765] Code, r.36. On partial bids, see the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids.
[766] The 1968 Code, r.26. See also the 1959 *Notes*, r.(vii), which reflected the same concern for partial offers.
[767] R. Sappideen (1986), supra n 23, p. 293.

The Code has subsequently shifted to a more flexible approach[768] and partial offers are no longer labelled as undesirable. This shift in policy is due to the use of partial offers in other countries and the sound reasons, such as limited funding, some offerors may have for making them. Despite the change of policy, however, according to a study by Ashurst Morris Crisp in July 2003, partial offers are less common than full offers. There has indeed been a paucity of partial offers in recent years[769].

Secondly, the Code requires the offeror to offer the same terms to all the offeree shareholders[770]. In other words, the offeror is prohibited from offering special terms to some shareholders who deal with it within the bid[771], which would give these shareholders an advantage over others and/or provide them with an inducement to accept the offer. By way of example, the offeror cannot offer shares with preferential rights, as a consideration for its offer, to some shareholders, who would in return agree to sell their shares in response to the general offer[772]. The Code does allow some special arrangements, however, provided certain requirements are met. These include, *inter alia*, arrangements whereby the offeror sells some of the offeree's assets to an offeree shareholder at a price lower than the real value of the assets[773]; and arrangements whereby the offeror remunerates an offeree shareholder for the part he has played in promoting the offer[774].

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[768] This change in approach occurred with the 1976 amendment of the Code; see the 1976 Code, r.27.
[769] Indeed, there have only been 4 partial offers since 2000 to date. These were, *inter alia*, Halifax Group plc against St James' Place Capital plc (up to 60 per cent); ZOO Hotels plc against Groucho Club London plc (up to 29%); Folkes Holdings Limited against Folkes Group plc (up to 75.1 per cent of the voting shares and up to 49.2 per cent of the non-voting shares); and Carnival Corporation against P&O Princess Cruises plc (up to 20 per cent); see http://www.ashursts.com/pubs/pdf/2618.pdf.
[770] Code, r.16. This rule goes back to the first edition of the Code; see the 1968 Code, r.32.
[771] Note that Rule 16 also prohibits the offeror from offering special terms to some shareholders who deal with it outside the bid. Indeed, prior to the adoption of Rule 16, it was quite common for the offeror to persuade major shareholders to sell their shares prior to the bid, with the promise of supplementary payments if the offeror would subsequently pay more under a general offer for the offeree company. This arrangement allowed such shareholders to be protected against both the prospects of selling out at too low a price and of the bid failing, with a resulting sharp fall in the value of the shares; see 'Second Stage Evidence', Vol. 1, Panel on Takeovers and Mergers, The Financial Institutions Directorate of the Commission of the European Communities (January, 1979), p. 18. This situation is now explicitly prohibited by Note 1 on r.16 of the Code.
[772] Note that, although the sale by the favoured shareholder occurs in response to the general offer, the special terms are necessarily outside the public offer.
[773] Code, Note 2 on r.16.
[774] Code, Note 3 on r.16.

The latter type of arrangement can be illustrated by the case of *Mooloya Investments/Customagic*[775]. In this case, an agreement was entered into between the offeror, Mooloya, and a shareholder of and consultant to the offeree company, Customagic. Under this agreement, Customagic contracted to influence certain shareholders, in return for a remuneration to be made by Mooloya. The Panel considered the remuneration to be in breach of the Code, on the grounds that it was an increased price paid to Customagic for its own shares and those it controlled already. For, in the view of the Panel, the sequence of events suggested that Customagic was *'unwilling to cooperate in furthering the offer unless it received a substantial procurement fee'*. It should be noted, however, that where two or more persons come together to form a consortium on such terms that each of them can properly be considered to be a joint offeror, Rule 16 will not be breached if one or more of them is already a shareholder in the offeree company[776]. The rationale behind this qualification to Rule 16, which results from the Panel's rulings, is to allow management buy-outs, which would otherwise be prohibited to the potential detriment of existing offeree shareholders[777]. It should further be added that, where the offeror revises the terms of its offer, all shareholders who had already accepted the original offer must have access to the revised terms[778].

Another provision which is closely related to Rule 16 is that prohibiting the offeror from furnishing information to some shareholders which is not made available to all shareholders[779]. Indeed, the equal treatment of shareholders within the offer cannot be guaranteed without also ensuring equality of information supplied to the offeree shareholders. This provision does not prevent, however, meetings of representatives of the offeror with shareholders of the offeree

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[775] Panel Statement of 6 July 1978.

[776] This was the case in *Canary Wharf Group plc*, where the largest shareholder in the offeree company, who was at the same time a joint offeror, was accorded a special class of shares with preferential rights as to income and capital not accorded to the shares held by other members of the bidding consortium or to ordinary shares held by others in the bidding company, including former Canary Wharf shareholders. In the event, however, the Panel considered that the preferential rights in the bid vehicle to be attached to the largest shareholder's shares were not incompatible with his status as joint offeror. They are therefore not to be regarded as special treatment to him *qua shareholder* contrary to Rule 16; see Panel Statement of November 21, 2003, pp. 7-8.

[777] Ibid, pp. 3-4.

[778] Code, r.32(3). Note that this requirement goes back to the Jenkins Report; see paras 265 to 294.

[779] Code, r.20(1).

company to take place during the offer period, provided that no material new information is revealed[780]. Nor does this provision prevent meetings with the offeree's employees in their capacity as such[781].

Thirdly, where there is more than one class of equity share capital, the offeror must make a comparable offer for each class[782]. The rationale underlying the requirement for a 'comparable' offer – rather than for an 'identical' offer – is that some classes of shares such as non-voting ordinary shares usually trade at a price lower than that of voting shares. As a result, any offer for them will usually be made for a price less than that for the voting shares. This shows that the Code takes the market reality into account in determining the price of different classes of equity share capital. The Code sets down a method of assessing the comparability, referred to as the 'six months average ratio', pursuant to which the ratio of the values of the offers for the two classes should normally equal the average of the ratios of the Stock Exchange middle market quotations of the two classes over the six months before the offer period[783]. The use of this ratio can produce some odd results, however, in that the difference between the prices of the two classes of shares may be affected by rumours of a takeover bid Indeed, the possibility of an offer is likely to drive up the price of the voting shares compared with the other classes of shares. The difference between the prices of the two classes of shares may also be affected by the offeror's purchases. Indeed, the offeror who is seeking to gain control will likely purchase voting shares in preference to limited voting or non-voting shares.

Furthermore, where an offer is made for a company's equity share capital and there are rights outstanding to subscribe for or purchase that company's equity share capital, the offeror must make an appropriate offer or proposal to the holders of such rights[784]. This requirement is intended to ensure that the interests of holders of such securities and rights are safeguarded. The 'appropriate offer' is an offer to acquire securities giving access to the capital at a price equal to their

[780] Code, Note 3 on r.20(1).
[781] However, the Panel must be consulted if any employees hold a significant block of shares; see ibid.
[782] Code, r.14(1).
[783] Code, Note 1 on r.14.
[784] Code, r.15(a).

intrinsic value at the time of the offer. The 'appropriate proposal' is a proposal to exchange the securities of the offeree company which give access at a later date to the capital with the securities issued by the offeror.

5.1.2 Operation of the Principle as Between Shareholders Selling Within the Offer and Shareholders Selling Outside the Offer

In pursuit of its philosophy of ensuring shareholder equality, the Code further attempts to remove any discrepancy between the price received by shareholders who accept the offer and that received by shareholders who sell to the offeror outside the offer[785]. The Code does so in a number of ways: First, it constrains the offeror in its choice as to the amount of the consideration offered. The latter shall be no less favourable than the highest price paid by the offeror for the acquisition of shares in the offeree company within the three-month period prior to the commencement of the offer period[786]. Thus, although the Code does not prevent the bidder from acquiring as many shares as it wishes in the pre-bid period, it nevertheless requires the offer price to be compatible with the price paid for the pre-bid purchases. This Rule is essentially a reflection of GP 1 of the Code[787] and ensures fair and equal treatment of all shareholders in the distribution of the bonus paid for the acquisition of a controlling position in the offeree company. The offeror is, however, free to choose the type of consideration offered. In other words, the offeror need not make a cash offer even if the pre-bid purchases had been for cash[788]. However, any securities offered as consideration must, at the date of the announcement of the firm intention to make an offer, have a value at least equal to the highest price paid in the pre-bid period.

The Code further requires the offeror, and the persons acting in concert with it, who purchases offeree shares, which are the subject of the offer, during the offer

[785] i.e. in the market or by private treaty.
[786] Code, r.6(1). Note that, prior to a Panel Statement of 17 December 1987, Rule 6(1) required such matching only when an offer was reasonably in contemplation. This caused uncertainty, however, for companies and their advisers, and their difficulties became more acute as a result of the sharp falls in the share market in October 1987; see G. K. Morse, 'Changes to the City Code Rule on Fixing the Price of an Offer-From the General to the Specific' (1988) J. Bus. L., pp. 164-165.
[787] Panel Statement of March 3, 2003 on *Six Continents plc/Capital Management and Invetsment plc*, p. 2.
[788] Code, Note 3 on r.6.

period at above the offer price, whether in the market or by private treaty, to increase its offer to not less than the highest price it paid for the shares so acquired and to make this increased price available to all shareholders who have already accepted the offer[789]. The Panel has no jurisdiction to set an adjusted price where for some reason the market price is inappropriate[790]. It should be noted in this respect that this requirement goes back to the first edition of the Code[791]. The original rule was not, however, one of absolute equality but rather of fair treatment. For it required the offeror to pay an increased price equal to the weighted average closing prices of the offeree shares on the stock exchange over a certain period of time before the date when the offeree shares were purchased above the offer price. However, the weighted average probably was not limited to purchases above the offer price, and probably also included purchases below the offer price. As a result, the original rule resulted in a fair treatment only, rather than in an absolute equality. In other words, the offeror received the benefit of such lower sales in determining the weighted average price.

Secondly, the Code constrains the offeror in its choice as to the nature of the consideration offered. The Code does so by requiring a cash offer or cash alternative at not less than the highest price in circumstances where the offeror purchases for cash offeree shares carrying ten per cent[792] or more of the voting rights during the offer period or in the year prior to its commencement[793]. Prior to the adoption of Rule 11, it was common for offerors to make a share-exchange offer while securing control through cash purchases in the market, and then to

[789] Code, r.6(2)(a). Note, however, that this increased price cannot be passed on to people who have sold their shares to the offeror through the market or otherwise at less than this price.
[790] Contr. this with Code, r.6(1), which gives the Panel such discretion in the context of purchases made prior to the offer. Thus, the Panel probably thinks that, without a discretion, equality would come at too high a price in the context of pre-bid purchases, and thus attempts to reduce the offeror's costs.
[791] Note, however, that even before the adoption of the Code, the Revised Notes stated that an offeror who publishes his terms and who subsequently acquires effective control by buying, in the market or otherwise, should without delay revise his existing offer or make a formal offer to all uncommitted shareholders at a fair price, having regard to the prices paid in the market. The test was not one of absolute equality, but of fair treatment for the uncommitted shareholders; see R. Pennington, 'Takeover Bids in the UK' (1969) 17 Am. J. of Compar. L. 159, pp. 171-172.
[792] Note that, prior to 1989, this figure was 15 per cent; see the 1971 Code, r.29A. The change intended to reduce the potential for inequality of treatment in share-exchange offers if cash purchases take place; see D. Hayton, 'The City Code in 1989: Creativity and its Limits' (1990) 11 Co. Law. 98, p. 101.
[793] Code, r.11(1). Note, however, that a cash requirement is not required if the Panel consents to it.

adjust the offer terms upwards in shares[794]. The latter course of action provided offerors with the opportunity to obtain their objective without having to pay cash to all the offeree shareholders. At the same time, share-exchange offers were favoured by the offeree shareholders, for such offers allowed them to defer their capital gains tax liability, which was introduced in 1965[795]. However, the problem was that it was impossible to value the shares offered as a consideration where the offeror's shares were novel and thus their value was speculative, or where the offeror was smaller in size than the offeree company. The latter can be illustrated by the case of *Adepton Ltd. and William Hudson Ltd.* In this case, the net assets value of the offeror was £2,205,000 whereas that of the offeree company was £8,814,000[796]. In such cases, it was unfair to offer securities to the offeree shareholders, who were coerced into accepting securities about which they had doubts regarding their long-term value. Hence the Panel stated in its 1970/1 report

> *'At times [...] the technique appeared [...] to be in breach of General Principle 8[797] which requires all shareholders of the same class to be treated similarly by an offeror company. The breach appeared all the more grave when the offeror succeeded in buying control of the offeree company in the market while shareholders were still digesting the offer document with the result that, frequently, the more experienced or better advised investors were found to have realised their investment for cash while the remainder had to be content with the offer of less marketable paper'.*

The Panel was not, however, prepared to intervene in such cases unless there were special circumstances, like in the case of Adepton/ William Hudson[798]. After the announcement of its share-exchange offer[799], Adepton pursued an aggressive buying of William Hudson's shares in the market and, in a few days, secured forty-one per cent of the offeree's shares. William Hudson claimed that Adepton's offer should be underwritten for cash. The Panel accepted such claim on the following grounds:

[794] T. Hadden, *Company Law and Capitalism* (London: Butterworth, 2nd ed., 1977), p. 384.
[795] Panel Statement of April 21, 1972 on *Morgan-Grampian Ltd / Haymarket Publishing Group Ltd/ Daltons Weekly Ltd*, where the Panel held that '*the MG offer was the more valuable of the two offers and it contained the capital gains tax advantage which the Panel considered was a factor the board was entitled to take into account*'.
[796] Panel Statement on *Adepton Ltd. and William Hudson Ltd*; see supra n 759.
[797] Now GP 1.
[798] Panel Statement on *Adepton Ltd. and William Hudson Ltd*; see supra n 759.
[799] The consideration offered in this case was convertible unsecured loan stock of Adepton.

'While theoretically all shareholders have a similar chance to sell, in practice this similarity may be more theoretical than real. Normally it will be only the knowledgeable shareholders who are close to the market who will have the option of selling in the market [...] By the time the small shareholder has received his advice, the offeror may well have withdrawn from the market and the market price of the shares will have fallen accordingly'.

In another case, where the offeror purchased twenty-five per cent of the offeree's shares from a single seller for cash after making a share-exchange offer, the Panel ruled that such purchase constituted a breach of GP 8[800] and held that *'paper bids which are not underwritten for cash are in their nature much subject to market fluctuations and the Panel feels that it must apply GP 8 strictly in such cases'*[801].

As a result of the above cases, Rule 11(1) was introduced in 1971. It should be emphasised that Rule 11 does not require an offer, but stipulates that, if an offer is made, that offer must be in cash or accompanied by a cash alternative. The Rule also envisages a cash offer or a cash alternative to be made in circumstances where the Panel considers it necessary to secure equal treatment of the offeree shareholders[802], irrespective of whether the ten per cent threshold is crossed. Such circumstances include cases where the sellers are either directors of the offeror or offeree companies or otherwise closely connected with them[803]. It should be added that an offeror who falls within the scope of Rule 6(2) will also fall within the scope of Rule 11, if it reaches the ten per cent threshold. As a result, Rule 11 supplements Rule 6, albeit in a way which has more far-reaching effects on the offeror[804]. It is believed, however, that, despite Rule 11(1), the Code falls short of full equality. Indeed, it is suggested that the latter can only be attained by stipulating that all offers must be in cash or accompanied by a cash alternative, without setting a particular threshold. For this would be the only way to ensure that those shareholders who receive cash by selling outside the offer will not obtain superior terms than the shareholders selling within the share-exchange offer.

[800] Now GP 1. The Panel ruled so, as only the single seller had its shares bought for cash at a price above the market price.
[801] Panel Statement of 24 March 1970 on *Trafalgar House Investments Ltd / The Cementation Company Ltd.*
[802] Code, r.11(1)(c).
[803] Code, Note 4 on r.11(1).
[804] On the far-reaching effects of the cash requirement on the offeror, see below.

Even though GP 1 requires equality of treatment, until recently, the Code did not require the offeror, who would purchase shares in exchange for securities during the course of its cash offer, to make a share-exchange offer[805]. This is not surprising, as it was assumed that offeree shareholders generally prefer cash[806]. There may be cases, however, where such assumption may prove false. Indeed, the offeree shareholders may prefer to receive the offeror's securities rather than cash, in order to defer any liability to capital gains tax. It should be noted in this respect that the offeree shareholders receiving cash may not always be able to purchase the offeror's securities on the same terms as those received by the shareholders who sold to the offeror outside the offer. This is because the market in the offeror's securities may be illiquid, or the offeror's securities may be expensive. In any event, the market impact of significant buy orders is likely to cause an increase in the price of the offeror's securities[807]. As a result, the Code introduced in 2002 a compulsory share offer regime[808]. Pursuant to the latter, if the offeror who purchases shares carrying ten per cent or more of the offeree's voting rights, in exchange for securities, in the three months prior to the commencement of and during the offer period, he will need to make a share-exchange offer[809]. However, the Code requires the offeror to make a cash offer or to provide a cash alternative in addition to offering shares, unless the securities received by the vendor include shares to which selling restrictions are attached[810]. Such selling restrictions include the holding of the securities received as consideration until the offer lapses or until the offer consideration is posted to accepting shareholders.

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[805] The position was different in a mandatory bid, however, where the Code says that '*where there have been significant acquisitions in exchange for securities, GP 1 may be relevant and such securities may be required to be offered to all shareholders. A cash offer will also be required. The Panel should be consulted in such cases*'; see Note 1 on r.9(5).

[806] T. I. Ogowewo, 'New Takeover Code Rules on Exchange Offers and Auctions' (2002) 23 Co. Law. 186, p. 187.

[807] *Purchases by the Offeror of Shares in the Offeree in Exchange for Securities*, Consultation Paper, PCP6 (October 2001), para 2.1.6, available at Takeover Panel website.

[808] *Response Statements 6, 7, and 8 and Code Amendments* (February, 2002), available at Takeover Panel website.

[809] The number of securities offered to accepting offeree shareholders for each offeree share held by them is equal to the number of securities issued to the vendor of the triggering stake for each of his offeree shares; see Note 1 on r.11(2).

[810] Code, r.11(2).

The Panel has no discretion to waive Rule 11(1) or Rule 11(2), but it has discretion to agree an adjusted price lower than the highest price paid in both cases. Factors which the Panel takes into account in exercising its discretion include the size and timing of the relevant purchases; the attitude of the offeree board; whether shares have been purchased at high prices from 'insiders'[811]; and the number of shares purchased in the preceding twelve months[812]. The rationale behind the Panel's discretion under this Rule, as opposed to Rule 6(2)(a), is that whereas the latter only relates to prices paid during the offer period, Rule 11 also relates to the highest price paid in the twelve months period preceding the offer. Due to the expanded time span under Rule 11, there is therefore a greater need for some discretion to be vested in the Panel. An example of where the Panel uses its discretion can be illustrated by the case of *Hillsdown Holdings plc / S&W Berisford plc*[813]. In this case, the Panel noted that the crossing of the ten per cent threshold was totally inadvertent[814]. The Panel further noted that the scale of the excess was small, some 0.2 per cent voting equivalent. As a result, the Panel concluded that to apply Rule 11 strictly in this case would involve so disproportionate an effective penalty on Hillsdown as to be in conflict with the spirit of the Code.

It should be added that, despite its virtues to ensure equality, Rule 11(1) may operate to tie the hands of some offerors, in particular in a competitive offer situation. For this rule is likely to favour offerors who have ready access to cash. It may be argued that the rule should not operate to curb meritorious offers, as an offeror would, in such a case, be able to obtain suitable underwriting. Underwriting is a contract by which a lead underwriter, which is typically an investment bank, agrees to purchase the offeree shares at the underpinning price. The lead underwriter lays off all or part of its risk by arranging sub-underwriting for all or part of the acquisition. Underwriters do, however, receive a fee for their services. This fee is a standard fee and not a fee which varies with risk[815]. It consists of two per cent of the gross proceeds of the issue for thirty days and a

811 e.g. directors or other persons closely connected with the offeror or the offeree company.
812 Code, Note on r.11(3).
813 Panel Statement of 8 May 1986 on *Hillsdown Holdings plc / S&W Berisford plc.*
814 Note that the Code held so by reference to Rule 29A of the 1971 edition of the Code.
815 *Underwriting Services forShare Offers* (1999), supra n 463, p. 9.

further 0.125 per cent for each additional seven-day period[816]. Consequences of Rule 11 from the point of view of the offeror are exacerbated by the fact that, as a general rule, if an offer has become or is declared unconditional as to acceptances, all alternative offers[817], including cash alternative offers, must remain open for acceptance for not less than fourteen days after the date on which it would otherwise have expired[818]. This is likely to stretch out the underwriting period and increase underwriting costs. For the amount of fee payable to underwriters depends on the risk borne by them, which in turn depends on the length of the offer period. The Code recognises the costs of underwriting in such circumstances and mitigates the offeror's costs by allowing it to limit its cash underwritten alternative[819]. This shows that the Panel here thinks that equality would come at too high a price if the offeror is not allowed to do so, and thus attempts to reduce the offeror's costs. However, the offeror is allowed to limit its cash underwritten alternative only where the value of the alternative is, at the time of announcement, more than half the maximum value of the offer[820].

5.1.3 Operation of the Principle Upon Acquisitions or Transfers of Control

It is a fundamental principle of the Code that a shareholder should have the right to exit the company if control of the company changes[821]. Control changes may occur upon an acquisition of control or upon a transfer of control. The former involves situations where control was not previously held by any shareholder and a person acquires control of the company through purchases in the market. The latter involves situations where control was previously held by a shareholder and a person acquires control by private treaty. The Code ensures equality upon both types of control changes, by way of a mandatory bid requirement. The latter is

[816] Note that although these figures concern circumstances where the offeror finances its share-exchange offer by way of an underwritten rights issue, the same figures apply in the context of cash underpinnings in acquisitions.
[817] Panel Statement of 27 May 1977 on *BRT Ltd / Andre Silentblc Ltd.* In the event, the Panel asked BTR to reopen its share alternative for 14 days and to afford to those who had already accepted cash for their Silentbloc shares the opportunity to switch to the share alternative.
[818] Code, r.33(2).
[819] Contr. this with the fact that, under the mandatory bid rule, the offeror has no option to shut off a cash underwritten alternative earlier than the period it stated in writing; see Code, Note 2 on r.33(2).
[820] Code, r.33(2).
[821] J. H. Farrar (1998), supra n 411, pp. 594-595.

intended to prevent the acquisition or transfer of effective control at inflated prices without offering the same terms to all shareholders[822].

i) History of the mandatory bid rule

The early editions of the Code sought to promote shareholder equality by requiring the offeree directors, related persons, or shareholders who transfer 'effective control' not to sell unless the buyer undertook to extend a comparable offer to the remaining shareholders[823]. However, this approach proved difficult in that it demanded that the Panel determine in each case whether or not 'effective control' was actually transferred[824]. Furthermore, the above rule only applied upon a transfer of control from an already existing controlling shareholder, but not upon an acquisition of control through purchases in the market. Indeed, in Ozalid's offer for Venesta International's shares, Ozalid made a share-exchange offer for the issued share capital of Venesta[825]. Shortly after, Norcros announced a competing offer, with the support of the Venesta board. Meantime, a shareholder in Venesta, Consolidated Signal, which was concerned that the competing offer was inadequate, conducted a heavy purchasing in the market and succeeded to frustrate Norcros's offer. Venesta appealed to the Panel on the grounds that the purchaser of shares in the market who, whether in a offer situation or not, had as its objective obtaining control of a company must, if it did by such purchases obtain control, make an offer for the remaining shares. In the view of Venesta, '*to stop at the purchase of fifty-one per cent would inevitably result in the forty-nine per cent minority shareholders being left, so to speak, out in the cold*', and would neglect the Code's requirement that all shareholders be treated equally. Venesta particularly referred to shareholders who had accepted Norcros's offer and who were therefore unable to sell their shares in the market during the time when Consolidated stood in the market. In the event, the Panel rejected Venesta's argument on the following grounds:

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822 T. Tridimas, 'Self-Regulation and Investor Protection in the UK: The Takeover Panel and the Market for Corporate Control' (1991) 10 Civil JQ 24, p. 32.
823 The 1968 Code, r.10. Indeed, this requirement goes back to the Revised Notes.
824 To reach a decision, the Panel had to look at such factors as the ownership structure and the level of shareholder involvement in the relevant company.
825 Panel Statement of 6 January 1972 on *Ozalid/ Norcros/ Consolidated Signal/ Venesta.*

'The present rules do not impose any obligation on an individual who has acquired control by a series of purchases in the market to endeavour to obtain the remaining shares. There have been many cases in the past where control has been acquired in this way'[826].

Following the above case, two rules were introduced into the Code. Each of these Rules described a different circumstance where an obligation to make a general offer would arise: Rule 35 concerned the acquisition of a forty per cent stake in the market[827]; and Rule 34 concerned the acquisition of a significant holding from directors or a limited number of sellers[828]. The rationale underlying Rule 35 was to prevent the acquisition of effective control through market purchases in a matter of days[829], as illustrated by the case of Ozalid/Venesta. By adopting Rule 35, the Code abandoned a previously fundamental principle of the Code, namely that the purchase of effective control through the normal operations of the market did not constitute a takeover within the provisions of the Code.

Unlike Rule 35, Rule 34 spoke only of selective purchases and contained no threshold when control was deemed to have passed. This difference between Rule 35 and Rule 34 was not as irrational as it might seem, since the acquirer of shares in the market often required a higher percentage to secure control, due to the fact that he would likely be in conflict with the existing board[830]. By contrast, a board of directors with thirty per cent of the votes was likely to be in control and able to transfer control to a purchaser. Indeed, the Panel said

'In the normal case, a holding of thirty per cent, and in many cases less than thirty per cent, would in practice confer control and the Panel's adoption of this percentage as the general criterion for the application of Rule 34 does usually reflect the reality of the matter'[831].

However, in special circumstances, the Panel decided to dis-apply the thirty per cent threshold of control. This can be illustrated by the case of *Marc*

[826] The Panel stated, however, that if the aim of Consolidated Signal was to frustrate the offer, then the then Rule 33 (now Rule 21) would come into play.
[827] The 1972 Code, r.35.
[828] The 1972 Code, r.34.
[829] The previous view of the Panel was that it would be impossible to acquire control of a company through market purchases, except over a very long period of time during which shareholders would be aware of what was happening and thus could take their decisions regarding their personal investments; see Panel Statement of 18 January 1972.
[830] 'Second Stage Evidence' (1979), supra n 771, p. 7.
[831] Panel Statement of 3 August 1973 on *The Weyburn Engineering Company Ltd.*

Gregory/Greencoat Properties, where the Panel lowered the threshold on the following grounds:

> *'If a party seeking control were permitted to buy up to, say, 29.5 per cent of the share capital by selective purchases, and then, having bought 0.6 per cent of the remaining shares in the market, were allowed to purchase a further 9 per cent from a limited number of sellers without incurring an obligation to make a general offer, the spirit of Rule 34 would be violated'*[832].

The 1974 revision of the Code replaced the old rules by one set of requirements[833]. The effects of this change was two-fold: First, it eliminated the problems arising under the old rules[834] from the distinction between selective purchases and market purchases; and, secondly, it established thirty per cent of the voting rights of a company as 'effective control' for Code purposes in virtually all circumstances.

ii) Current operation of the mandatory bid rule

The present Code[835] requires that if a purchaser, including persons acting in concert with him, acquires effective control, he must then make a general offer for the outstanding shares. The rule applies regardless of whether control is acquired through purchases in the market, or is transferred from an already existing controlling shareholder. Furthermore, the term 'acquisition' used by the Code must be broadly construed so as to include the exercise of any conversion or subscription rights into voting shares of the company[836]. However, the Rule does not impose an obligation to make a bid merely because a person happens to hold thirty per cent or more of the shares[837]. Furthermore, a person will not be required to make a bid if he crosses the relevant threshold upon a company's redemption or purchase of its own shares, provided he is not a director and is not acting in concert with a director[838]. Nor will he be required to make one if he crosses the relevant threshold upon an issue of new securities as consideration for an

[832] Panel Statement of 24 July 1973 on *Marc Gregory Ltd/Greencoat Properties Ltd.* The Panel held that Marc Gregory should make a general offer for the Greencoat shares.
[833] The 1974 Code, r.34.
[834] i.e. Rules 34 and 35 of the 1972 Code.
[835] Code, r.9(1).
[836] Code, Note 11 to r.9(1).
[837] H. L. Ffrench, *International Law of Takeovers and Mergers: The EEC, Northern Europe, and Scandinavia* (New York; London: Quorum, 1986), p. 229.
[838] Code, Note 1 to r.37(1).

acquisition, provided there is an independent vote by shareholders in general meeting[839]. It should be noted that if effective control is transferred from the directors-shareholders, who already hold control in the company, then the directors must condition their transfer on the fulfilment by the purchaser of the mandatory bid obligation[840]. This provision constitutes an additional safeguard to Rule 9(1).

For the Code's purposes, 'effective control' means shares carrying thirty per cent of the voting rights, irrespective of whether such shares do or do not in fact provide control. It should be noted that the Code's adoption of thirty per cent threshold derives from its belief that a listed company will likely be controlled by persons holding less than fifty per cent of the voting rights. It should be noted in this respect that a proposal was made in 1989 to reduce the thirty per cent threshold. The Panel rejected this proposal, however, on the ground that the current figure '*had stood the test of time*'[841]. Similarly, another proposal was made in 1992 to reduce the threshold to twenty per cent. This proposal was also rejected, however, on the grounds that other mechanisms may be more appropriate to protect companies from the influence of material shareholders, such as a clause in the articles of association requiring a shareholder who reaches twenty per cent level to make a bid for all the outstanding shares. This would give shareholders, who control the articles of association, a choice as to whether to adopt such a clause on a case-by-case basis[842].

The mandatory bid obligation is equally applicable where a shareholder, or his concert parties, who already hold between thirty and fifty per cent of the voting rights of a company, consolidate their control by acquiring additional shares which increase their percentage of the voting rights[843]. It should be noted in this

[839] Note 1 on Dispensations from Rule 9. This is referred to as the 'whitewash' procedure.
[840] Code, r.9(6).
[841] Panel Statement of 26 June 1989 on the *Report of a Panel Working Party on Takeover Rules and Practices*.
[842] A. Paul (1993), supra n 474, pp. 147-148.
[843] Code, r.9(1). Note that, prior to 1998, the purchaser could purchase up to 1 per cent under this part of the mandatory bid rule. This threshold was removed following *Re Astec (BSR) Plc* [1998] 2 BCLC 556, however. In this case, the minority could not avail themselves from the mandatory bid rule since the offeror had never crossed the minimum 1 per cent limit. As a result, the only means for the minority to exit the company was to apply for a s.459 remedy.

respect that the obligation arises if there is any increase at all in the percentage level of that holding. However, if a shareholder already owns over fifty per cent, he can continue to acquire shares without having to make a general offer. For strengthening a controlling stake which is already over fifty per cent is not regarded as affecting the minority shareholders to the same extent as the two previous situations regulated by the Code[844]. It should be added that the rule may also be triggered if a person acquires statutory control of a company which owns more than thirty per cent of the shares in a second company, provided the shareholding in the second company is significant in relation to the first company and one of the main purposes of acquiring control of the first company was to secure control of the second company[845]. The latter can be illustrated by the case of *British Land Company plc / Stanhope Properties plc*, where the full Panel dismissed an appeal by Rosehaugh against the Panel Executive's ruling that the offer made by British Land for Stanhope should not trigger an offer for Rosehaugh's 50 per cent share in Broadgate by application of the chain principle. The Panel took the view that the deadlock arrangements between Stanhope and Rosehaugh were such that the Panel did not consider that British Land's offer for Stanhope would lead, in terms of the Code, to a change of control of Broadgate[846]

The bid must be made to the holders of any class of equity share capital, whether voting or non-voting[847], and to the holders of any class of voting non-equity share capital in which the offeror or any other person acting in concert with it holds shares. If, for instance, the offeror holds both ordinary and voting preference shares, it must then make an offer for the preference shares as well as for the ordinary shares[848]. Thus, the scope of the mandatory bid is larger than that of the voluntary bid, which does not require the offeror to extend its offer to the holders of voting non-equity share capital. However, the offeror is not required to extend its offer to non-voting non-equity and to offeree shares held in treasury[849].

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[844] J. H. Farrar (1998), supra n 411, p. 595.
[845] Code, Note 8 to r.9(1). This is referred to by the Code as the 'chain principle'.
[846] Panel Statement of 7 March 1995.
[847] Code, Note 8 to r.9(1).
[848] Code, Note 8 to r. 9(1).
[849] Note 16 to r.9(1).

As far as the amount of the mandatory bid is concerned, this shall be no less than the highest price paid for the shares purchased during the offer period and within the preceding twelve months[850]. This prevents the offeror from offering a low price so as to render the offer unattractive. The Panel may, however, be prepared to consider a dispensation from the highest price requirement in exceptional circumstances[851], such as the occurrence of adverse movements in the market between the time *de facto* control is acquired and the time the full offer is made. The latter shows that the Panel here thinks that equality would come at too high a price and thus attempts to reduce the offeror's costs.

As far as the nature of the consideration of the mandatory bid is concerned, this must be in cash or accompanied by a cash alternative, irrespective of whether the shares triggering the mandatory bid rule have been purchased for cash or for a consideration other than cash[852]. This allows the minority shareholders to get completely clear of the offeror, and this would not be achieved if the sole consideration consisted of the offeror's shares. Where there have been significant acquisitions in exchange for securities, however, such securities may be required to be offered to all shareholders, in order to give effect to GP 1 of the Code[853].

Like voluntary bids, mandatory bids are also subject to the fifty per cent acceptances condition. The latter ensures that, except through a partial offer, effective control of an offeree company does not pass unless legal control[854] also passes[855]. Weinberg (1979) criticises the fifty per cent acceptances requirement under the mandatory bid as being illogical. In his view,

> '*Having required that an offer be made because effective control has passed, the Code surprisingly requires the offer to be conditional upon actual voting control passing. Small shareholders may, as a result, be precluded from realising their shares at the price at which control has passed unless the offeror is prepared to buy significant numbers of shares in the market or a sufficient number of other shareholders decide that they want to accept the offer so that the fifty per cent condition is satisfied*'[856].

[850] Code, r.9(5).
[851] Code, Note 3 to r.9(5). For this purpose, the Panel takes into account the same factors as it does in connection with the cash requirement; see supra n 812 and the accompanying text.
[852] Code, Note 1 to r.9(5).
[853] Code, Note 1 to r.9(5). Note, however, that a cash offer will also be required.
[854] i.e. a majority of votes.
[855] Code, r.9(3).
[856] M. A. Weinberg and M. V. Blank (1979), supra n 457, p. 152.

As a counter-argument to the above criticism, it may be argued, however, that the entire group of remaining shareholders were at least given the opportunity of selling at the premium price, and that the scenario described by Weinberg would occur only because most of the remaining shareholders would have declined that opportunity[857]. Other than the fifty per cent acceptances condition, the mandatory bid cannot be subject to any other conditions, except with the consent of the Panel[858]. The rationale underlying the latter is to prevent the offeror from defeating the purpose of the mandatory offer rule by attaching conditions to the offer which would make its acceptance unattractive to offeree shareholders. Accordingly, if the implementation of a general offer is to be dependent upon, for instance, the passing of a shareholders' resolution in general meeting, no acquisition of shares should be made such as would trigger a mandatory offer[859].

The Panel has discretion to waive the mandatory bid obligation. Indeed, it would be inequitable to require a general offer in some cases[860]. However, waivers of the Code's mandatory bid rule are only granted in exceptional circumstances[861]. Such circumstances include, *inter alia*, situations where effective control is acquired in the context of a rescue operation[862]; through inadvertent mistake, provided the holding is within a short period reduced to below thirty per cent by sales to persons unconnected with the purchaser[863]; on an enfranchisement of non-voting shares, provided the holder of such shares had no reason to believe at the time of acquiring the non-voting shares that enfranchisement would take place[864]; and where a person makes arrangements prior to the acquisition for the placing of sufficient shares to reduce his holding to below thirty per cent[865]. Waivers are also available in the context of a consolidation of control. Indeed, a waiver may be granted where persons holding fifty per cent state in writing that they will not

[857] S. Kenyon-Slade and M. Andenas (1993), supra n 59, p. 179.
[858] Code, r.9(3)(a).
[859] Code, r.9(3)(b). This proviso was introduced in 1972, following problems encountered in the early 1970s, when persons triggering the mandatory bid obligation either refused to implement it or were unable to do so.
[860] 'Second Stage Evidence', supra n 771, p. 8.
[861] Panel Statement on *British Land Company plc/Stanhope Properties plc*, supra n 845.
[862] Code, Note 3 on Dispensations from Rule 9.
[863] Code, Note 4 on Dispensations from Rule 9.
[864] Code, Note 6 on Dispensations from Rule 9.
[865] Code, Note 7 to r.9(1).

accept the mandatory offer; where shares carrying fifty per cent or more of the voting rights are already held by one other person[866]. It should be added that waivers are further available in special cases, such as the case of *B.S.& W. Whiteley Ltd* where the Panel waived the mandatory bid obligation on the grounds that its application '*might have resulted in the transfer abroad of control of the sole manufacturer of electrical insulating pressboard in the UK*'[867].

5.1.4 Sell-Out Right of the Minority

It should be mentioned that the law - but not the Code - provides the offeree shareholders with a further exit right. Indeed, the offeree shareholders may force the offeror to buy their shares where the offeror acquires ninety per cent or more of a company's shares by a takeover bid[868]. It should be emphasised that this right can only be invoked following a takeover bid. The offeror is bound to buy the remaining ten per cent shares on the terms of the offer or on such other terms as may be agreed[869]. Thus, if the terms of the offer give shareholders a choice of consideration, then the offeror must offer a similar choice to the remaining shareholders[870]. Davies (1997) notes that the latter requirement has remarkable consequences, as it obliges the offeror to keep all cash underwritten alternatives open for considerably longer than is required under the Code in all cases where the offer has been ninety per cent successful[871].

5.2 Concepts Increasing the Potential for Attaining Equality

This Section briefly describes those provisions in the Code which help to achieve equality, by complementing the equality provisions set out in the previous Section.

[866] Code, Note 5 on Dispensations from Rule 9.
[867] Panel Statement of 2 December 1975.
[868] CA 1985, s.430A.
[869] CA 1985, s.430B(2).
[870] CA 1985, s.430B(3).
[871] P. L. Davies (London: Sweet & Maxwell, 7th ed., 2003), supra n 182, p. 745.

5.2.1 Concept of 'Acting in Concert'

The Code defines the concept of 'persons acting in concert' as '*persons who, pursuant to an agreement or understanding, whether formal or informal, actively cooperate, through the acquisition by any of them of shares in a company, to obtain or consolidate control of that company*'[872]. This concept was introduced to prevent certain rules of the Code, and in particular the mandatory bid rule[873], from being easily circumvented. Indeed, before the introduction of this concept, the offeror could conceal its purchases by 'warehousing'[874] the shares purchased under the names of nominees, thereby gaining control without the expense and formality of a general offer[875].

The Code sets out a list of persons who will be presumed to be acting in concert unless the contrary is established, and who will therefore be required to make an offer. In particular, the purchaser will be presumed to act in concert with the seller, where he acquires slightly fewer than thirty per cent but effectively exercises a significant degree of control over the retained shares[876]. This may be due to the fact that the purchaser pays a very high price for the shares purchased, or where the seller is an insider. Furthermore, the shareholders will be presumed to act in concert with the directors where they seek to acquire board control through proposals at the general meetings. The determination as to whether a particular proposal is board control-seeking is carried out by reference to a list of factors, the key factor being the relationship between the activist shareholders and the proposed directors. Only if the latter factor is present that the Panel will move on to consider other factors. It should be emphasised that this presumption does

[872] Code, Definitions.
[873] Note, however, that the concept of 'persons acting in concert' is also relevant to the application of Rule 11. Indeed, the cash offer or cash alternative under Rule 11 will be set at not less than the highest price paid by the offeror or any person acting in concert with it, whichever is the higher.
[874] The Panel has described 'warehousing' as '*the practice whereby a person or company (or group of persons and/or companies) accumulates, without public disclosure, a substantial block of shares in a company with a view either to making a takeover offer or to selling the block to someone else who then makes an offer*'; see *Panel Answers to DTI Inquiry* of July 1974, cited in M. A. Weinberg and M. V. Blank (1979), supra n 457, p. 569.
[875] T. Hadden (1977), supra n 794, 368.
[876] Code, Note 5 to r.9(1).

not intend to interfere with the activist shareholders' legitimate collective action designed to maximise overall shareholder value[877].

However, not all forms of co-operation fall within the scope of the concept of 'acting in concert'. Thus, the Panel will not normally regard the underwriter of a mandatory bid, by virtue of his underwriting alone, as being a member of a group acting in concert and, therefore, responsible for making the offer, in circumstances where the offeror is unwilling or unable to implement the offer[878]. Likewise, an agreement between a shareholder and a bank under which the shareholder borrows money for the acquisition of shares, which gives rise to a mandatory bid obligation, will not of itself fall within the scope of the mandatory bid rule[879].

5.2.2 Rules Governing Substantial Acquisitions of Shares

In addition to removing the potential for unequal treatment of shareholders where a *de facto* control threshold of thirty per cent is transgressed, the Code also seeks to reduce shareholder inequality by restricting the speed at which acquirers are able to accumulate strategic stakes exceeding fifteen per cent of a company's shares. Indeed, potential offerors may attempt to ensure the success of their offer by purchasing offeree shares prior to making their offer. The Code's Rules Governing Substantial Acquisitions of Shares[880] were introduced in 1980 by the then Council for the Securities Industry to deal with the problem of '*market raids*', which were carried out in 1979 and 1980[881]. These raids involved the acquisition

[877] *Shareholder Activism and Acting in Concert*, Panel Consultation Paper No. 10 (March, 2002), para 4.1, available at Takeover Panel website.
[878] Code, Note to r.9(2).
[879] Ibid.
[880] Hereafter the SARs.
[881] The example that has prompted action by the Council for the Securities Industry was the 'dawn raid' for Consolidated Goldfields by De Beers in the summer of 1980. In that case, De Beers secretly accumulated over 13 per cent of the company's shares through a variety of nominee holdings. Indeed, each nominee purchased less than 5 per cent of the company's shares so that no individual nominee would be required to disclose his stake. Having done so, they bought a further 12 per cent in the market in a matter of minutes by offering a 18 per cent premium over the market price. The main criticism of this and other raids was that the speed at which they were carried out excluded small shareholders from the higher price, which was snapped up by institutional shareholders enjoying a privileged position.

of shares carrying up to 29.9 per cent[882] of the votes of a company at a substantial premium over the previous market price in a very short time span.

Pursuant to the SARs, a person is precluded from acquiring, in any seven day period, shares carrying ten per cent or more of the voting rights of a company if such acquisition, when added with any existing holding, would give him between fifteen and thirty per cent of the voting rights of that company[883]. By giving freedom to purchase only up to 14.9 per cent of a company's voting rights, the SARs slow down the acquisition process by potential acquirers. It should be emphasised that the SARs do not apply to a person who acquires thirty per cent or more of the offeree's voting rights. For such person will be subject to Rule 5 of the Code and will, if appropriate, be obliged to make a mandatory bid under Rule 9[884]. Nor do the SARs apply when a person makes a tender offer. For the latter ensures that small shareholders participate in any premium which would be payable in connection with the establishment or consolidation of a substantial minority holding in a listed company.

5.3 Rationales of the Code's Emphasis on the Principle of Equality

The rationales of the Code are the equality of access to the market as between institutional investors and their private counterparts; the protection of the minority, and the prevention of the pressure to tender.

5.3.1 Equality of Access to the Market Between Institutional Shareholders and their Private Counterparts

One of the rationales of the Code's provisions on equality is to ensure equal access to the market between institutional shareholders and their private counterparts[885]. This rationale is also referred to as the 'public confidence in the market' rationale. Indeed, by virtue of their superior experience, resources and

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[882] Note that an offer would be necessary at 30 per cent.
[883] SARs, r.1. However, this restriction does not apply to acquisitions from a single shareholder if it is the only such acquisition within any period of 7 days, nor to acquisitions made with the agreement of the offeree board and conditional upon the announcement of an offer; SARs, r.2.
[884] SARs, Introduction, 2.
[885] This aim is explicitly stated in the Hampel Report, para 5.24.

access to management, institutional shareholders[886] have a better opportunity to evaluate a company's prospects than their private counterparts. As a result, whilst institutional shareholders can react rapidly and take advantage of whatever superior terms are available[887], their private counterparts who are less informed may not be so fortunate[888]. Consequently, there is a risk that the private investors will not be treated equally.

The Code attempts to remove the above discrepancy in a number of ways, all of which ensure that institutional shareholders who are closer to the market enjoy no price advantage over their private counterparts. These include the requirement for equality of information for all shareholders[889], the mandatory bid rule, and the *pro rata* requirement in the context of partial offers, which is intended to avoid that large and well-informed shareholders respond promptly to first come, first served offers[890].

5.3.2 Protection of the Minority

Another rationale of the Code's provisions on equality is to protect the minority. An example of the Code's rules on minority protection is the rule requiring the offeror in a voluntary bid to make a comparable offer for each class, where there is more than one class of equity share capital[891]. Another such rule is that requiring the offeror to make an appropriate offer or proposal to the holders of rights to subscribe for or purchase the company's equity share capital[892]. However, the Code's major contribution in this respect is the mandatory bid obligation. The latter encompasses two objectives at the same time: First, the mandatory bid rule constitutes a substitute for minority protection. Indeed, when a company is controlled by a new person, in circumstances where it was previously controlled by another person or not controlled at all, shareholders should be given

[886] For more information on UK institutional investors, see the chapter on the ownership structure of listed companies and the market for corporate control in the UK and France.
[887] B. R. Cheffins *Company Law: Theory, Structure and Operation* (Oxford, 1997), p. 474.
[888] Panel Statement on *Adepton Ltd. and William Hudson Ltd.*; see supra n 760.
[889] Code, GP 2.
[890] T. I. Ogowewo (1996), supra n 515, pp. 474-475. This requirement thus removes the pressure to tender hastily which might otherwise exist in partial bids.
[891] Code, r.14(1).
[892] Code, r.15(a).

the chance to exit the company[893]. This is because control over a company provides the controlling person with significant private values[894]. The controlling person may use the latter to structure dividend policies to satisfy his peculiar interests, or to strip the assets of the company and transfer the proceeds to himself, leaving the minority shareholders with an interest in a mere shell[895]. Without the mandatory bid rule, the non-controlling shareholders would have no chance to sell to the offeror, despite the fact that the market value of their shares would likely be adversely affected by the control change. This objective is all the more important, for UK general company law does not adequately protect the minority[896].

It should be noted that a number of scholars disagree with the first objective of the mandatory bid rule. Thus, Bradley (1990) argues that, even if there was no mandatory bid rule, minority shareholders in offeree companies would still seem to be in no worse position after a change of control than they were under the previous inefficient management. This is because, her argument goes, the offeror needs to increase the company's share price, if it wishes to avoid future takeovers, which presumably benefits minority shareholders[897]. On the other hand, other scholars make use of this first objective of the mandatory bid rule to justify their proposition that the mandatory bid rule should also apply in other circumstances, such as a change in the composition of the board following a successful proxy fight, or the death of the principal shareholder and director. For instance, Wymeersch (1992) argues that the latter circumstances justify the application of the mandatory bid rule, on the grounds that they also involve a change of control and may thus operate against the minority shareholders[898].

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[893] T. P. Lee, 'Takeover Regulation in the UK' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), p: 137.

[894] This is why, in the US, the price paid in a sale-of-control transaction often exceeds the value of non-controlling shares by a substantial margin; see M. Kahan, 'Sales of Corporate Control' (1993) 9 J. of L. Econ. & Org. 368, p. 369.

[895] It should be noted, however, that a number of provisions of the CA 1985 reduce the risk posed to minority shareholders in an offeree company, such as ss. 125-129 which protect the holders of class rights from variation of their rights without their consent; or ss. 89-96 of the same Act which require new issues of shares to be made *pro rata* to existing shareholdings.

[896] On the minority's protection under UK general company law, see B. R. Cheffins (1997), supra n 887, Ch. 10.

[897] C. Bradley (1990), supra n 513, p. 182.

[898] E. Wymeersch, 'The Mandatory Bid: A Critical View' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), p. 359.

The second objective of the mandatory bid rule only applies in situations where effective control has been transferred from an already existing controlling shareholder. Pursuant to this objective, all shareholders, not just the old controller, should benefit from the premium over the market price, which is paid upon the passing of control[899]. This is because, as Andrews (1965) rightly argues, the non-controlling shareholders are providing finance for the purchaser and their continued ownership is what makes possible the power of the purchaser to control. Because they may have different views as to the competence of the purchaser, the non-controlling shareholders should have the opportunity to sell their shares at the price received by the seller of control[900]. Indeed, and as Brudney (1983) notes it, the transfer of control results in a new controller-manager, and the minority, without its consent, is participating in a different enterprise[901]. As a result, the remaining shareholders must be offered an exit right. It should be added that only the second objective of the mandatory bid rule justifies the requirement that the non-controlling shareholders be paid the same price as the block-holder. Indeed, the first rationale is adequate to justify the payment of a fair price, but not the payment of a same price. As a result, these two rationales have different implications on the price of the mandatory bid.

5.3.3 Prevention of the Pressure to Tender

The element of coercion or the pressure to tender, and its ability to distort investment decisions, is obvious in offers structured in a discriminatory manner, such as two-tier offers, where the bidder offers to pay a higher price for the shares it needs to acquire control than for those it purchases thereafter, or non-regulated partial offers[902]. Indeed, as seen in the Introduction, both types of offers distort shareholders' decision-making. For, even if shareholders as a group would be

[899] This premium derives from the fact that the right to control a business is seen as having a value, because it is the route to improved managerial control and hence to enhanced value: J. Charkham and A. Simpson (1999), supra n 243, pp. 91-93.
[900] W. D. Andrews, 'The Stockholder's Right to Equal Opportunity in the Sale of Shares' (1965) 78 Harv. L. Rev. 505, p. 521.
[901] He alternatively suggests that the seller should divide the premium with the remaining shareholders; see V. Brudney, 'Equal Treatment of Shareholders in Corporate Distributions and Reorganizations' (1983) 71 Calif. L. Rev. 1072, pp. 1122-1126. It should be noted that Brudney's argument would also apply in the context of an acquisition of control.
[902] B. R. Cheffins (1997), supra n 887, p. 474.

better off by not tendering, the coercive nature of such offers compels individual shareholders to tender. The Code attempts to eliminate coercion in relation to discriminatory offers by prohibiting two-tier offers and by subjecting partial offers to stringent requirements, including the consent of the Panel[903]; the obligation to scale down acceptances proportionately if too many are received[904]; and the requirement for an approval of shareholders holding fifty per cent of the voting rights not held by the offeror and persons acting in concert with it where the partial offer could result in the offeror holding shares carrying thirty per cent or more of the offeree's voting rights[905]. The latter requirement ensures that a partial offer will be successful only if the majority of the offeree shareholders indeed prefer it to succeed. It should be noted in this respect that the shareholders who vote to disapprove the partial offer do not lose their ability to tender their shares if the partial offer is on the whole approved.

It should be noted, however, that coercion also exists in relation to full offers. For, as explained in the Introduction, the pressure to tender stems from the differential between the price offered and the post-takeover value of minority shares. In other words, the ultimate factor contributing toward coercion is the threat of retaining devalued minority shares. Accordingly, even in the context of a full offer, shareholders are captured by a '*prisoner's dilemma*' that a majority of the shareholders will in fact tender and that the non-tendering shareholders will be locked into minority status. As a result, the assurance that a shareholder who tenders will not be relegated to minority status in no way reduces the threat of holding devalued minority shares if he does not tender[906].

The Code attempts to eliminate coercion in relation to full offers by requiring that the offer which has become or is declared unconditional as to acceptances remain open for acceptance for not less than fourteen days after the date on which it would otherwise have expired[907]. The latter requirement ensures that shareholders are given the opportunity to tender once it is clear that the offer has succeeded and

[903] Code, r.36(1).
[904] Code, r.36(7).
[905] Code, r.36(5).
[906] L. A. Bebchuk (1988), supra n 48, pp. 917-922.
[907] Code, r.31(4). This rule goes back to the Jenkins Report; see para 285.

the offeror has acquired *de jure* control. As a result, this requirement removes the fear of offeree shareholders who consider an offer inadequate but are afraid of being locked into the minority status if the offer is declared unconditional. The latter assurance is all the more important in the event that the offer is accepted by the holders of less than ninety per cent of the shares, as the remaining minority cannot avail themselves of the sell-out right[908]. As a result of this provision, a shareholder who doubts the value of a bid may leave his final decision to the end of the offer period and thus see how others are reacting and whether he is likely to find himself in a minority position if he does not accept. If he accepts within the fourteen-day limit, he will receive the highest price previously paid[909]. Bebchuk (1985) argues that Rule 31(4) of the Code is in accordance with his proposal pursuant to which an offer should only go through if the offeror receives the approval of a majority of the shareholders who are tendering their shares[910]. In his view, shareholders who express a preference for the bid's success should tender their shares in the first round, and those who express a preference for the bid's failure should hold out in that round[911]. If the offeror fails to receive the above approval, he should be prevented from obtaining a controlling participation[912]. The Code's requirement turns the first round into the equivalent of an approval vote, since a shareholder's decision whether to tender in the first round matters only if his decision proves pivotal in order for the bid to meet the fifty per cent acceptances condition and thus to succeed.

Conclusion

The foregoing indicates that the Code is permeated by a philosophy of fairness to offeree shareholders. To this end, the Code strictly regulates the offeror's behaviour in the context of voluntary offers, by imposing strict limitations upon the offeror's ability to determine the scope of its offer and to set the offer price. For instance, the Code requires the offeror to bid for all the shares of the offeree

908 CA 1985, s.430A.
909 'The City Code Completes its Takeover Code', *The Times*, January 5, 1968.
910 L. A. Bebchuk (1988), supra n 48, pp. 931-933.
911 L. A. Bebchuk (1985), supra n 49, p. 1798.
912 Bebchuk further proposes that an offeror who, in case he is rejected, would like to keep the option of acquiring a non-controlling minority interest, could include in its offer a second request for permission to do so; see L. A. Bebchuk (1988), supra n 48, p. 932.

company and to determine the offer price by reference to the purchases made prior to the offer. In addition, the Code requires the offeror to increase its offer price in the event that it purchases shares in the market or otherwise during the course of its offer. The Code's major contribution in ensuring equality is its mandatory bid rule. The latter constitutes the strongest expression of the equality principle. It should be noted that many European countries have been and still are inspired by the egalitarian rules of the Code, and their takeover laws or regulations contain rules which are in essence similar to those of the Code[913].

However, the Code goes much further than its European counterparts in its endeavours to protect offeree shareholders. Indeed, apart from ensuring equality, the Code further attempts to remove shareholders' pressure to tender. To this end, the Code contains a number of mechanisms, the most important of which is Rule 31(4). Indeed, as seen above, the latter ensures that shareholders are given the opportunity to tender once it is clear that the offeror has acquired *de jure* control.

[913] For an overview of the takeover regulations prevailing in other European MS, see V. de Beaufort, *Les OPA en Europe* (Economica, 2001); G. Lekkas, *L'Harmonisation du Droit des Offres Publiques et la Protection de l'Investisseur* (Paris; L.G.D.J, 2001); and E. Wymeersch, 'Problems of the Regulation of Takeover Bids in Western Europe: A Comparative Survey' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992).

Chapter 6 The Principle of Equality of Shareholders and the Protection of the Minority Under the French Takeover Regime

Introduction

Like in the UK, the principle of equality in France requires that all shareholders be treated alike, and that an operation which would otherwise concern a limited number of shareholders be extended to all shareholders under the same terms[914]. The rationale behind the adoption of the principle is no different than that in the UK. It is intended to ensure that all shareholders have an equal opportunity to decide on the merits of an offer and, accordingly, to decide whether or not accept it. Indeed, the minority should not be condemned to remain in a company which is no longer the same and where they risk being in a hostile environment, with a reduced patrimony[915]. The principle is also intended to ensure that all shareholders have an opportunity to share in the control premium[916].

The principle of equality is omnipresent in the French takeover regime. This is evidenced by the AMF's regulations. Indeed, the CMF's General Regulation provides that its provisions relating to takeovers are aimed at '*ensuring that participants to an offer comply with the principle of equal treatment of offeree shareholders*'[917]. Likewise, the COB's Regulation 2002-04 stipulates that '*every person must act in accordance with the principle of equal treatment of shareholders of the companies concerned*'[918]. To ensure compliance with the principle, the latter regulations contain a number of mechanisms designed to ensure equal treatment of offeree shareholders. This is all the more important, for the French market is characterised by a concentration of ownership and control, where most listed companies are controlled by large blockholders. Such a share ownership structure could easily prevent the development of the French market,

[914] D. Schmidt and C. Baj, 'Réflexions sur les Effets de l'Action de Concert' (1991) 27 RD bancaire 182, p. 187.
[915] A. Couret, 'Cession des Sociétés Cotées et Protection des Minoritaires' (1992) Bull. Joly 363, p. 364.
[916] A. Petitpierre-Sauvain, 'L'Egalité des Actionnaires dans L'Offre Publique d'Achat' (1991) 5 RD aff. int. 645, p. 646.
[917] CMF regs, r.5-1-1.
[918] COB regs, r.4.

should new minority shareholders fear investing in companies with large blockholders. However, as will be seen below, the minority find that their interests are largely taken into account, along with those of the block-holders[919].

This chapter provides an overview of the equality rules under the French takeover regime. Section I analyses the operation of the principle amongst shareholders selling within the bid. Section II analyses the operation of the principle as between the shareholders who sell within the bid and shareholders who sell outside the bid[920]. Finally, Section III analyses the operation of the principle in circumstances where control is acquired in the market, and where control is transferred from an already existing controlling shareholder.

6.1 Operation of the Principle Within the Offer

The French regulations ensure that shareholders selling within the offer are treated equally. The main provision demonstrating the latter is Rule 5-1-2 of the CMF's General Regulation, which requires the offeror in a voluntary offer to bid for all the equity shares, whether voting or non-voting, and all the securities giving access to the shares or the voting rights of the offeree company[921].

It should be noted that, prior to the reform of 1992, the offeror could limit its offer to only two-thirds of the shares of the offeree company. The rationale behind the choice of the two-thirds threshold was that it was sufficient to enable the offeror to alter the company's articles of association. At the same time, this threshold constituted a compromise between the advocates of a full bid and the advocates of a limited bid, who were reluctant to make takeovers too burdensome. However, as stated above, under the present regime, the offeror must bid for all the shares of the offeree company, including those without voting rights. The offeror must further bid for the securities which give access at a later date to the equity or the voting rights.

[919] J. M. Garrido and A. Rojo, 'Institutional Investors and Corporate Governance: Solution or Problem?' in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 433.
[920] i. e. in the market or by private treaty.
[921] These encompass convertible, exchangeable, or reimbursable bonds; and bonds with warrants to buy shares or investment certificates.

Despite the requirement to bid for all the shares of an offeree company, the regulations also allow partial bids, albeit restrictively. Indeed, partial offers are permitted for only up to ten per cent of the offeree's voting shares or voting rights. In determining this threshold, the voting shares and/or the voting rights already held by the offeror are taken into account[922]. It should be noted, however, that this restricted approach toward partial bids may be circumvented in the context of a share-exchange offer, by using *certificats de valeur garantie*[923]. The latter is a negotiable, publicly quoted security which guarantees its holder a future cash payment, provided at a specified future date the market value of specified reference securities, which constitute the consideration in the share-exchange offer, is lower than a pre-determined value. In the event that the reference securities are those of the offeree company, the CVGs act as an incentive for the offeree shareholders to retain their shares, and as an opportunity for the offeror to defer part of the acquisition of the offeree's shares. The CVG holders will be entitled to sell their offeree shares at the pre-determined price, if the market price of the offeree shares falls, at a certain future date, below the pre-determined level[924]. Given that the offeror is not obliged to purchase the offeree shares so long as the market price of the offeree shares does not fall below the pre-determined level, this technique allows the offeror to effect a partial offer above the ten per cent threshold. In view of its advantages for the offeror, the CVGs have become well-established tools in French takeovers.

Another provision ensuring equal treatment of shareholders in the context of voluntary offers is the rule which requires the offer price to be the same for all shareholders of the same class. Thus, the Code prevents the offeror from creating a price discrepancy amongst the shareholders of a same class on the basis of the number of shares they bring to the offer[925]. The regulation allows, however, the offeror to set a different price where this is justified by the nature of the share in question. Thus, non-voting shares may not be offered the same price as voting

[922] CMF regs, r.5-3-2.
[923] Hereafter the CVGs.
[924] *Public Takeovers in France* (2003), supra n 216, p. 18.
[925] P. Didier, 'L'Egalité des Actionnaires: Mythe ou Réalité' (1994) 5 Cahiers dr. entrepr. 18, p. 23.

shares. This is in line with the fact that the law resolves different situations in a different fashion[926].

The regulation further guarantees the equal treatment of shareholders as far as access to information relating to the offer is concerned. Ensuring this duty lies with the AMF, and several of its regulations[927] contain provisions relating to information. It should be noted, however, that the French regulations do not contain an express prohibition along the lines of Rule 16 of the Code, which prohibits agreements which favour some but not all shareholders. The regulations merely require such agreements to be disclosed to the companies concerned, to the AMF, and to the public, where the clauses of such agreements may bear an impact on the evaluation of the offer or on its outcome[928]. However, give that such agreements are likely to breach the equality of offeree shareholders, the AMF may issue an injunction against the offeror, with a view to compelling him to restore equality. Moreover, the Paris Court of Appeal may nullify such agreements, at the request of a shareholder.

6.2 Operation of the Principle as Between Shareholders Selling Within the Offer and Shareholders Selling Outside the Offer

Under the French regime, there is a fundamental difference between cash offers and share exchange offers in terms of the offeror's ability to deal in the shares of the offeree company during the offer period. Indeed, whilst dealings in the shares of the offeree company are allowed in the context of a cash offer, the offeror is prohibited from carrying out such dealings in the context of a share-exchange offer[929]. The rationale behind this prohibition is to ensure equality between the offeree shareholders. Indeed, had such dealings been allowed during the currency of a share-exchange offer, shareholders selling outside the bid would receive cash whereas those accepting the share-exchange offer would have to content themselves with the offeror's securities. It is suggested that the latter argument is

926 A. Viandier (1999), supra n 224, pp. 314-315.
927 In particular Regulation No. 2002-04 of the COB.
928 COB regs, r.5.
929 CMF regs, r.5-2-12.

not very convincing. For it could be refuted by a provision along the lines of Rule 11 of the Code, which requires the offeror to provide a cash alternative if it purchases shares outside the bid during its share-exchange offer.

As far as the ability of the offeror to deal in the shares of the offeree company during a cash offer is concerned, the latter is not without limits: First, in order for the offeror to do so, it must have no right to withdraw its offer if it does not obtain a minimum number of shares[930]. The latter requirement probably aims at preventing situations whereby the offeror would accumulate a significant amount of offeree shares outside the bid and would subsequently withdraw its offer upon the acquisition of, say, less than ninety per cent of the acceptances. Such an outcome would leave the offeror with a significant amount of shares in the offeree company and prejudice the offeree shareholders, who would have lost their chance to exit the company in which they may no longer wish to stay. Furthermore, the market value of the shares of the shareholders who have accepted the bid would probably decrease following the offeror's withdrawal. At the same time, the shareholders who have sold their shares to the offeror outside the bid would probably be better off, since it is likely that the market value of their shares was high at the time they sold their shares to the offeror.

Secondly, all dealings in the shares of the offeree company must be carried out through the market[931]. In other words, the regulation does not allow the offeror to purchase offeree shares by private treaty during the currency of its cash offer. The rationale behind this restriction is to ensure market integrity, by avoiding purchases during the bid at preferential conditions[932]. The application of this rule can be illustrated by the case of *Schneider/ Télémécanique*. In this case, Schneider made a hostile bid on the shares of Télémécanique, which is a listed company. Subsequently, Framatome – a white knight - decided to acquire the shares of Cofitel, which is the unlisted subsidiary of Télémécanique. Cofitel had an option to buy ten per cent of the shares of Télémécanique. Thus, the acquisition of control in Cofitel would allow Framatome to also acquire control in

[930] CMF regs, r.5-2-11.
[931] CMF regs, r.5-1-11.
[932] M-J. Vanel, 'Investor Protection in the Context of Public Offerings' (2001), available at http://www.amf.france.org/styles/default/documents/general/3903_1.pdf.

Télémécanique. Schneider disputed the purchase by Framatome of Cofitel shares, on the grounds that such purchase amounted to an indirect acquisition of control in the offeree company whilst the regulation strictly prohibits any acquisition outside the market during the course of a cash offer. The Court of Appeal held that the acquisition of majority control in an unlisted company whose sole object was to hold securities issued by the listed company, which was subject to a hostile cash bid, amounted to the acquisition outside the market of the shares of the listed company[933].

Thirdly, if the offeror conducts market purchases at a price above the offer price, the latter is automatically increased by at least two per cent, even if the price paid for the shares purchased in the market is lower than the two per cent threshold, and even if the amount of shares acquired at above the offer price is trivial. The latter provision aims at providing a minimum degree of protection to the shareholders who have already accepted the bid. At the same time, however, this rule creates a price discrepancy between the shareholders who have sold outside the bid and the shareholders who have accepted the bid, to the detriment of the former. Furthermore, if the price paid for the shares acquired in the market is higher than a hundred and two per cent of the offer price, then the offeror must increase its offer price to the level of the actual price paid for the shares so acquired, irrespective of the number of shares it acquired in the market[934]. The *raison d'être* of the latter requirement is to remove the inequality of price which would otherwise arise between the selling and the accepting shareholders[935]. It should further be noted that during the period between the end of the bid and the publication of its outcome by the AMF, the offeror and the persons acting in concert with it are prohibited from purchasing the offeree shares at above the offer price[936].

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[933] CA Paris, 18 March 1988, *Cofitel c/Télémécanique électrique et autres* (1989) D., p. 359.
[934] CMF regs, r. 5-2-11. Note that prior to the Law of 1989, the offeror could acquire offeree shares in the market at above the offer price without having to subsequently raise the latter, so long as the purchase price did not exceed five percent of the offer price; see M-C. Robert, 'The Internationalization of the Markets and the Experience of the French COB With Mergers and Acquisitions' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), p. 406.
[935] P. Didier (1994), supra n 925, p. 23.
[936] CMF regs, r.5-2-11.

Despite the above safeguards, the French regulation seems to present a major shortcoming: the regulation does not rigorously deal with the pre-bid purchases, save for disclosure requirements. Indeed, the regulation does not require a linkage between the price paid for the shares purchased prior to the offer and the offer price. This demonstrates that the French regulation only partly removes the price discrimination between the shareholders who have accepted the bid and those who have sold outside the bid. Viandier argues, however, that the AMF's power to control the price acts as a substitute for the non-regulation of pre-bid purchases. Indeed, if an offeror purchases a block of shares prior to its offer at say £10 per share, and it subsequently sets the offer price at only £8 per share, it is likely that the AMF would refuse to approve the offer document. This would, in turn, compel the offeror to increase the offer price. However, if the same offeror purchases a handful of shares prior to its offer at £10 per share, even if it subsequently sets the offer price at £8 per share, the AMF would still approve the offer document. For, in the latter case, the principle of equality of shareholders would not be breached by the sale of a handful of shares prior to the offer at a price above the offer price[937]. It should also be noted, in this respect, that where the offeror already holds, directly or indirectly, alone or in concert with others, the majority control of the offeree company, the AMF requires the offer price not to be lower than the average market price during the sixty market days preceding the publication of the offer document[938]. The latter rule constitutes yet another example of the AMF's power to control the offer price. However, given that it operates only in circumstances where the offeror is a majority controller, it is believed that it cannot be seen as a substitute for the absence of the regulation of pre-bid purchases.

6.3 Operation of the Principle Upon Acquisitions or Transfers of Control

Even prior to the reform of 1989, there was a type of mandatory bid requirement in France. Indeed, a person who would acquire a control block of shares in a listed

[937] I am indebted to Professor Alain Viandier at the University of Paris V for his valuable comments on this point during my interview with him in January 2003.
[938] CMF regs, r.5-3-4. See also Paris, 13 November 2001, No. 2001/13003 and 2001/13157, *Consorts Koering, ADAM et autres c/Sté Expand et autres* (2002) RTD com., p. 127.

company from an identified seller was required, except in limited circumstances, to offer the other shareholders the opportunity to sell their shares at the same price as that paid to the seller, during what was called a *maintien de cours*[939]. The latter came under much criticism, however, in two respects: First, there was no regulatory definition of a control block[940], as a result of which the stock exchange authorities had to determine on a case-by-case basis whether a control block was actually acquired. This inevitably resulted in an uncertainty. In determining whether a control block was actually acquired, the then *Chambre syndicale* took into account the price at which the sale was realised, the total number of shares of the company concerned, the distribution of the capital in the public, and the number of shares the acquirer already held in the company. As a result of the latter method, the *Chambre* could decide that a control block was acquired even in circumstances where a fraction lower than the majority of the capital was acquired, in particular where the capital of a company was dispersed[941]. Secondly, the old rule was applicable only where purchases were made from identified sellers by private treaty, and not where purchases were made in the market[942]. In other words, the old rule required a mandatory bid only upon a transfer of control from an already existing controller, but not upon an acquisition of control through purchases in the market, where control was not previously held by any shareholder. Consequently, the Law of 1989 abolished the *maintien de cours* and provided for two alternative procedures, namely the mandatory bid and the price guarantee procedure. The applicability of the latter depends on whether the one-third or the fifty per cent threshold is crossed, and on whether the shares are purchased in the market or from an identified seller[943]. The Law of 1989 further introduced the sell-out right in favour of the minority. Before proceeding to the analysis of these three procedures, it must be emphasised that they have all been

[939] This was introduced following the acquisition of control of *Antar* by *Elf* and the acquisition of control of *Bon Marché* by the brothers *Willot*. In the latter cases, the minority shareholders claimed that they were prejudiced by the latter acquisitions and that they should benefit from the control premium, which derived from the difference of price between the price of the sale of the control block and the market value of the shares at the time of the sale.
[940] D. Berger, 'Guidelines for Mergers and Acquisitions in France' (1991) 11 Nw. J. Int.l L. & Bus. 484, p. 519.
[941] COB Report (1978), p. 90.
[942] Indeed, it was because of this limited application of the *maintien de cours* that the COB issued the above-mentioned General Decision, with a view to applying the latter to control blocs acquired outside the market; see A. Viandier (1999), supra n 224, pp. 370-371.
[943] J. Epstein and S. Deparis-Maze, 'French Takeovers: Control and Concert' (1991) I.F.L.Rev. 30, p. 30.

introduced to allow the minority to exit the company where dealings in the shares of their company affect the structure of share ownership in that company[944].

6.3.1 Mandatory Bid

i) Rationale and operation of the rule

The rationale of the mandatory bid is two-fold: First, all shareholders must be offered a right to exit the company upon a change of control[945]. This is because, in the AMF's view, in the absence of a mandatory bid rule, a person might purchase enough shares in the market or by private treaty to acquire control of a company, without the remaining shareholders being able to benefit from the guarantees offered by the procedure of takeovers[946]. This would destabilize companies and breach the principle of equal treatment of shareholders[947]. Secondly, all shareholders must share in the control premium.

It should be noted that, before the reform of 1992, the mandatory bid obligation was limited to two-thirds of the offeree company[948]. At the time, it was believed that the two-third limit allowed companies to prevent creeping acquisitions of control, and at the same time allowed purchasers to keep their resources while obtaining effectively unlimited control. This is because, under French company law, a shareholder with 66.66 per cent of the voting rights can approve even the most significant corporate transactions, such as mergers or liquidations, in the face of the minority's opposition[949]. This limited bid angered all market

[944] L. Faugérolas, 'La Protection des Minoritaires dans le Titre V du Réglement Général du Conseil des Marchés Financiers', in *Droit Bancaire et Financier-Mélanges AEDBF-France*, t. II (Paris: Banque éditeur, 1999), pp. 202-203.
[945] F. Peltier and M-N. Dompé, *Le Droit des Marchés Financiers* (PUF, 1998), p. 98. Note that a number of legal scholars argue that the mandatory bid rule breaches a fundamental principle of the French law, namely the freedom to purchase or to sell; see e. g. C. Baj, 'La Cessibilité du Droit de Vote' (1996) 4 Cahiers dr. entrepr. 16, p. 16.
[946] COB Report (1989), 162.
[947] Bull. COB (1992), p. 14.
[948] The choice of sixty-six per cent as the triggering threshold constituted a compromise between the proponents of a mandatory offer on the totality of the shares and those in favour of an offer on fifty per cent plus one of the shares; see Bull. COB (1992), p. 14.
[949] J. Epstein, J. Swank and S. Deparis-Maze, 'France' (1992) I.F.L.Rev., p. 2.

participants, however[950]. For it had been used to circumvent the application of the price guarantee procedure[951]. Indeed, bidders were taking all possible safeguards to avoid the application of the latter procedure, as they would then be obliged to bid for all the remaining shares instead of a mere sixty-six per cent under the limited mandatory bid rule. However, in some instances, the AMF did intervene to prevent the circumvention of the application of the price guarantee procedure and required the offeror to file a price guarantee procedure *in lieu of* a mandatory bid on two-thirds[952]. Following the reform of 1992, the mandatory bid related to a hundred per cent of the outstanding shares. By enabling all shareholders of the offeree company to sell their shares to the offeror, this reform had the merit of removing an enduring source of litigation[953].

Under the current regime, the mandatory bid obligation can be triggered by either of the following: where a person acting alone or in concert with others acquires one-third of the voting shares or the voting rights of a listed company[954], or where a person acting alone or in concert with others already holding directly or indirectly between one-third and one-half of the voting shares or the voting rights of such a company increases its holding by over two per cent in less than twelve consecutive months[955]. Upon crossing one of the two thresholds, the purchaser must file an offer with the AMF for the purchase without condition of all the voting equity share capital[956] and the securities giving access at a later date to voting shares or voting rights, which will be tendered by the offeree's shareholders. Two remarks must be made in this regard: First, non-voting shares and rights to acquire at a later date shares or voting rights are not taken into account in determining whether the one-third or the two per cent threshold has been crossed[957]. Secondly, the mandatory bid obligation will be triggered upon crossing the one-third or the two per cent threshold of either the voting shares or

[950] A. Hirsch and G. Hertig, 'Comments on Defensive Measures, the Regulation of Multinational Offerings and Mandatory Bids' in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths, 1992), pp. 435-436.
[951] For this procedure, see below.
[952] COB Report (1991), p. 56.
[953] A. Viandier, 'Droit de la Bourse' (1992) 29 JCP 359, p. 359.
[954] CMF regs, r.5-5-2.
[955] CMF regs, r.5-5-4.
[956] CMF regs, r.5-5-1 expressly states that the equity shares referred to in the chapter relating to the mandatory bid mean voting equity shares.
[957] CMF regs, r.5-5-1.

the voting rights. Such an alternative is indeed necessary due to the discrepancy which often exists in France between the shares and the voting rights[958].

The rule may be triggered not only by the acquisition *stricto sensu* but also by the conversion of bonds into shares; the obtaining of double voting rights; the subscription to an issue of shares; the granting by the company of bonus shares; the reduction of the total number of voting rights; or the acquisition of the control of an unlisted company which itself holds directly or indirectly more than one-third of the shares or the voting rights of a listed company, provided the main assets of the newly controlled company consist of the shares or the voting rights of the listed company[959]. The latter qualification means that where a person acquires, say, a thirty-two per cent stake in an unlisted company which in turn owns thirty-four per cent of a listed company, that person will not be obliged to make an offer for the listed subsidiary, so long as the parent's shareholding in the listed subsidiary does not constitute an essential part of the parent's assets[960]. It should be noted, however, that the AMF may authorise the crossing of the one-third threshold, without obliging the acquirer to make a bid, if the shares in excess of the threshold represent less than three per cent of the total number of shares or voting rights of the issuer, and the purchaser undertakes to resell the excess shares or voting rights within six months[961].

As far as the price of the mandatory offer is concerned, the French regulation leaves its determination to the offeror's discretion. Thus, unlike in the UK, there is no highest price rule regarding mandatory offers. At first sight, it may be thought that this might lead the offeror to propose a low price with a view to discouraging the sellers and thus lowering the costs of its mandatory bid. However, as seen in the chapter on the UK and French regulatory framework concerning the regulation of takeovers, the terms of the offer must be acceptable to the AMF. Indeed, the AMF may compel the offeror to revise its offer price[962] if it considers that the offer may prejudice the principles embodied in its regulations,

[958] L. Faugérolas (1999), supra n 944, p. 203.
[959] CMF regs, r.5-5-3. This shows that the French regulations accept the 'chain principle' in some cases.
[960] J. Epstein and S. Deparis-Maze (1991), supra n 943, p. 12.
[961] CMG regs, r.5-5-3-1.
[962] CMF regs, r.5-1-9.

and in particular the principle of equality of shareholders[963]. Aware of the likelihood of the above opportunism on the part of the offeror, the AMF in practice requires the price of the mandatory bid to equal the highest price paid by the offeror for its purchases which triggered the mandatory bid obligation[964].

The AMF has power to dispense the acquirer of effective control from the mandatory bid obligation[965]. The rationale behind such power is that the mandatory bid obligation contravenes the freedom of contract principle, for the sake of ensuring the equality of shareholders. It is therefore believed that the mandatory bid rule should be supplemented by a corrective principle, namely the principle of equity[966]. The latter principle in no way departs from the principle of equality[967], but simply aims at correcting the rigidity of the quantitative criteria, which trigger an obligation which has severe implications[968]. In other words, the AMF believes that the imposition of a mandatory bid in all circumstances would constitute a cumbersome and disproportionate remedy to protect the minority. It should be noted, however, that the AMF has discretion whether to grant or deny a dispensation. In other words, a dispensation is never acquired as of right, but is subject to the AMF's approval. In deciding whether to grant or deny a dispensation, the AMF examines such factors as the circumstances in which the threshold is crossed, or the structure of the share ownership in the company in question[969]. The AMF generally tries to strike a balance between the interests of the minority and the imperatives of economic reorganisations[970].

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963 CMF regs, r.5.1.1, and COB regs, r.4.
964 A. Couret (1992), supra n 915, p. 370.
965 In 2002, the CMF took 39 decisions to dispense acquirers from the mandatory bid obligation. The grounds for taking these decisions were as follows: transfer of the shares or voting rights of the issuer between companies or persons belonging to the same group (14); holding of the majority of the voting rights of the company by the acquirer (11); subscription by the acquirer to an issue of shares made by a company in financial difficulty (7); reduction of the total number of the shares or the voting rights of the issuer (4); combination of a merger or a contribution in kind with an agreement entered into by the shareholders of the companies concerned (2); merger or a contribution in kind (1); see CMF, Annual Report 2002, p. 25.
966 CA, Paris, H., 20 February 1998, *Compagnie Générale des Eaux/Havas* (1998) 51 RTD com. 379, pp. 383-384; note N. Rontchevsky.
967 T. Bonneau and L. Faugérolas (1999), supra n 603, p. 69.
968 *Compagnie Générale des Eaux/Havas* (1998), supra n 966.
969 CMF regs, r.5-5-6.
970 J. P. LeGall and P. Morel (1992), supra n 595, p. 191.

Circumstances where the AMF may grant a dispensation at the request of the person crossing the threshold include, *inter alia,* cases where the crossing of the threshold results from a merger or a contribution in kind, subject to approval by shareholders in general meeting[971]; a combination of the latter operation with an agreement entered into by the shareholders of the companies concerned, which amounts to a concerted action[972]; and a subscription of shares in the context of a capital increase made by a company in financial difficulty, subject to approval by shareholders in general meeting[973]. The latter situations deserve to be dispensed, as the interests of the shareholders have already been taken into account by another mechanism, namely the general meeting which has been conveyed to rule upon the particular operation. It is therefore believed that the AMF should not interfere with shareholders' decision. Other circumstances include the reduction of the total number of shares or voting rights of the issuer[974]; the transfer of the shares or voting rights of the issuer between companies or persons belonging to the same group[975]; and the holding of the majority of the voting rights of the company by the acquirer or by a third party[976]. The latter situations deserve to be dispensed because the existing shareholder base has not changed.

It should be noted that, in view of numerous grounds for dispensation, it may be questionable whether the minority actually have a 'right to exit' the company in the event of a change of control. However, both the AMF and the Paris Court of Appeal usually require the acquirer of effective control to make a bid where the market is illiquid[977]. Thus, the latter authorities attach a high value to the liquidity of the market. Frison-Roche (1998) argues that, although there is no autonomous

[971] CMF regs, r.5-5-7(c).
[972] CMF regs, r.5-5-7(d).
[973] CMF regs, r.5-5-7(b).
[974] CMF regs, r.5-5-7(e). The reduction may result from a reduction of capital, a share buy-back, or an increase by a subsidiary of the percentage of the shares it holds in its parent company.
[975] CMF regs, r.5-5-7(g). See e.g. CA Paris, 19 March 2002, *Tharreau c/Tharreau*, (2002) 3 RD bancaire et financier 148.
[976] CMF regs, r.5-5-7(f). The Paris CA held that the majority control means the holding of more than fifty per cent of the voting rights of a company; see CA Paris, 1e Ch., section CBV, 24 June 1991 (1991) JCP éd. E, t. II, p. 215.
[977] See e. g. Com., 6 May 1996, *Caves de Roquefort* (1996) Rev. Soc., p. 803, note P. Le Cannu, where the court held that Rule 5-5-2 of the CMF's General Regulation is intended to allow the minority shareholder, whose share lost its liquidity on a market which became narrow by the relative weight of the majority shareholder(s), to exit the company under normal conditions of price; see L. Faugérolas (1999), supra n 943, p. 212.

right to exit, there is a right to the liquidity of the shares, whose breach results in the right to exit the company[978].

Where the acquirer of control fails to comply with his obligation to make an offer and where there is no ground for dispensation, the voting rights attaching to his shares in excess of the threshold will be suspended for a period of two years. Furthermore, such person will likely face a pecuniary sanction. This can be illustrated by the case of *HFP/Hubert Industries*. In this case, HFP acquired control of Hubert Industries, as a result of which it had to make an offer at the price of FF 97.55 per share. In order to avoid the costs associated with the mandatory bid, HFP proposed an alternative financial arrangement to the minority shareholders, pursuant to which they would abstain from bringing their shares to the mandatory bid in return for a payment of FF 45 per share. The AMF objected to such arrangement and imposed a pecuniary sanction against HFP. It should be added that failure to comply with the mandatory bid obligation may also result in the nullification of the transaction by the courts, on the grounds that the transaction contravened the AMF's regulations.

ii) Concept of acting in concert

The AMF ascribes a major role to the concept of 'acting in concert', which serves to prevent the circumvention of the mandatory bid rule by way of secret alliances[979]. This concept, which was introduced into the French law by the Law of 1989[980], is defined more narrowly in France than in the UK[981]. Indeed, under the French takeover regime, persons acting in concert are those who have entered into a binding agreement, written or verbal, with a view to purchasing or selling voting rights[982], or to exercising voting rights either in the boardroom or in the

[978] M-A Frison-Roche, 'La Prise de Contrôle et les Intérêts des Associés Minoritaires' (1998) Rev. JP com, No. spéc. 94, p. 98.
[979] Note that this concept is also used for the purpose of determining whether the threshold triggering the price guarantee procedure is reached, and whether certain thresholds triggering disclosure requirements are reached.
[980] OJ No C 162, 6.6.1996, p.5; with explanatory memorandum, COM(95) 655 final.
[981] For the definition of the 'concert party' under the UK regime, see the chapter on the principle of equality of shareholders and the protection of the minority under the UK takeover regime.
[982] This encompasses agreements obliging a party not to sell his shares before a specified date or before the approval of the other party. However, an acquisition or a sale agreed and executed

general meeting, in order to implement a common strategy *vis-à-vis* the offeree company[983].

Agreements which are likely to be viewed as 'concerted action' and thus likely to trigger the mandatory bid rule include agreements which require the parties to concert in advance on all important decisions in order to reach a uniform vote within the corporate organs[984]. However, agreements entered into with a view to exercising voting rights for only a specific matter, such as the composition of the board of directors, will not trigger the mandatory bid rule. For the objective of the latter type of agreements is merely to design the composition of a corporate organ, rather than to implement a common corporate strategy[985]. Nor will the mandatory bid rule be triggered if the acquirer of the one-third threshold declares acting in concert with other shareholders who already hold, alone or in concert, the majority of the offeree company's share capital or the voting rights, provided the latter shareholders continue to be the predominant shareholders[986].

It should be noted in this respect that, prior to 1998, the AMF used to think that 'the objective of implementing a common strategy *vis-à-vis* the offeree company', set out at the end of the definition, only applied to agreements entered into to exercise voting rights, and not to agreements entered into to purchase or sell voting rights[987]. This view was also shared by the doctrine. For instance, Daigre (1999) argued that the above objective was required only for the second part of the definition. For, in his view, the type of agreements referred to in the first part of the definition were characterised by their ability to be executed instantaneously whilst the type of agreements referred to in the second part of the definition were

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instantaneously between a seller-shareholder and his acquirer would not fall within the statutory definition. Nor would agreements whose purpose is merely to determine the conditions of an acquisition or a sale fall within the latter definition.

[983] Code of Commerce, art. L. 233-10.

[984] Decision CBV No. 92-1988 of 17 July 1992, *Safic Alcan*.

[985] D. Schmidt and C. Baj (1991), supra n 914, p. 91.

[986] CMF regs, r.5-5-5.

[987] J-J. Daigre, 'De l'Action de Concert-Après la Décision du CMF du 13 Novembre 1998' (1999) 72 RD bancaire 56, p. 56.

characterised by their successive execution[988]. A Decree in 1998 made it clear, however, that the above objective applies to both parts of the definition[989].

Despite the 1998 reform, the statutory definition of the concept of 'concert party' still meets criticism. A major criticism relates to the fact that a single definition is used for two different objectives, namely the promotion of the transparency of the securities markets through mandatory disclosures of shareholdings, on the one hand, and the protection of the minority through mandatory bids in the event of control changes, on the other[990]. Opponents of the statutory definition recommend a broad definition for the former objective and thus agree with the existing definition. However, they argue that the latter objective deserves a narrower definition than the existing one. This is because, in their view, the objective of protecting the minority should not deter legitimate activity in the financial markets[991]. In support of their view, they point out to the UK Code, which requires the parties to actively co-operate, acquire shares and intend to obtain or consolidate control of the offeree company, in addition to reaching an agreement or understanding, in order to characterise an agrement as concerted action[992].

6.3.2 Price Guarantee Procedure

The French regulation contains a special tender offer procedure for the event that the acquirer acquires a block carrying a majority of the shares or the voting rights in a listed company from a shareholder who already holds, alone or in concert with others, such block.

i) Rationale

At first sight, the sale of a control block by a controlling shareholder may not seem to affect the corporate organisation. For neither the company nor the

[988] Ibid, p. 57.
[989] Decision No. 198 O1041 of 13 November 1998 on *Bouygues-Bolloré*.
[990] 'Hard Cases, Bad Law and Perrier', *Mergers & Acquisitions International*, June 1, 1992, p. 3, available at Lexis-Nexis Executive.
[991] Ibid, p. 4.
[992] Code, Notes on r.9(1).

minority are involved in this transaction. The company remains the same and thus the protection of the minority may not seem necessary. When one takes a closer look, however, it appears that there has indeed been a reorganisation of the company and that the situation of the minority has indeed been affected[993]. This is because, at the time the minority shareholders participated in the investment contract, they probably expected the controlling shareholder(s) to run the company in a certain fashion. The sale of control has however breached the minority's expectation and the minority should therefore be able to exit the company. Indeed, as the courts put it, this procedure is necessary to '*avoid that shareholders become prisoners [...] of the strongest*'[994]. Frison-Roche (1998) argues that this procedure further protects the financial market's ability to anticipate what the outcome of investing in a company with an already existing controller will be[995].

Without prejudice to the above rationale, the question remains as to why the AMF does not regulate the acquisition of a control block from an identified seller within the framework of the mandatory bid. The answers to the latter question are probably two-fold: First, the price guarantee procedure was the first mechanism set up by the then market authorities to give an exit right to the minority. In other words, this procedure was introduced prior to the mandatory bid procedure and even prior to the regulation of takeovers in general[996]. Secondly, this procedure presents undeniable advantages compared to the mandatory bid, such as flexibility, the rapidity of transaction, and the absence of bidding and of price modulation[997]. In particular the absence of bidding allows the offeror to best adjust its estimates of the costs of acquiring control[998]. This is because the sale of a control block is definitive in that the seller of control will not be freed from its contractual obligation, should a competing bid arise[999].

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993 M-A Frison-Roche (1998), supra n 978, p. 95.
994 Ord. réf., T. com. Paris, 19 October 1995, *Nouvelles Frontières Internationales*; see ibid, p. 97.
995 Ibid, p. 98.
996 See supra n 939 and the accompanying text for the *maintien de cours*.
997 L. Faugérolas (2003), supra n 584, p. 334. For the absence of price modulation, see below.
998 J. P. Deschanel, 'Fixation du Prix des Offres Publiques' in J. Stoufflet and J. P. Deschanel (eds), *Etudes sur le Cours de Bourse* (Economica, 1997), p. 245.
999 Note, however, that in CA, Paris, *Mutuelle du Mans v. OCP*, pp. 157-162, the Paris CA held that the seller of a control block could always sell his controlling shares in the event of a subsequent cash offer, on the grounds that the specific objectives of the procedure of takeovers - namely the protection

It is suggested, however, that the French regulation would do better to integrate this procedure within the mandatory bid rule. Indeed, it is believed that the minority cannot be said to be in greater danger in the context of an acquisition of a control block from an identified seller than in the context of an acquisition of effective control in the market or otherwise, or in the context of an acquisition of a control block in the market. Furthermore, such a course of action would not only simplify the French regulation but also remove the discrepancy between the price of the price guarantee procedure and that of the mandatory bid[1000]. Moreover, the fact that the AMF has power to place this procedure under the mandatory bid regime demonstrates that such integration is feasible. Indeed, the AMF has discretion to use such power under two circumstances: First, where the controlling block has been acquired from persons who had not previously held the majority of the voting rights of the company[1001]; and secondly, where the transaction is accompanied by closely related elements, which are likely to affect the equality between the price paid for the control block and that paid to the minority[1002], such as the creation of a pension scheme in favour of the seller of the control bloc to offset the low price paid by the acquirer of control.

ii) Operation of the rule

Under the French regulation, if a person, or a group acting in concert, acquires shares from one or more identified sellers and thereafter holds more than fifty per cent of the shares or the voting rights of a listed company, that person or group must file a price guarantee procedure[1003]. In determining whether the fifty per cent threshold has been crossed, the shares or the voting rights which are already held by the acquirer are taken into account. As a result, the acquirer will be deemed to have acquired a control block even though the transaction would

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of the interests of the minority and the transparency of the market - require the holding back of certain principles, such as the principle of the binding power of contracts; see supra n 217.

[1000] Albeit probably at the expense of the more favourable price requirement under the price guarantee offer. For whereas the price of the latter must match that paid to the seller of control, the price under the mandatory bid must be determined according to the multi-criteria method.

[1001] CMF regs, r.5-4-3(b).

[1002] CMF regs, r.5-4-3(a).

[1003] CMF regs, r.5-4-1.

have acquired a control block even though the transaction would concern the sale of less than the absolute majority of the shares or the voting rights[1004].

Upon acquisition of the control block, the acquirer must file a price guarantee procedure with the AMF[1005]. Subsequently, he must purchase in the market all the remaining shares offered to him during a minimum period of ten market days following the date of publication of the price guarantee procedure[1006]. The price offered to the remaining shareholders must, except in exceptional circumstances[1007], be the same as that paid to the seller of control[1008]. The rationale underlying the latter requirement is that control is a corporate asset, which belongs to all the shareholders, and not just to the majority shareholder[1009]. It should be noted that the minority may receive a price higher than that paid for the control block so long as the acquirer of the block consents to such a course of action[1010]. For the CMF's General Regulation merely requires the price to be 'at least' equal to that paid for the control block. It should further be noted that different classes of securities may not be offered the same price. Thus, the voting certificates will not be offered the same price as the investment certificates. Nor will the ordinary shares be offered the same price as the convertible bonds or options. This is because, like in the context of both voluntary and mandatory bids, the French takeover regime endorses the view that '*à identité de situation, identité de traitement*'[1011].

It should finally be emphasised that, between one-third and fifty per cent of the shares or the voting rights, only the mandatory bid rule applies, irrespective of whether the seller is identified. In other words, where a person crosses the one-third, he will be subject to the mandatory bid regime even if he crosses that

[1004] T. Bonneau and L. Faugérolas (1999), supra n 603, p. 235.
[1005] CMF regs, r.5-4-1.
[1006] CMF regs, r.5-4-2.
[1007] Indeed, in the event that the acquisition of the block includes specific warranties, or that the price paid to the blockholder includes a deferred consideration element, then the acquirer may offer a different price for the remaining shares.
[1008] It should be noted, however, that the price paid for the control block may not reflect the reality. This will be so where the acquirer pays a relatively low price but offers other advantages to the seller of control.
[1009] A. Viandier (2000), supra n 699, p. 248.
[1010] A. Viandier (1999), supra n 224, pp. 393-394.
[1011] Ibid, pp. 314-315.

threshold by acquiring shares from an identified seller. Where a person crosses the fifty per cent threshold, however, the offer to be filed is either the mandatory bid or the price guarantee procedure, depending on whether the seller is identified[1012]. In other words, where a person crosses the fifty per cent threshold, he will be required to file a mandatory bid if he crosses that threshold through purchases in the market. That person will be required to file a price guarantee procedure, however, if he crosses the same threshold through purchases from identified seller(s).

6.4 Sell-Out Right of the Minority

The French regulation also allows the minority to request that the majority shareholder(s) buy out their shares[1013], though the minority's request is subject to the AMF's approval[1014]. The French sell-out right is peculiar in two respects: First, the exercise of the sell-out right requires the offeror to initiate an offer, referred to as the 'buy-out offer'. The latter offer is closely associated with the offeror's buy-out right[1015]. For an offeror that wishes to exercise its buy-out right must first make a buy-out offer. Thus, the French sell-out and buy-out rights do not constitute autonomous market operations and cannot be contemplated independently from a buy-out offer[1016]. It should be noted in this respect that the reason for maintaining the buy-out right, in addition to the buy-out offer, lies in the fact that the buy-out offer never results in the acquisition of a hundred per cent of a company's shares. The second peculiarity of the French sell-out right is that it is not limited to the take-over. Indeed, as we shall see below, the sell-out right in France may be exercised in circumstances where there is no takeover, but where some important events take place in the company, which are likely to modify the situation of the minority.

[1012] T. Vassogne and H. Le Diascorn, 'Que Reste-t-il de la Procédure d'Acquisition d'un Bloc de Contrôle?' (1990) 17 RD bancaire et bourse 24, p. 29.
[1013] CMF regs, r.5-6-1.
[1014] CMF regs, r.5-6-6. Though, as we shall see below, in one particular circumstance, the CMF is obliged to compel the offeror to make a buy-out offer. This reveals a contrast with the CMF's quasi-automatic authorisation where the offeror exercises its buy-out right.
[1015] This allows the controlling shareholder to get rid of the minority and to terminate the company's status as a public company. In order to exercise his buy-out right, the ninety-five per cent controlling shareholder must apply to the CMF to buy-out the remaining five per cent minority; see CMF regs, r.5-6-3.
[1016] A. Viandier, 'Le Retrait Obligatoire' 10 (1994) RJDA 783, p. 784.

Circumstances which allow the minority to exercise their sell-out right are as follows: where a public limited company re-incorporates as a SCA[1017]; where a company's articles of association are significantly changed [1018]; where a subsidiary merges with its parent company; where all or substantially all of a company's principal assets are disposed of[1019]; where a company's business purpose changes; and where a company stops paying dividends for several years. It should be noted that the latter circumstances do not involve a change of control. However, the fact that the latter events change the 'investment contract' to a significant extent has led the AMF to provide the minority with an exit right, and hence to dis-apply the majority rule of company law, with a view to strengthening the protection of the minority[1020]. Another instance which triggers the minority's sell-out right, and which is more important for our purposes, is where a person holds more than ninety-five per cent of the voting rights of a listed company[1021]. The rationale behind allowing the minority to invoke their sell-out rights in the latter instance is that the minority find themselves with a controlling shareholder who is vetted with full powers and who may therefore impose, without taking into account the interests of the minority, a reorientation of the corporate activity or a modification to the rights of the shareholders. The particularity of the latter instance is that the sell-out right is triggered where a person 'holds' ninety-five per cent of the voting rights. In other words, the sell-out right may be exercised irrespective of whether the relevant ninety-five per cent threshold has been reached following a takeover, by purchases in the market, or by private treaty[1022]. Thus, unlike in the UK, even this instance is not limited in France to the takeover situation.

It should be noted that, as mentioned above, all circumstances which trigger the minority's sell-out right, save for the transformation of a public limited company

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[1017] CMF regs, r.5-6-5.
[1018] CMF regs, r.5.6.6.
[1019] CMF regs, r.5.6.6. On the evaluation of the 'principal assets', see Decision CMF, No. 200C1593 of 25 October 2000, *La Rochette* (2001) 77 Banque et Droit 32, note J-J. Daigre and H. Vauplane, p. 34.
[1020] L. Faugérolas (2003), supra n 584, p. 331.
[1021] CMF regs, r.5-6-1.
[1022] Note that, since 1998, the CMF has power to compel the majority shareholder who reaches the 95 per cent threshold to file a buy-out offer, even in the absence of an application by the minority or the offeror.

into a SCA, are subject to the approval of the AMF. The latter subjects the minority's application to a careful consideration as to its appropriateness. In particular, the AMF examines whether, in view of the characteristics of the market of the share concerned and the volume of the planned sale, the minority have the opportunity to sell their stake under normal conditions of price and of time limit. For instance, the presence of a liquid market which would allow the minority to sell their shares, or the fact that the minority shareholders had not tendered their shares in a prior public offer in the instance where the sell-out right would be triggered upon the acquisition by a person of ninety-five per cent of the voting rights following an offer, will likely result in the rejection of the minority's application[1023].

As far as the price which will be payable to the minority is concerned, the price is set by the offeror on a discretionary basis, albeit under the AMF's control. Thus, the minority plays no role in determining the price and the only remedy available to them, where they find the price unsatisfactory, is to bring an action against the AMF's decision to approve the buy-out offer, which is a prerequisite for the exercise of the sell-out right[1024]. To determine the price, the offeror must evaluate the shares according to objective methods and by taking into account, according to an appropriate weighting, the value of the company's assets, its profits, its market value, its working capital, the existence of subsidiaries, and the future prospects of the company[1025]. The price set by the offeror, as well as the choice and weighting of the criteria, are subsequently scrutinised by the AMF. A number of judicial rulings have laid down the criteria to be taken into consideration by the AMF during its scrutiny. Thus, in 1991, the Paris Court of Appeal held that the AMF must ensure that the price offered is '*not likely to harm the interest of the minority shareholders*'[1026]. The same Court held in another case in 1992 that the AMF must assess whether the controlling shareholder determined the price according to objective and multiple criteria, such as the share price, the net assets,

[1023] J. P. LeGall and P. Morel (1992), supra n 595, p. 191.
[1024] A. Viandier (1999), supra n 224, p. 457.
[1025] CMF regs, r.5-7-1. Note that the nature of the securities is also taken into account in determining the price. Thus, ordinary shares will not be offered the same price as investment certificates.
[1026] CA Paris 18 April 1991 (1991) Rev. Soc. 765, comment by D. Carreau and D. Martin.

and the amount of dividends paid by the company[1027]. The AMF must also take into account the characteristics of the company as well as the particular event which triggered the exercise of the sell-out right. For instance, a controlling shareholder holding ninety-five per cent of the voting rights of a company will be better placed to impose its view of the 'equitable price' than a controlling shareholder who has transformed a public limited company into a SCA. Without prejudice to the above, it should be noted that the AMF usually requires the price to be paid to the minority not to be less than the average market price for the last sixty trading days preceding the filing of the buy-out offer[1028].

It should further be added that, if the sell-out right is exercised following the acquisition by a person of ninety-five per cent of the voting rights upon a share-exchange offer, then the AMF considers that the value of the securities remitted in exchange in the context of the share exchange offer cannot in itself be a yardstick for pricing the buy-out offer[1029]. In other words, in this instance, the price will still be determined on the basis of the criteria listed above. It is suggested that this approach of the AMF indicates *a contrario* that if the sell-out right is exercised following the acquisition by a person of ninety-five per cent of the voting rights upon a cash offer, then it is likely that the AMF will consider the cash consideration offered in the context of the cash offer as a yardstick for pricing the buy-out offer.

It should finally be added that the French sell-out right presents two major shortcomings: First, whereas non-compliance with the obligation to make a mandatory bid results in the loss of the voting rights attaching to the shares in excess of the threshold, no such sanction is available where the controlling shareholder refuses to make a buy-out offer, which is a pre-requisite under the French takeover regime in order for the minority to be able to exercise their sell-out right. However, in such a case, the President of the AMF may apply to the President of the *Tribunal de Grande Instance* of Paris for an injunction

[1027] CA Paris, 8 July 1992 (1992) BRDA, p. 14.
[1028] A. Viandier (1999), supra n 224, p. 458.
[1029] J. Palmer,B. Basuyaux, R. Thaeter, M. Arnold, M. van den Wall Bake, and J. Broekhuis 'Squeezing-out Minority Shareholders After a Successful Public Offer' (2004), p. 46, available at http://www.practicallaw.com/ jsp/binaryContent. jsp?item=:1457245&tab=3.

compelling the controlling shareholder to make a buy-out offer. Furthermore, the controlling shareholder may be held liable to pay damages to the minority if he voluntarily delays the making of such offer[1030]. Secondly, there is a risk of *abus* of this procedure by the minority. Indeed, the latter could '*prevent the execution of a transaction which is vital for the company with the sole objective to favour their own interests at the expense of all the other shareholders*'[1031]. This would be unfortunate, for the likelihood of an *abus de minorité* might reduce a company's willingness to take investment decisions such as those that trigger the sell-out right. It is believed, however, that such risk is mitigated by the AMF's discretion in allowing the minority to invoke their sell-out right. Indeed, as seen above, the presence of a liquid market will likely result in the rejection of the minority's application.

Conclusion

As the foregoing indicates, the French regime contains many provisions designed to ensure the equal treatment of offeree shareholders. Some of these provisions suggest a very strict approach to equality. These include the rule permitting partial offers for only up to ten per cent of the capital of a company; the rule prohibiting the offeror from purchasing offeree shares in the market during the currency of a share exchange offer; the rule prohibiting the offeror from purchasing shares by private treaty during the currency of an offer; and the numerous grounds allowing the minority to invoke their sell-out rights.

At the same time, however, the French regulation falls short of ensuring equality in two respects: First, as seen above, the French regulation does not regulate the impact of pre-bid purchases upon the offer price. The non-regulation of pre-bid purchases results in a partial removal of the price discrimination between shareholders who sell within the bid and those who sell outside the bid. Secondly, as seen above, whilst the acquisition of effective control triggers the mandatory

[1030] See e.g. CA, Paris, 5 February 2002, *SA Parfival c/ Sté Viel et Cie Finance*, 20 JCP 2002, p. 787. In this case, the minority claimed damages on the grounds that they were prevented from reinvesting, in the market, the consideration they were supposed to receive upon the exercise of their sell-out right, and that they were thus prevented from realising financial returns on such consideration.

[1031] Cass. com. 15 July 1992, *arrêt Six* (1992) D., J. 279, note Le Diascorn.

bid rule, the acquisition of a control block from an identified seller triggers the so-called price guarantee procedure. It is believed that the existence of different mechanisms governing the acquisition of effective control on the one hand, and the acquisition of a control bloc on the other, is not efficient. It is therefore suggested that the price guarantee procedure should be brought within the framework of the mandatory bid rule, with a view to simplifying the takeover regulation. It should further be added that, by not providing a provision similar to Rule 31(4) of the Code, the French regulation presents a major shortcoming in its attempt to prevent shareholder coercion. Indeed, it is believed that other provisions of the French regulation, which are designed to ensure uncoerced decision-making by offeree shareholders, are not adequate to act as substitutes for the lack of a rule similar to Rule 31(4) of the Code.

Chapter 7 A Comparative Analysis of the UK and French Regimes as Regards the Issues of Defensive Measures and Equality in the Context of Takeover Bids

Introduction

This chapter describes the differences between the UK and French takeover regimes as regards the topics discussed in earlier chapters. Section I examines the differences in relation to the role of the offeree board both prior to and during a bid. Section II examines the differences concerning the equal treatment and protection of offeree shareholders. It should be noted that this chapter also refers to the Directive on takeover bids, where relevant.

7.1 A Comparative Analysis of the UK and French Regimes as Regards the Role of the Offeree Board

The issue of defensive measures constitute a topic where more differences exist between the UK and France as compared to the issue of equality, which will be discussed in the following section. These differences relate to both pre-bid and post-bid defences. In some cases, there seem to be exact parallels between the two takeover regimes. For instance, the new French rules on share buy-backs seem very similar to those in the UK. The same holds true for the disclosure requirements. This is not surprising since both countries must abide by Community law in respect of the latter defences. Indeed, as Aïdan (2002) rightly put it, it is now established that the Community law will become the main source of regulation of the law of financial markets[1032]. Despite the latter remark, however, there are a number of significant differences as to the regulation of some defences.

[1032] P. Aïdan, 'La Communautarisation du Droit des Marchés Financiers' (2002) Bull. Joly Bourse 81, p. 81.

7.1.1 Doctrinal Differences as to Pre-Bid Defences

As far as pre-bid defences are concerned, both jurisdictions regulate the latter mainly pursuant to company law. Despite the latter, however, there are a number of differences in relation to the rules governing such defences: First, whereas UK company law regulates such defences mainly by reference to judicially-formulated fiduciary duties, French company law does so by reference to legal rules embodied in the statutes and in particular in the Code of Commerce[1033]. Indeed, as seen in the chapter on the regulation of defensive measures in France, although a number of French legal scholars and court decisions refer to the doctrine of fiduciary duties, this doctrine is not widely recognised in French law. Instead, the French courts judge upon the validity of pre-bid defences mostly by reference to statutory concepts, such as the principle of the interests of the company [1034] or the concept of the *abus de biens sociaux,* which are both embodied in statutes[1035]. Thus, the French courts usually make use of legislative provisions to regulate directors' actions prior to the bid.

As mentioned earlier, the rationale behind the absence of a legal fiduciary duty in France is believed to derive from the fact that, until recently, there was less sensitivity in France to the conflicts of interests of directors, due to the predominance of controlling, especially family holdings in many listed companies[1036]. Tunc (1982) argues that the absence of a broad and philosophical foundation to the French statutory rules governing directors' action is a serious lacuna of French law. In his view, this prevents these statutory rules from having a positive expression of their *raison d'être* and embracing the various aspects of the behaviour expected from a director[1037]. It should be noted, however, that, the UK has also had to multiply legislative measures, due to the insufficiency of the doctrine of fiduciary duties to prevent all abuses. This in turn has brought the UK takeover regime closer to its French counterpart. The UK legislative measures are, however, inspired by a philosophy slightly different from that prevailing in

[1033] e.g. Code of Commerce, art. L. 242-6, which regulates the *abus de pouvoir.*
[1034] Civil Code, arts 1832 and 1833.
[1035] Code of Commerce, art. L. 225-43.
[1036] E. Wymeersch (2003), supra n 44, p. 583.
[1037] A. Tunc, 'French Lawyer Looks at British Company Law' (1982) 45 Modern L. Rev. 1, p. 13.

France. Indeed, whilst French law contains a greater number of imperative rules, legislative measures in the UK, other than those prohibiting loans to directors, mainly rely on disclosure or, at most, on approval by shareholders in general meeting[1038].

Secondly, in addition to common and statutory company law, the UK further relies on self-regulatory rules, and in particular on the UK Listing Rules, to regulate pre-bid defences. For instance, the rule that requires listed companies to seek prior approval of their shareholders in general meeting where they decide to carry out significant transactions [1039] constitutes an additional hurdle for companies wishing to ward off potential offerors by way of pre-bid defences. No such governance obligation on listed companies exists in France. Thirdly, whilst in France the breach by directors of the statutory rules will often incur their criminal liability[1040], the breach by directors of their fiduciary duties will rarely incur their criminal liability in the UK[1041]. Indeed, unlike the French law which often relies on criminal law, the UK usually relies on civil law to enforce directors' duties. It should finally be added that the main difference between the two jurisdictions in the context of pre-bid defences probably lies in the fact that the power of institutional shareholders prevents listed companies in the UK from adopting pre-bid defences. Indeed, a lot of inhibitions in the UK result from shareholder opposition rather than regulation. By contrast, institutional shareholders in France are not as powerful as in the UK, though, as seen above, a culture of shareholder activism is developing in France, albeit timidly.

Before turning to the comparative analysis of selected pre-bid defences, it is suggested to examine what impact the Directive on takeover bids will likely have on the UK and French pre-bid defences. Pursuant to the Directive's break through rule, restrictions on the right of ownership which may prevent the offeror from acquiring securities of the offeree company, such as the imposition of a ceiling on shareholdings or the right for the company or other holders of securities to veto

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[1038] Ibid, pp. 13-14.
[1039] Listing Rules, Ch.10.
[1040] See Code of Commerce, art. L. 242-6, which lists a number of offences which give rise to directors' criminal liability.
[1041] This will be so, for instance, where a director breaches s.330 of the CA 1985, which restricts loans to directors.

any transfer of shares, shall be rendered unenforceable against the offeror during the period for acceptance of the bid[1042]. In addition, restrictions on voting rights, such as limits on voting rights and deferral of voting rights shall cease to have effect when the general meeting decides on post-bid defensive measures[1043]. The same applies to shares with multiple voting rights[1044]. The break through rule further authorises the offeror who manages to hold seventy-five per cent of the voting securities of the offeree company following the bid to break through any such restrictions, extraordinary rights of shareholders [1045], or multiple-vote securities at the first general meeting following the closure of the bid, whereby the offeror is likely to amend the articles of association or remove or appoint board members[1046]. The latter is intended to dismantle, if the bid is successful, at least some of the most common pre-bid defensive measures that can be regarded as hindering bids [1047]. It is noteworthy in this respect that the latter rule is reminiscent of the AMF's proposal in 1989 with respect to voting caps, pursuant to which companies should include in their articles a standard clause which would automatically invalidate the cap if the offeror receives acceptances for more than fifty per cent of the shares[1048].

The rationale behind the break through rule is to eradicate national barriers to a control transfer. Indeed, this rule would have the effect of enfranchising overnight, as regards the sale of control, shares with limited or no voting rights, as well as shares with multiple voting rights, in UK or French listed companies. By doing so, the rule would reduce the substantial differences between the takeover defences based on EU company law[1049], and would redefine the very concept of ownership in the takeover context[1050]. However, the potential effects of the

[1042] Directive, r.11(2).
[1043] Directive, r.11(3).
[1044] Directive, r.11(3).
[1045] e. g. concerning the appointment or removal of board members provided for in the offeree's articles of association.
[1046] Directive, r.11(4).
[1047] B. Dauner Lieb and M. Lamandini, 'The New Proposal of a Directive on Company Law Concerning Takeover Bids and the Achievement of a Level Playing Field' (2002), p. 3, available at europa website.
[1048] Annual Report COB 1989, p. 124 and Annual Report COB 1993, p. 51.
[1049] G. Hertig and J. A. McCahery, 'Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?' (2003), p. 4, available at SSRN website.
[1050] J. McCahery, L. Renneboog , P. Ritter and S. Haller, 'The Economics of the Proposed European Takeover Directive' (2003), p. 81, available at http://www.vwl.uni- mannheim.de/ hellwig/sascha/

Directive's break through rule are muted by the fact that MS are allowed to opt out from the rule.

7.1.2 Technical Differences as to Pre-Bid Defences

It should be noted that the following is a comparative overview of only those pre-bid defences where substantial differences exist between the UK and France, and of those defences which only exist in one jurisdiction, such as the French SCAs. Thus, the following excludes the pre-bid defences whose use is subject to similar restrictions in both jurisdictions. This is not surprising since some pre-bid defences are to some extent governed by Community law[1051].

i) Nature of the shares

In France, most listed companies use bearer shares, which make it more difficult for potential offerors to identify the shareholders relevant to a bid campaign. In the UK, however, all of a company's issued shares are registered[1052]. As a result, it is easier in the UK to mount a takeover over the heads of the incumbent management, since the offeror can easily identify the offeree shareholders by examining the company's share registry. It should be noted, however, that the UK law offers something similar to bearer shares by providing that a company may issue, with respect to a fully paid share, a warrant stating that the bearer is entitled to the shares specified in it[1053]. The issue of share warrants is, however, relatively uncommon in the UK.

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pics/CEPS_report_on_EU_takeover_regulation.pdf.

[1051] See e. g. art. 23 of the Second Company Law Directive, which requires MS to prohibit companies from making loans or granting guarantees in order to cause or facilitate the subscription or purchase of their shares by a third party or a shareholder. For the implementation of this rule in the UK and France, see CA, s.151 and Code of Commerce, art. L. 225-216, respectively.

[1052] CA, s.361.

[1053] CA, s. 188. Note, however, that the holder of a share warrant typically has fewer rights than a registered holder.

ii) Non-voting shares and shares with double voting rights

Non-voting preference shares are used in both jurisdictions. However, probably because of its relatively frequent use, this pre-bid defence is subject to stringent rules in France. Thus, only companies that have made distributable profits during the two fiscal years preceding the date of the proposed issuance are allowed to issue such shares[1054]. Furthermore, the number of such shares cannot exceed one-fourth of the capital[1055]. Moreover, holders of preference shares who have not been offered a dividend over three consecutive years regain their voting rights until the close of the first fiscal year during which their dividend is paid[1056]. There are no such restrictions as regards the use of this pre-bid defence in the UK. This is because it was thought that the legislative abolition of non-voting shares would simply encourage alternative methods of vesting control in the holders of particular shares or classes of shares[1057]. This should not be of concern, however, since very few UK listed companies use such shares. This is evidenced by the fact that '*there have been no instances in recent years of a company seeking a listing for a new class of non-voting capital*' [1058]. Indeed, the powerful institutional shareholders in the UK have always lobbied against the use of non-voting shares. Given that institutional investors are the largest category of shareholders in UK listed companies, they have thus far successfully prevented these companies from adopting this pre-bid defence. Such shares exist in a few large UK businesses though, including the investment bank Schroders, the brewer Young & Co's, and the newspaper group Daily Mail & General Trust[1059].

Likewise, companies in both jurisdictions are allowed to issue shares with double voting rights. As in the case of non-voting shares, French listed companies use this defence more often than their UK counterparts. Indeed, an analysis of 156 companies in 1999 shows that 68 per cent of companies in France have a regime

[1054] Code of Commerce, art. L. 225-126.
[1055] Code of Commerce, art. L. 228-12.
[1056] Code of Commerce, art. L. 228-14. .
[1057] Jenkins Report, para 136.
[1058] M. A. Weinberg and M. V. Blank, *Weinberg and Blank on Take-overs and Mergers* (London: Sweet and Maxwell, 5th ed, 1989), para 3-805.
[1059] 'John Laing Gives Shareholders the Vote', *The Financial Times*, March 24, 2000.

of double voting rights[1060]. Probably because of their frequent use, double voting shares are also subject to stringent requirements. Indeed, only shares which are registered for at least two years in the name of the same holder are eligible for double voting rights[1061]. At first sight, the latter requirement seems to make it more difficult for shareholders to obtain double voting rights. Indeed, in the UK, shareholders can obtain double voting rights immediately following an issue of shares to which double voting rights are attached, or by inserting a clause in the articles of association. As a result, they need not wait for the expiry of a certain period of time to avail themselves of double voting shares. The above requirement in France makes double voting shares a stronger pre-bid defence for the offeree company, however, as it prevents potential offerors from gaining real control in the offeree company for a period of at least two years. This is because, upon transfer, the shares lose their double voting rights. Thus, the offeror will not obtain double voting rights upon acquisition of the offeree shares to which they are attached. He will need to wait for a minimum period of two years before becoming eligible for double voting rights. Seen from this perspective, the French rule seems to act as a stronger deterrent for potential offerors.

iii) Share buy-backs

Listed companies in both the UK and France are allowed to purchase their own shares. This is not surprising, since this pre-bid defence is governed by Community law. However, whilst the UK law does not put a limit on the amount of shares that can be purchased, the maximum percentage of shares that companies listed in France may purchase is only ten per cent of the capital. Furthermore, in both countries, companies are allowed to hold the repurchased shares in treasury provided the aggregate nominal value of the treasury shares do not exceed ten per cent of the nominal value of the issued share capital of the company[1062]. There are, however, a number of differences between the two regimes as to the rules governing treasury shares. Indeed, in the UK, if the maximum ten per cent threshold is exceeded at any time, the excess shall be

[1060] C. Van Der Elst (2003), supra n 311, p. 30.
[1061] Code of Commerce, art. L. 225-123.
[1062] The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003.

automatically cancelled. In France, however, shares in excess of the ten per cent threshold are not automatically cancelled. Instead, they may be kept for a period of one year, following which they must be either sold or cancelled[1063]. In the meantime, the shares are, however, deprived of their voting rights. Furthermore, in the UK, only listed companies are able to hold treasury shares whilst in France both listed and unlisted companies may hold treasury shares. It should be noted in this respect that, although the approach of both jurisdictions *vis-à-vis* treasury shares is in conformity with the Second Company Law Directive[1064], the Winter Proposal on a Modern Regulatory Framework for Company Law in Europe suggests that holding shares in treasury should be allowed within the limits of the distributable reserves, without limiting it to an entirely arbitrary percentage of legal capital like the ten per cent limit[1065].

Another difference which is closely related to share buy-backs, is that the UK law prohibits subsidiaries from holding shares in the capital of their parents[1066]. Even the Companies Regulations 2003 did not relax this prohibition[1067]. The UK's approach *vis-à-vis* this defence differs from the French law where a subsidiary can hold up to ten per cent of the capital of its parent, though the shares held by the subsidiary do not carry voting rights[1068]. It should be noted in this regard that some of the post-bid defences which are prohibited in France, and which have no equivalence in the UK, derive from this permissive approach of the French law *vis-à-vis* the above defence. This is the case for the French rules according to which subsidiaries cannot increase the shares they hold in the capital of their parents, or sell such shares to a third party during the currency of an offer.

[1063] Code of Commerce, art. L. 225-214.

[1064] Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent; OJ L 026, 31/01/1977 P. 0001 – 0013, as amended by Council Directive 92/101/EEC of 23 November 1992, art. 19(1)(b).

[1065] *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* (2002), supra n 679, pp. 84-85.

[1066] CA, s.23.

[1067] *Treasury Shares* (2001), supra n 483, p. 10.

[1068] Code of Commerce, art. L. 233-31.

iv) Cross shareholdings

Cross shareholdings are not regulated in the UK, on the grounds that any such provision would necessarily be complex and arbitrary[1069]. It is believed that the non-regulation of such shareholdings in the UK should not be of concern, given that they are rarely used by companies listed therein. By contrast, cross-shareholdings are regulated in a quite detailed manner in France. Indeed, the law prohibits a company from holding more than ten per cent of the capital of another company if the latter holds more than ten per cent of the capital of the former[1070]. The French law also regulates the consequences of excessing the stipulated threshold. The rationale behind such detailed regulation probably lies in the fact that this defence is commonly used in France. Indeed, such shareholdings have always been an attribute of the French takeover regime. It is suggested that a statutory provision along the lines of the French law would be useful in the UK, at least for listed companies where large family shareholdings still prevail.

7.1.3 Doctrinal Differences as to Post-Bid Defences

As far as post-bid defences are concerned, both jurisdictions seem to be in line as regards the approach taken towards such defences. In other words, both seem to prohibit *ex ante* frustrating action without the consent of shareholders. However, whereas this prohibition is made explicit in the Code, this approach *vis-à-vis* post-defences stems in France from the market practice. Indeed, the French takeover regulations do not contain a clear-cut 'no frustrating action' rule, such as GP 7 of the Code. Nor do the French regulations provide a list of actions which can only be taken upon shareholder approval, such as that embodied in Rule 21 of the Code. Instead, the French regulation stipulates a mere obligation of notification. However, the latter obligation has always been interpreted by the offeree directors as prohibiting post-bid defences other than those authorised by shareholders in general meeting. As a result of the neutrality rule prevailing in both jurisdictions, the board of an offeree company which strongly opposes a bid may only resort to one or more of the following: search for a white knight; use of its delegated

1069 Jenkins Report, para 153.
1070 Code of Commerce, art. L. 233-29.

authority to increase capital or to carry out share buy-backs; appeal to regulatory authorities or to courts; or appeal to the general meeting to authorise defensive action.

Both jurisdictions' approach towards post-bid defences is in conformity with the Directive, which also contains a neutrality rule. Indeed, the Directive provides that the board of an offeree company must refrain from taking any defensive measures that may result in the frustration of a bid, unless it has the prior authorisation of the general meeting of shareholders for the purpose[1071]. The objective of this rule is '*to limit the powers of the board of the offeree company to engage in operations of an exceptional nature without unduly hindering the offeree company to carry out its normal business activities*'[1072]. In particular, unless authorised by the general meeting, the offeree board cannot decide to issue voting securities or securities that confer the right to subscribe to such securities, such as warrants and convertible bonds. However, the 'no frustrating action' rule in the Code is broader than that embodied in the Directive. This is evidenced by the fact that, whilst the Code prohibits a wide range of measures by referring to the concept of '*contracts otherwise than in the ordinary course of business*'[1073], the latter concept is absent in the Directive[1074]. More important for our purposes, the potential effects of the Directive's neutrality rule are muted by the fact that MS are allowed to opt out from the rule. During the negotiations preceding the adoption of the Directive, the UK Takeover Panel had noted that it saw little benefit in a Directive that would weaken the neutrality rule and hence allow offeree boards to frustrate offers against the wishes of their shareholders[1075].

[1071] Directive, r.9(2).
[1072] Directive, Recital No. 16.
[1073] Code, r.21(1)(e).
[1074] It should be noted in this respect that the original 1989 Directive had contained a concept similar to that of the Code, namely '*transactions which do not have the character of current operations concluded under normal conditions*'. This language was, however, subsequently dropped from the later versions of the Directive.
[1075] The Takeover Panel, 2003 Annual Report, 2003/15, p. 3.

7.1.4 Technical Differences as to Post-Bid Defences

The first technical difference relates to the fact that, as noted above, whilst the City Code contains a clear-cut prohibition of frustrating action and a non-exhaustive list of forbidden acts, the COB's Regulation No. 2002-04 merely contains an obligation for the offeree board to inform the AMF of its acts other than those which have been accomplished in the ordinary course of business and other than those which have been approved by shareholders in general meeting during the course of the offer. As suggested earlier, the reason behind the absence of a clear-cut 'no frustrating action' rule in France probably lies in the fact that France has not experienced many hostile bids. In addition, given that conflicts of interests in France mostly arise as between controlling and non-controlling shareholders, the regulators probably did not feel the need to place much emphasis on the regulation of post-bid defences. As a result, the French provision seems 'milder' than that of the City Code. However, as mentioned earlier, French listed companies have thus far viewed the above obligation of notification as if it were a prohibition.

In addition to the obligation of notification, Rule 4 of the COB's Regulation contains a series of principles to be observed by the parties during the course of an offer, such as the equality of treatment and of information of the shareholders of the companies concerned, the transparency and the integrity of the market, and the honesty in the transactions and the competition. The existence of principles rather than concrete rules, such as Rule 21 of the Code, is believed to be advantageous by some scholars, who argue that the principles embodied in Rule 4 have the advantage of conferring a greater discretion on the AMF[1076]. It should be noted, however, that most of the principles embodied in Rule 4 are aimed at solving the conflicts of interests as between the offeror and the offeree shareholders, rather than those as between the management and the offeree shareholders. It is therefore suggested that it would be preferable if Rule 4 of the COB's Regulation had contained a clear and separate 'no frustrating action' rule.

[1076] This view is shared by Professor Thierry Bonneau at the University of Paris II, to whom I am indebted for his valuable comments during my interview with him in January 2003.

It should also be noted in this respect that, as mentioned in the chapter on the regulation of defensive measures in France, there are additional principles that the offeree boards in France must observe during the course of an offer, such as the principle of the interests of the company. The problem with the latter principle, however, is that the French view of the interests of the company is in sharp contrast with that in the UK. Indeed, the Code narrowly focuses on the protection of shareholders' short-term financial interests during a takeover bid[1077]. By contrast, for many years, the institutional theory has had the upper hand in France[1078]. Pursuant to this theory, the corporate interest is the superior interest of the legal entity itself pursuing its own objects as distinct from those of its stakeholders, but which corresponds to their common general interest, which is to ensure the prosperity and continuity of the enterprise. Foster (2000) argues that the pre-eminence of the institutional theory in France is no accident and derives from specifically French conditions. In his view, commerce in France has historically been less well regarded and has not had the same importance as in the UK. As a result, his argument goes, the statement in France that the '*action of the directors must be inspired by the sole concern of the interest of the company*' is quite different from any equivalent sentiment concerning the 'interest of the company' in UK law[1079].

That the principle of the interests of the company has a different meaning in France than in the UK has significant implications. Indeed, given that the corporate interest encompasses in France the interests of constituencies other than shareholders, there is a risk that some post-bid defences might withstand the neutrality test, though there is no judicial decision to date confirming this view. Such risk has been highlighted by the CLR, which, in its support for the UK's enlightened shareholder value, said

[1077] Note that, although, as seen in the chapter on the regulation of defensive measures in the UK, the CLR has opted for the enlightened shareholder value approach of the company, the CLR's endorsement of this approach is limited, as no proposal has been made to deal with the Code's narrow focus on the protection of shareholders' short-term financial interests during a takeover bid; see J. Armour, S. Deakin and S. Konzelmann (2002), supra n 472, p. 9.

[1078] See e. g. *Principes de Gouvernement d'Entreprise* (2004), supra n 723, p. 5.

[1079] N. H. D. Foster, 'Company Law Theory in Comparative Perspective: England and France' (2000) 48 A.J.C.L. 573, pp. 599-600.

'Attempting to graft continental stakeholder model of directors' duties into the very different cultural and politico-economic environment of the UK would give rise to risks of reduced accountability'[1080].

It should be added in this respect, however, that Foster (2000) notes the recent trend in France towards contractualisation. In support of his view, he particularly refers to the Marini Report, which rejects the highly regulated model of the institutional company in favour of a more contractual approach in which the shareholders would be much freer to determine the rules and procedures of the company[1081]. This trend indicates that there may eventually be a convergence between the UK and France as regards the meaning of the 'interests of the company'.

Without prejudice to the above trend, it should be noted that the Directive stipulates that the offeree company's employees, or their representatives, should be given an opportunity to state their views on the foreseeable effects of the bid on employment[1082]. However, the latter provision in no way suggests that the offeree directors may take post-bid defences on the basis of the offeree's employees' interests. Indeed, although the High Level Group expressly acknowledged that the interests of the employees might be at stake in the context of a takeover bid, they nevertheless believed that *'this in itself does not justify measures by the board which deny shareholders the opportunity to successfully tender their shares to a bidder who is willing to buy their shares'*[1083].

The second technical difference as regards post-bid defences in the UK and France relates to the fact that there are a number of rules in the French regulation, which seem to undermine the impact of the neutrality rule. First and foremost, whilst the neutrality rule begins in the UK from the moment the board has reasons to believe that a bona fide offer is imminent, the French regulation imposes this rule from the day the prospectus is filed with the AMF[1084]. One might argue that

[1080] *Modern Company Law for a Competitive Economy: Developing the Framework* (2000), supra n 453, p. 28.
[1081] N. H. D. Foster (2000), supra n 1079, pp. 599-600.
[1082] Directive, Recital, No. 23.
[1083] *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union* (January, 2002), p. 16, available at europa website.
[1084] COB regs, r.2.

the French rule is an objective one[1085] and therefore preferable to the Code's rule, on the grounds that it is easily understood by the markets and applied by the courts. Indeed, it is not easy to prove that an offeree board had reason to believe that an offer was imminent. It is suggested, however, that the French rule is actually more lenient than the Code's rule in that it allows the board of an offeree company to have access to information regarding the imminent presentation of a bid and thus rapidly organise a defensive tactic[1086]. This type of risk does not exist in the UK. Secondly, the length of the minimum offer period in France is likely to facilitate the convening of a general meeting to decide upon defensive measures during the course of an offer. This is because whilst the City Code requires all offers to be kept open for a minimum of twenty-one days after their initial posting[1087], the minimum offer period is twenty-five days in France[1088].

7.2 A Comparative Analysis of the UK and French Regimes as Regards Equality and Protection of Offeree Shareholders

The equality of shareholders constitutes both the Code's and the French regulations' cornerstone. However, there are significant differences between the two jurisdictions as to the rationale underlying some mechanisms designed to ensure equality. This in turn results in a number of technical differences as regards the operation of such mechanisms.

7.2.1 Rationale and Significance of Doctrinal Differences as to Equality

As seen in earlier chapters on equality, both the UK and French takeover regimes contain provisions to ensure equal treatment of shareholders in the context of voluntary and mandatory bids. Likewise, both jurisdictions provide mechanisms to prevent shareholder coercion. On a closer analysis, however, differences

[1085] Note that the Directive also provides for an objective rule, as it requires the neutrality rule to operate from the time the offeree board receives the information and until the result of the bid is made public or the bid lapses, unless the MS decide to provide for an earlier stage; see r.9(2).
[1086] P. Câmara, 'Defensive Measures Adopted by the Board: Current European Trends', Company Law Reform in OECD Countries-A Comparative Outlook of Current Trends (2000), p. 7, available at OECD website.
[1087] Code, r.31(1).
[1088] CMF regs, r.5-2-2.

emerge between the UK and France with respect to the rationales underlying these provisions and mechanisms. This stems from the fact that the UK and France have a different share ownership structure. Indeed, whereas most UK listed companies have a dispersed ownership, French listed firms usually have a concentrated ownership, whereby minority shareholders are under a constant threat of being oppressed by the majority. This in turn has implications as to the relevance of some equality provisions or mechanisms over others.

The difference of rationale underlying the equality provisions in the UK and France can be illustrated by the French price guarantee procedure. Indeed, the French regulation provides a special tender offer, referred to as the price guarantee procedure, for the event that, within the listed company, there is already a shareholder acting alone or in concert holding a majority of voting rights or capital and that majority shareholder decides to sell his shares. In other words, the French regulation offers an additional exit right in favour of the minority to be exercised at a most significant level of acquiring control. This procedure is similar to the mandatory bid procedure in that it potentially allows all shareholders to leave the company at the same price as that paid to the majority shareholder[1089]. As seen in the chapter on the principle of equality of shareholders and the protection of the minority under the French takeover regime, this procedure was introduced before the mandatory bid procedure. The rationale behind the upholding of this procedure is mainly historical[1090]. However, the price guarantee procedure still represents the most frequently invoked procedure in France.

It is suggested, however, that the very fact that the French regulations impose a type of mandatory bid upon crossing the fifty per cent threshold should be seen in the context of the concentrated share ownership structure in France[1091]. Indeed, most French listed companies have controlling owners and control changes usually occur as a result of private negotiations between the acquirer and the controlling shareholder(s). Such negotiations confer on the acquirer more than

[1089] CMF regs, r.5-4-1.
[1090] art. 201 of the General Regulation of the *Chambre syndicale des agents de change*, and the General Decision of February 27, 1973 of the COB.
[1091] It is noteworthy that, prior to the reform of 1998, the mandatory bid rule also regulated the acquisition by a person, acting alone or in concert with others, of more than fifty per cent of the shares or the voting rights in a listed company.

fifty per cent of the voting rights of the company. The ensuing offer – namely the price guarantee procedure - is just a formality to withdraw the company from the exchange. In other words, the price guarantee procedure is used in France mostly as a means to de-list a company, rather than as a means to effect a change of control. This explains the fact that the price guarantee procedure is more often invoked in France than the mandatory bid *stricto sensu.* By allowing all shareholders to leave the company at the same price as the previous blockholder[1092], the price guarantee procedure aims at solving the main conflicts of interests in France, namely that between controlling and minority shareholders, which are likely to arise as a result of the above-mentioned private negotiations.

As far as the UK is concerned, the Code does not regulate the crossing of fifty per cent threshold. For strengthening a controlling stake which is already over fifty per cent is not regarded by the Code as affecting the minority shareholders to the same extent as the crossing of thirty per cent threshold or the consolidation of control, which are regulated by the Code[1093]. Furthermore, as seen in the chapter on the ownership structure of listed companies and the market for corporate control in the UK and France, full majority control in UK listed companies is very rare. As a result, it is unlikely in the UK for a person to acquire fifty per cent of a company's voting rights from a previous blockholder. The absence of a price guarantee procedure in the UK does not mean, however, that the UK does not regulate the transfer of a control bloc from an identified seller. Indeed, as seen in earlier chapters on equality, the UK mandatory rule also applies when effective control is transferred from an already existing controlling shareholder, and not only when effective control is acquired through purchases in the market. In particular, Rule 9(1) regulates the transfer of control from a director. The difference is, however, that the Code regulates such transfers of control only when they confer on the transferee effective control, and not majority control.

The difference of rationale underlying the equality provisions in the UK and France can also be illustrated by the sell-out right. Indeed, the rationale underlying the sell-out right in the UK is to balance the buy-out right conferred on

[1092] CMF regs, r.5-4-1.
[1093] J. H. Farrar (1998), supra n 411, p. 595.

the offeror. In other words, the UK sell-out right is a way of rendering an expropriation right conferred on the offeror acceptable. On the other hand, the French sell-out right is part of a broader theory about the 'investment contract'. This in turn impacts upon the scope of the sell-out right in these two countries. For instance, the UK sell-out right is very take-over specific in that it is applicable only following a takeover bid. By contrast, the French sell-out right may be exercised irrespective of a takeover bid. Indeed, the French sell-out right is exercisable in a wide range of circumstances, in particular in circumstances which do not involve a change of control but which nevertheless significantly alter the 'investment contract'. The latter include circumstances where the controlling shareholder proposes significant changes to the company's articles of association[1094]; or decides to change the business purpose; or decides not to pay dividends for several years. The different rationale behind the French sell-out right probably also explains the discretion of the AMF as to whether or not to impose the majority shareholder(s) to make a buy-out offer. Indeed, whereas the controlling shareholder in the UK is obliged to purchase the shares of the minority who exercise their sell-out right, the controlling shareholder in France is required to do so only if the AMF decides so. For instance, as seen in the chapter on the principle of equality of shareholders and the protection of the minority under the French takeover regime, the AMF is unlikely to impose such obligation upon the majority shareholder(s) if the market in the shares of the offeree company is liquid.

It should be noted in this respect that the French approach of protecting the minority in the event of changes to the investment contract, which do not involve changes in control, has also inspired a number of rules in the UK, which are not related to the sell-out right. Indeed, such approach lies behind the UK Listing Rules' requirement for shareholder approval in the context of 'Class One' transactions[1095]. It is suggested that this approach also lies behind the UK Listing Review's recent proposal to require shareholder approval as a general rule before de-listing. Indeed, under the current UK de-listing regime, minority shareholders are not adequately protected, as they may be forced to sell their shares at a price

[1094] CMF regs, r.5.6.6.
[1095] Listing Rules, Ch. 10.

they consider to be unfairly low, or to hold unlisted securities. This is of particular concern where there has been no compulsory acquisition of minority shares or where there has been no formal offer. The UK Listing Review proposes that an issuer willing to de-list voluntarily should obtain the prior approval of seventy-five per cent of its shareholders in general meeting[1096]. However, the proposal falls short of providing the minority with a right to be bought-out[1097].

It should be added that the relatively narrow scope of the sell-out right in the UK is partially[1098] compensated by the Code's requirement that all offers remain open for acceptance for not less than fourteen days after the date on which it would otherwise have expired[1099]. Indeed, due to the existence of the latter rule, minority shareholders in the UK rarely invoke their statutory sell-out rights. This is because, by allowing the offeree shareholders to invoke it upon the acquisition by the offeror of fifty per cent of the acceptances - rather than ninety per cent of the voting rights of the offeree company - the Code's rule constitutes a stronger minority protection rule than the statutory sell-out right.

7.2.2 Technical Differences as to Voluntary Bids

Although both jurisdictions require the offeror to bid for all voting and non-voting equity share capital during the course of a voluntary offer, there are a number of substantial differences as to the scope of this requirement: First, whereas the UK rule requires an 'appropriate' offer to be made to the holders of convertible securities, subscription rights, and options[1100], if there are any, the French rule requires the extension of the same offer to the latter holders. Indeed, the French regulation requires the offeror to extend its offer to the holders of securities which give access to the capital or the voting rights, if there are any[1101]. Given that an 'appropriate' offer is not the same as the 'offer' itself, it is suggested that the French rule is more protective of offeree shareholders.

[1096] *Review of the Listing Regime* (2003), supra n 282, p. 53.
[1097] Note that this proposal will probably take effect towards the end of 2004; see FSA Statement, *Proposals to De-list*, July 30, 2004, available at FSA website.
[1098] This is because Rule 31(4) of the Code still operates only in a takeover bid.
[1099] Code, r.31(4).
[1100] e. g. convertible bonds, subscription rights, warrants, and call options.
[1101] CMF regs, r.5-1-2.

Secondly, as far as the impact of pre-bid purchases are concerned, both jurisdictions require such purchases to be disclosed. However, only the UK adheres to a strict equal treatment philosophy by requiring the voluntary bid to have no less favourable terms than those offered for the shares acquired during the three months prior to the bid. The Panel may even extend this requirement beyond the three-month period, if it considers this is necessary to preserve the equal treatment of shareholders as to the offer price. The absence of such provision in France creates a potential for price discrimination between shareholders selling before the bid and the accepting shareholders. Furthermore, additional self-regulatory rules apply in the UK to curb so-called dawn raids. Indeed, the Code's SARs seek to slow down the acquisition process, and thus to reduce shareholder inequality, by limiting acquisitions of shares to ten per cent over a period of seven days if such acquisitions would result in the acquirer holding more than fifteen per cent but less than thirty per cent[1102]. By contrast, France provides no rules analogous to the SARs.

Thirdly, as far as purchases made during the bid are concerned, whereas the UK regime allows the offeror to deal freely in the offeree company's shares during the course of a cash or a share-exchange offer, the French regime allows such dealings only during the course of a cash offer[1103]. The Code's more liberal approach lies in the unexpressed but fundamental principle of the Code that it is undesirable to fetter the market by imposing any bar on market dealings by the parties to a bid, subject to certain requirements[1104]. Accordingly, in the UK, the parties remain free, following the announcement of a share-exchange offer, to deal in the offeree company's shares.

By preventing shareholders selling in the market from receiving cash whilst the shareholders accepting the share-exchange offer are left with the offeror's securities, the above French rule seems to constitute a stronger minority protection rule than the Code's rule. However, the Code ensures that the accepting shareholders are treated equally, by compelling the offeror to provide a

[1102] SARs, r.1.
[1103] CMF regs, r.5-2-11.
[1104] T. Hadden (1977), supra n 794, p. 379.

cash alternative where it purchases shares in the market during the course of its share-exchange offer, no matter how small its purchase is. As a result of the latter rule, the Code completely offsets the potential for inequality between shareholders selling in the market and those accepting the share-exchange offer. Furthermore, it is believed that the UK rule has the advantage over the French rule of distributing cash to shareholders in a share-exchange offer, bearing in mind that cash payments are shareholders' favourite payment method.

Finally, the Code's requirement that all offers be conditional on over fifty per cent acceptances ensures that, except through a partial offer, effective control of an offeree company does not pass unless legal control also passes. The fifty per cent requirement further ensures that the offeror offer a price sufficient to obtain the majority of the voting rights[1105]. The French regulation does not contain such requirement. Indeed, the CMF's Regulation merely allows the offeror to stipulate a minimum acceptance percentage in its offer document[1106]. The rationale behind the absence of a fifty per cent requirement in France probably lies in the AMF's price approval role, which ensures that the offer price cannot be very low. In other words, an offeror in France cannot offer a very low price and expect that at least effective control would pass to him with such low offer price. For the AMF would refuse to approve an offer document which contains a poor offer price. Thus, due to the price approval power of the AMF, it is unlikely for unsophisticated shareholders to be coerced into accepting such poor offers. It should be noted, however, that the price approval role of the AMF only partly acts as a substitute in France for the absence of the fifty per cent requirement. This is because, even assuming that the offeror offers a reasonable price, the absence of the fifty per cent requirement makes it easier for offerors to take over a company than in the UK, as their bid can succeed even with a less than fifty per cent share capital of the offeree company.

The foregoing indicates that, as far as voluntary offers are concerned, the UK overall seems to better protect shareholders than France. This is because a number

[1105] G. Ferrarini, 'Shareholder Value and the Modernisation of European Corporate Law', in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (OUP, 2003), p. 253.
[1106] CMF regs, r.5-1-3-1.

of crucial safeguards embodied in the Code, such as the rule governing pre-bid purchases and the fifty per cent acceptances requirement, are absent in the French takeover regulation. On the other hand, the UK takeover regime manages to ensure such equality without hindering the normal operation of the market, as shown by its liberal approach towards share dealings made during the course of an offer.

7.2.3 Technical Differences as to Mandatory Bids

In both the UK and France, the transfer of *de facto* control triggers an obligation upon the transferee to make a bid for the relevant listed company. Without prejudice to the latter, however, there are substantial differences between the two jurisdictions as regards the regulation of mandatory bids: First, unlike in the UK, transferees in France are not required to extend the mandatory bid to the holders of non-voting equity share capital[1107]. Furthermore, although the French rule requires the mandatory bid to also be extended to the holders of securities which give access at a later date to the shares or the voting rights, it does not require the bid to be extended to the holders of non-equity. In contrast, Rule 9 of the Code also extends the bid obligation to the holders of voting non-equity share capital, though provided the acquirer or the persons acting in concert with him hold shares therein. As a result, the scope of the UK mandatory bid rule is wider than that of the French rule.

Secondly, although both countries require a bid upon consolidation of control, whilst the French regime requires a bid upon acquisition of a two per cent stake following the crossing of the one-third threshold, the Code requires a bid from each acquisition onwards, no matter how little it is[1108]. Thus, the Code is more rigorous in this respect. Furthermore, the French regime requires a mandatory bid upon consolidation of control only if such consolidation occurs in less than twelve 'consecutive months'. This suggests that, if the acquirer increases his holding by

[1107] This is because Rule 5-5-1 of the CMF's Regulation expressly states that the equity shares referred to in the chapter relating to the mandatory bid mean voting equity shares.
[1108] Code, r.9(1)(b).

two per cent but does so with a one-month interval[1109], he will not be obliged to make a bid[1110]. This demonstrates that the French regime is more lenient in this respect than the Code, which does not qualify the consolidation of control in terms of the time limit.

Thirdly, as far as the price of the mandatory bid is concerned, the UK regime stresses equal treatment by requiring the highest price at which the acquirer had acquired his shares during the twelve preceding months. In other words, the minority shareholders in the UK are offered the maximum acquisition price. In contrast, the French regime contains no price condition. However, as in the case of voluntary bids, the AMF controls whether the offer has a fair chance to succeed at the proposed price[1111]. This prevents the offeror from setting an offer price well below the private transfer price, which would render the mandatory bid completely unattractive[1112]. Thus, although the regulation contains no price condition, the bidder's freedom to set the price of the mandatory bid is far from being unrestricted. In practice, the AMF insists on the offeror to take the transfer price as the basis for its mandatory bid.

It is suggested, however, that the French regime would do better to expressly contain a highest price requirement, which offers the double benefit of allowing the minority shareholders to fully share in the premium paid by the acquirer, while at the same time providing the offeror with the certainty that it will not have to pay more under the mandatory bid than it was willing to pay in the preceding period and as a result allowing him to determine the maximum price it is prepared to acquire all the securities of a company[1113]. It is believed that the AMF's General Regulation will introduce such requirement, in order to render the French regime compatible with the Directive on takeover bids. Indeed, the latter defines the equitable price to be paid in the case of a mandatory bid as being the highest

[1109] i. e. if the acquirer purchases, say, 1 per cent at a particular month, then makes no purchases at all the following month, and then purchases another 1 per cent the following month.
[1110] G. Lekkas (2001), supra n 913, p. 346.
[1111] CMF regs, r.5-1-9.
[1112] J. Wouters, 'Towards a Level Playing Field for Takeovers in the EC? An Analysis of the Proposed Thirteenth Directive in Light of American Experiences' (1993) CMLR 30 C.M.L.Rev. 267, p. 281.
[1113] *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union* (2002), supra n 1083, p. 50.

price paid for the same securities by the offeror over a period of between six and twelve months prior to the bid[1114].

It should be added in relation to the price of mandatory offers that, unlike in France, the mandatory bid in the UK must be in cash or accompanied by a cash alternative. The absence of such provision in France constitutes a major shortcoming. For, in some cases, such as where the shares offered in exchange are issued by a company which is also controlled by the offeror, the minority shareholder will be prevented from truly exiting the company. It should be noted, however, that, as in the case of the highest price requirement, the AMF's General Regulation will likely introduce a cash requirement in the French mandatory bid rule, in order to be compatible with the Directive. This is because the latter requires a cash alternative. However, the Directive requires a cash alternative if the consideration does not consist of liquid securities admitted to trading on a regulated market[1115]. Thus, the Directive's cash requirement is more lenient than that under the Code. Indeed, by preventing the offeror from offering securities which are not easily marketable, the Directive presents a compromise that protects offeree shareholders without making large takeovers more difficult[1116]. It should be noted that the Directive's lack of a stringent cash requirement is unfortunate. This view is shared by the Federation of European Securities Exchanges that have criticised the Directive's cash requirement rule, on the grounds that the liquidity in the markets varies very much security by security and payment in listed securities of one company may be quite different from payment in the securities of another company in view of the current and future market conditions[1117]. The problem is exacerbated by the fact that the Directive does not define what constitutes 'liquid securities'. It should be added that the Directive also requires the offeror to offer a cash alternative where, over a period beginning at least six months before the bid is made and ending when the offer closes for

[1114] Directive, r.5(4).
[1115] Directive, r.5(5).
[1116] J. Harris, 'Common Position Adopted on Takeover Directive' (2001) 22 Co. Law. 88, p. 88.
[1117] *European Parliament Legal Affairs Committee Meeting on the Proposed Takeover Directive*, Speaking Notes, Paul Arlman (January, 2003), p. 4, available at europa website.

acceptance, it has purchased in cash securities which carry more than five per cent of the voting rights of the offeree company[1118].

Finally, whereas the success of the mandatory bid in the UK is conditional on the receipt of over fifty per cent acceptances, there is no such requirement in France. The absence of a fifty per cent condition means that an offeror in France could ensure that a mandatory bid will be unsuccessful by making its bid conditional on the receipt of acceptances from no less than a hundred per cent of the shares to which the bid relates, as the offeror is allowed to stipulate a minimum acceptance percentage in its offer document. An acceptance level of a hundred per cent is simply untenable and yet the offeror would have fulfilled the mandatory bid obligation under the French regulation[1119].

The foregoing indicates that, as far as mandatory bids are concerned, both jurisdictions seem to provide similar safeguards, though the UK regime seems to be slightly more protective of offeree shareholders, in particular due to the absence in France of a cash requirement and a fifty per cent condition in the context of mandatory bids. It should be borne in mind, however, that the French takeover regime was the first takeover regime in Europe to introduce the concept of mandatory bid. Indeed, as seen in the chapter on the principle of equality of shareholders and the protection of the minority under the French takeover regime, the French takeover regulator had introduced the so-called *maintien de cours*[1120], which is a type of mandatory bid, long before the introduction of the mandatory bid *stricto sensu*. Pursuant to this procedure, minority shareholders of companies listed on the French stock exchange were able to sell their shares for the same price as that paid to the controlling shareholder, following the private acquisition by a person of a control block of shares[1121]. This indicates that the protection of the minority has long been a major concern for French takeover regulators.

[1118] Directive, r.5(5).
[1119] S. Kenyon-Slade and M. Andenas (1993), supra n 59, p. 182. Note that this problem is exacerbated by the fact that the Directive contains no such requirement either.
[1120] This is the predecessor of the price guarantee procedure.
[1121] Note that the 'maintien de cours' did not apply where the purchase of a control bloc was made via purchases in the market.

7.2.4 Differences as to Mechanisms Designed to Prevent the Pressure to Tender

There are also differences between the two jurisdictions as to the availability and scope of mechanisms designed to prevent shareholder coercion: First and foremost, unlike in the UK, there is no requirement in France that an offer which has become or is declared unconditional as to acceptances remain open for acceptance for not less than fourteen days after the date on which it would otherwise have expired [1122]. As a result of this provision, a shareholder in the UK who doubts the value of a bid may leave his final decision to the end of the offer period and thus see how others are reacting and whether he is likely to find himself in a minority position if he does not accept. If he accepts within the fourteen-day limit, he will be able to tender his shares on the same terms as the accepting shareholders[1123]. By allowing hitherto dissenting shareholders to accept the offer on the same terms, the UK provision reduces offeree shareholders' pressure to tender. This provision is particularly important where the offeror receives between fifty and ninety per cent of the acceptances following its bid. For this provision allows the non-tendering shareholders to realise that they risk being relegated to the minority status without the protection of section 430A of the CA 1985[1124], should they continue to reject the bid[1125].

The lack of a Rule similar to Rule 31(4) of the Code does not suggest, however, that the French regulation does not attempt to prevent shareholder coercion. On the contrary, some French provisions go even farther than the Code in promoting uncoerced shareholder decision-making and may act as substitutes to Rule 31(4) of the Code. Indeed, whilst shareholders in the UK can withdraw their acceptances only after the expiration of a twenty-one day period after the first closing date of the initial offer, if the offer has not by such date become or been declared unconditional as to acceptances[1126], shareholders in France have the right

[1122] Code, r.31(4).
[1123] 'The City Code Completes its Takeover Code', *The Times*, January 5, 1968. Note that if dissenting shareholders do not accept the bid within this 14-day limit and if the offeror manages to receive 90 per cent of the acceptances after the closing of its offer, then the offeror may exercise its buy-out right to buy the remaining 10 per cent shares, pursuant to s.429 of the CA 1985.
[1124] For this section only applies to a minority of ten per cent or less.
[1125] A. Johnston (1980), supra n 62, p. 248.
[1126] Code, r.34.

to withdraw their acceptances up to the last day of an offer[1127]. Likewise, tenders filed by shareholders in response to an initial offer are automatically cancelled upon the announcement of a competing offer[1128]. The latter provisions not only allow the offeree shareholders to accept the superior terms of a competing offer but also remove the potential for coercion by the original offeror. It should be noted in this respect that it is questionable whether the French sell-out right may act as a substitute to Rule 31(4) of the Code. This is because the French sell-out right is exercisable following an offer[1129] if and only if the offeror holds ninety-five per cent of the voting rights of the offeree company. This threshold is even higher than that under the CA 1985.

Finally, although both jurisdictions allow the offeror to make a partial bid, there are significant differences between the two countries as to the scope of the latter. Under the UK regime, it is possible to make a partial offer for even more than fifty per cent of the shares of a company, provided the offeror obtains the Panel's consent[1130] and affirmative shareholder approval from over fifty per cent of the offeree's voting rights[1131], excluding shares held by it or its concert parties[1132]. Thus, partial offers in the UK may provide the offeror *de facto* or even *de jure* control of an offeree company. This shows that the Code recognises that, subject to certain safeguards, partial offers may well be unobjectionable. In particular, partial offers which are directed at acquiring a stake below thirty per cent of an offeree's voting rights normally receive the Panel's consent[1133]. This is because, in the latter case, 'control' as defined by the Code will not have passed and the acquirer could in any event have proceeded unhindered via market purchases or private acquisitions. It may seem surprising that the Panel's consent is still required in the event of a partial offer aiming at less than thirty per cent of a

1127 CMF regs, r.5-2-1.
1128 CMF regs, r.5-2-7.
1129 Note that other instances triggering the sell-out right in France do not involve a takeover context.
1130 Note, however, that consent will normally be refused if the offeror or its concert parties have acquired, selectively or in significant numbers, shares in the offeree company during the twelve months preceding the application for consent, or if shares have been purchased at any time after the partial offer was reasonably in contemplation; Code, r. 36(2).
1131 This approval requirement may, however, be waived by the Panel if over fifty per cent of the voting rights of the offeree company are held by one shareholder.
1132 Note that the 1976 edition of the Code further required that offers which would result in the offeror holding between thirty and fifty per cent of a company's voting rights be permitted only if recommended by the board of the offeree company. The latter requirement was abolished in 1981.
1133 Code, r. 36(1).

company's voting rights. Ffrench (1986) argues that this is probably due to the fact that the Panel wishes to exercise a degree of supervision over offer documents by ensuring that they are properly prepared and dispatched and that all shareholders are treated equally[1134].

In France, however, the regulation allows the offeror to make a partial offer for only up to ten per cent of the voting shares or the voting rights of a company[1135]. By restricting the scope of partial offers, the French regulation seems to be more protective of shareholders. It is suggested that the French approach toward partial offers is unfortunate. This is because some French listed companies may be shielded from full offers due to their enormous size[1136]. Indeed, the only way to make the managers of such companies vulnerable to the constraints of the market for corporate control is probably via partial offers. It should further be noted that the French regulation presents two major shortcomings in this respect: First, a partial offer may be followed by a general offer. Because successive offers result in the acquisition of control of an offeree company by phases, this is likely to prejudice the equal treatment of offeree shareholders, in particular as far as the price offered during successive offers is concerned. Secondly, whereas the Code requires acceptances to be scaled down proportionately if too many are received[1137], no such provision exists in France. This is unfortunate, since the latter requirement is necessary to prevent acquisitions from only selected persons and thus to ensure equality of treatment[1138].

The foregoing suggests that the UK fares better than France in alleviating the impact of coercion on shareholders' decision-making, which is inherent in takeovers. For it is believed that the absence in France of a rule similar to Rule 31(4) of the Code cannot be compensated by other mechanisms which are present in the French regulation.

[1134] H. L. Ffrench (1986), supra n 837, p. 258.
[1135] CMF regs, r.5-3-2.
[1136] T. I. Ogowewo, *The Market for Corporate Control and the Investments and Securities Act 1999* (BIICL, 2002), p. 34
[1137] Code, r. 36(7). This has been so since the original *Notes*; see r. (vii).
[1138] R. Sappideen (1986), supra n 23, p. 298.

Conclusion

As far as the defensive measures are concerned, both the UK and France have endorsed the view that, in the event of a change of control, solely the shareholders must have the power to decide the company's fate. However, as seen above, certain principles and rules embodied in the French law and regulations are likely to undermine the impact of the neutrality rule. This holds true for the concept of the interests of the company, the starting date of the neutrality rule, and the length of the offer period. It should be borne in mind, however, that the issue of post-bid defences arises less in France than in the UK. This is because listed companies in France have a wide variety of pre-bid defences at their disposal, which render them less vulnerable to hostile takeovers. Indeed, due to such pre-bid defences, French listed companies have not experienced hostile takeovers to the same extent as UK listed companies have. The tendency in France has therefore usually been towards friendly deals. As far as the UK is concerned, listed companies therein rarely resort to pre-bid defences, due to the stringent stock exchange rules restricting their use and the power of institutional investors, who view some of these defences as likely to deter value-enhancing takeovers.

It should be noted, however, that the increasing role of both domestic and foreign institutional shareholders will eventually result in a weakening of both pre-bid and post-bid defences in France. For instance, empirical evidence suggests that there is a movement in France away from the 'stakeholder' view of the company in view of the need to respond to the demands of foreign pension funds, which are heavily present in the French market. Indeed, French listed companies are increasingly referring to the concept of 'creation of shareholder value'. According to a study by the AMF, 21 out of 40 CAC40 companies refer to the latter concept in their annual reports. For instance, Crédit Commercial France expressly states in its annual reports that their central objective is to '*create value for shareholders by increasing the return on shares*'. Similarly, Vivendi talks about its '*permanent quest of creation of value*'. Equally, the LVMH Group has recently announced that they have brought about '*a series of fundamental changes to increase* *shareholder value*'[1139]. The latter examples suggest that French listed companies will no longer take pre-bid or post-defences by reference to the interests of stakeholders other than shareholders.

As far as the equal treatment of offeree shareholders is concerned, although both the UK and French takeover regimes contain provisions to ensure equality, the doctrines underlying these provisions are quite different in these two jurisdictions. This is particularly the case for the sell-out right in France, which even applies in the event of changes to the company's business or its legal structure. Furthermore, certain mechanisms in the French regulation, such as the price guarantee procedure, have no equivalent in the UK. As seen above, this mainly derives from the pre-eminence of different conflicts of interests in the UK and France. In most respects, the UK regime seems to better protect offeree shareholders. This holds true for such issues as the impact of pre-bid purchases upon the offer price and the uncoerced decision-making by offeree shareholders. The existence of stricter equality rules in the UK lies behind the existence of a stricter neutrality rule therein.

[1139] *Création de Valeur Actionnariale* (2000), supra n 354, p. 66.

Conclusion and Future Possibilities

The foregoing analysis indicates that there are some major differences between the UK and French takeover regimes with respect to the regulatory framework, the equal treatment of shareholders, and the role of the offeree board both prior to and during takeover bids. As far as the regulatory framework is concerned, whilst the Panel is non-statutory, the AMF is statutory; the French authorities have more discretion, especially regarding price, than their UK counterparts; and challenges to the regulatory authority's decisions are more common in France than in the UK.

As far as the equal treatment of shareholders is concerned, there are a number of substantial differences as to equality between the two jurisdictions. Indeed, although both jurisdictions provide mechanisms to protect the minority and to prevent shareholder coercion, the doctrines underlying some of these mechanisms are different in the UK and France. This difference in the doctrines is mostly due to the different share ownership structure prevailing in these countries. Indeed, the degree of concentration of share ownership and the identity of shareholders, as well as the operation of the market for corporate control, vary quite markedly in the UK and France. Whilst firms in France present a more concentrated ownership structure, shareholdings in the UK are often widely dispersed and in the hands of institutional shareholders. Due to such doctrinal differences, the scope of certain mechanisms, such as the minority's sell-out right, is wider in France than in the UK. Furthermore, some mechanisms are more frequently used in France over others, such as the more frequent use in France of the price guarantee procedure as compared to the mandatory bid *stricto sensu*.

As far as the role of the offeree board in the context of takeover bids is concerned, on the one hand, there are a number of differences in terms of the concepts used to regulate pre-bid defences. Indeed, whereas UK company law regulates such defences mainly by reference to judicially formulated fiduciary duties and self-regulatory rules, French company law does so by reference to legal rules embodied in the statutes. On the other hand, although both jurisdictions seem to prohibit *ex ante* frustrating action without the consent of offeree shareholders, this prohibition is made explicit in the Code. By contrast, such prohibition stems in France from the market practice.

The existence of a number of variations in the regulation of takeovers in the UK and France should also be placed in a broader context. Such variations indeed exist throughout Europe and, as seen in the Introduction, this has been the main motive behind the adoption of the Directive on takeover bids. As far as the Commission's objective of protecting the investors is concerned, the Directive's minority protection rules seem to ensure a substantial harmonisation of this aspect of takeover law. However, as described in the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids, some of the Directive's substantive provisions relating to equality are less protective of offeree shareholders than the equality rules in the UK, and therefore undermine the effectiveness of the Directive from the viewpoint of shareholder protection. This is particularly the case for the absence of a mandatory cash requirement in the context of mandatory bids; the absence of a requirement that all offers be conditional on over fifty per cent acceptances; and the absence of a requirement that an offer which has become or is declared unconditional as to acceptances remain open for acceptance for a certain period of time after the date on which it would otherwise have expired.

As far as the Commission's objective of 'europeanisation' of firms is concerned, the Directive is unlikely to bring about a substantial harmonisation. This is because, as seen in the chapter on the comparative analysis of the UK and French regimes as regards the issues of defensive measures and equality in the context of takeover bids, the Directive makes compliance with crucial clauses, such as the neutrality and the break through rules, optional[1140]. Thus, MS are entitled to decide whether to impose the neutrality and/or the break through rule on companies which have their registered offices within their territories. By making articles 9 and 11 optional, the Directive fails to create the hoped-for level playing

[1140] Directive, art. 12.

field for takeovers in Europe. This is unfortunate, for currently there is no 'level playing field' for takeovers throughout the EU, due to either the different level of capitalisation of national markets, or to company law provisions, which may ensure that the control of a company remains in the hands of 'friendly' shareholders [1141]. Indeed, the market for corporate control through hostile takeovers operates in Europe on only a very limited basis and the takeover activity is concentrated in a few Member States, and in particular in the UK. It is also unfortunate that, unlike the Portuguese proposal[1142], the Directive does not require the opting-out regime to be subject to discussion, every two years, in a general meeting of shareholders. Such a clause would serve to put some pressure on the management of companies and thus help to speed up the process of *de facto* harmonisation. The only requirement that the Directive contains in this respect is the rule which stipulates that companies whose securities are admitted to trading on a regulated market in a MS must regularly present their defensive structures and mechanisms in reports to general meetings of shareholders, with a view to rendering such structures and mechanisms transparent[1143].

It should be noted in this respect, however, that an opt-out decision by most MS from the break through rule should not be of great concern. Indeed, studies have shown that only a small number of companies would be affected by the break through rule, had all European MS opted into the rule. This is because most companies in continental MS have other structures in place, which are not covered by the break through rule and which are designed to defeat takeover bids. Indeed, Bennedsen and Nielsen (2002), who have identified which firms within the EU would be affected by the break through rule, have shown that, out of 1,035 European listed companies with dual class share structures, only three to five per cent would face a direct loss of control after the introduction of the break through rule [1144]. Pursuant to their study, these companies are mainly in Denmark, Germany, Italy and Sweden[1145].

[1141] e. g. disproportionate voting rights enjoyed by certain categories of shares.
[1142] 'Portugal Presents Alternative Solution for Embattled EU Takeover Directive', *World Markets Analysis*, May 22, 2003, available at Lexis-Nexis Executive.
[1143] Directive, Recital No. 18.
[1144] It should be noted, however, that between twenty and thirty-one of these firms belong to the group of largest European firms; see M. Bennedsen and K. Nielsen, 'The Impact of a Break-

As far as the UK and France are concerned, it is believed that both countries will likely decide to retain the neutrality rule, since both countries already have such a rule in their takeover regulations. Indeed, the UK contains a clear-cut prohibition of post-bid defensive measures. Similarly, offeree directors of companies listed in France have always interpreted the French regulations as prohibiting post-bid defences, other than those authorised by shareholders in general meeting, even though the French regulations do not contain an explicit 'no-frustrating action' rule. As a result, the decision by the UK and France of not opting out from the Directive's neutrality rule will not bring about major changes to the existing takeover rules in the UK and France. It should be noted in this respect that this author believes that it is unlikely that listed companies in the UK and France will be allowed to benefit from the reciprocity rule[1146] and thus to opt out from the neutrality rule, should they become subject to a hostile bid from a company based in another MS or in a non-EU jurisdiction that permits post-bid defensive measures. This is because Rule 12(3) of the Directive provides that MS may dispense companies which 'apply' Rule 9 from 'applying' Rule 9 if they become subject to an offer made by a company which does not 'apply' the same Rule as they do. The use of the word 'apply' in the latter Rule suggests, in this author's view, that the individual company opt-out under the Directive applies only to rules into which the individual company has voluntarily opted, and not to rules into which the individual company has involuntarily opted. If the latter interpretation of Rule 12(3) proves correct, listed companies in the UK and France will not be able to opt out from the neutrality rule, should they become subject to a hostile bid from US companies where offeree boards can use an array of post-bid defences without resorting to shareholder approval[1147].

Through Rule on European Firms' (2002), p. 19, available at http://www.cebr.dk/upload/dp1002.pdf.

[1145] For instance, the Wallenberg family in Sweden owns only 7 per cent of Ericsson, but they nevertheless control the company because one class of shares carries 1000 times the voting rights of another class; see 'Lowest Common Denominator', *The Economist*, November 29, 2003.

[1146] Directive, art. 12(3).

[1147] At the time of writing, it is not known whether the UK or France will exercise the MS option in favour of allowing a UK or French offeree company to dis-apply the neutrality rule, if they are faced by an offeror that does not apply the neutrality rule as the UK or French offeree does.

On the other hand, it is believed that both countries will likely opt out from the break through rule, since the latter has no equivalent in the UK and France. A decision by France to opt out would not be surprising. For, unlike in the UK, many companies listed therein have different company and/or capital structures. Such structures are even supported by the French government, which is keen on helping French companies to defeat takeovers from foreign predators and thus creating national champions. Even in the UK, where most listed companies have a unitary share structure, some companies still present a dual share structure. Indeed, 23.91 per cent of listed firms in the UK have dual class shares[1148]. Companies in the UK with dual class shares include Shell, British Airways, Unilever and Cadbury Schweppes[1149]. It is further believed that the UK would not like the idea of being the sole MS not to opt out from the break through rule, given that all continental MS will most probably opt out from the latter rule. Indeed, particularly in the Scandinavian MS, voting rights are usually attributed with a multiple of a hundred, or even a thousand[1150].

One might ask whether individual companies in the UK or France would decide to voluntarily opt back into the break through rule. Indeed, a MS that decides to opt out from the break through rule must nevertheless allow companies registered in its territory to opt back into the latter rule, should such companies wish to do so[1151]. It is suggested that individual companies would consider doing so where they have a one-share-one-vote structure. Since most UK listed companies have such share structure, they would have nothing to lose from such opt-in. Such companies would even gain by opting in, as they may be entitled to benefit from the reciprocity rule, which is described below[1152]. Secondly, companies which have pre-bid defences not covered by the Directive would also consider opting

[1148] Note that this figure does not distinguish whether one of the classes consists of multiple voting shares or of non-voting preference shares; see J. McCahery, L. Renneboog, P. Ritter and S. Haller (2003), supra n 1050, p. 20.
[1149] M. Bennedsen and K. Nielsen (2002), supra n 1144, Appendix, Table A.1.
[1150] E. Wymeersch, 'Convergence or Divergence in Corporate Governance Patterns in Western Europe?' in J. McCahery, P. Moerland, T. Raaijmakers and L. Renneboog (eds), *Corporate Governance Regimes: Convergence and Diversity* (OUP, 2002), p. 242.
[1151] Directive, art. 12(2). Note that the same applies to the neutrality rule.
[1152] At the time of writing, it is not known whether the UK or France will exercise the MS option in favour of allowing a UK or French offeree company that has chosen to opt back into the break through rule the power to dis-apply the latter rule, if they are faced by an offeror that does not apply the break through rule as the UK or French offeree does.

into the break through rule. Indeed, the break through rule leaves untouched a great number of pre-bid defences, such as non-voting shares, pyramids, cross-shareholdings, and golden shares[1153]. As a result, companies with such defences would remain bid-proof even they were to opt into the break through rule. Similarly, blockholder controlled companies would also continue to be shielded from hostile bids, though they would be able to bid for the control of widely held companies using the break through rule[1154]. Since most listed companies in France are controlled by blockholders and since pyramid structures are widely available therein, it is fair to assume that French companies would still be protected from hostile bids, should they decide to opt into the break through rule.

Against this background and given that the Directive does not ensure a level playing field throughout Europe, one might ask whether a Directive was necessary at all? This author believes that some legal harmonisation is necessary to at least ensure the orderly conduct of takeover bids throughout Europe. The rest, however, can and should be left to the market forces, which will continue their *de facto* harmonisation. In other words, this author believes that, despite the optional nature of the Directive's Rules 9 and 11, changes in the field of takeovers will occur via the operation of market forces[1155]. As a result, this author does not believe that strict legal harmonisation is a *sine qua non* tool to bring about harmonisation of European takeovers regimes. This is evidenced by the fact that European MS had already embraced rules ensuring the equality of shareholders even prior to the Directive. In particular, the mandatory bid requirement was introduced into continental European takeover laws and codes, even prior to the adoption of the Directive. Even the German Takeover Act contains such requirement despite the fact that Germany has a far-reaching group law[1156]. Likewise, the neutrality principle had been taken up by nearly all continental European countries' laws or codes on takeovers, prior to the adoption of the

[1153] Note, however, that the ECJ's recent golden share cases referred to in the chapter on the ownership structure of listed companies and the market for corporate control in the UK and France will certainly restrict the freedom of governments to do the defensive job on management's behalf.
[1154] M. Becht, 'Reciprocity in Takeovers' (2003), pp. 6-8, available at SSRN website.
[1155] This is also evidenced by the anti-insider dealing laws that leading European exchanges had introduced in advance of the Community's legislation.
[1156] K. J. Hopt, 'Common Principles of Corporate Governance in Europe?' in B. S. Markesinis (ed.), *The Coming Together of the Common Law and the Civil Law* (Oxford: Hart, 2000), p. 112.

Directive[1157]. Moreover, in many MS, pre-bid defences have been subject to major legal changes. This has been the case in France where, in 1985 and 1987, cross-shareholdings were reduced to ten per cent, both in the parent-subsidiary relationship and between independent enterprises[1158]. This has also been the case in Germany, where multiple voting rights and voting caps have become illegal following the enactment in 1998 of the German Control and Transparency Law.

Despite MS' efforts to bring their regulation in line with market demands, some of the factors which inhibit takeovers cannot be eliminated by legislation of any kind, since they are extra-legal. These are path-dependent differences in corporate governance that are deeply embedded in a country's tradition, history, and culture[1159]. Our comparison of the UK and French takeover regimes indeed contains examples of such factors. For instance, in France, the number of potential offeree companies is restricted, as important companies may not be structured as a public limited company. In addition, there is a revival of obsolete corporate forms, and in particular of the SCAs, partly because of fears of hostile takeovers. Furthermore, the widespread use of bearer shares complicates shareholder identification and delays takeovers[1160]. Moreover, unlike in the UK where most of the large companies have their equity shares listed on the exchange and their shareholdings widely dispersed, many listed companies in France are owned and managed by families, or influenced by the State through golden shares or *noyaux durs*. Hopt (2000) argues that such path-dependent differences would not change or change very slowly, given that any changes to these are bound to affect vested rights and interests[1161].

However, companies are voluntarily removing some of the obstacles to takeovers, in the absence of any law or regulation. This voluntary process is evidenced by

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[1157] Ibid, p. 111.
[1158] E. Wymeersch, 'The Regulation of Takeover Bids in a Comparative Perspective' in Buxbaum, Hertig, Hirsch and Hopt (eds), *European Economic and Business Law* (Walter de Gruyter, 1996), p. 309.
[1159] K. J. Hopt (2000), supra n 1156, p.118.
[1160] J. Wouters (1993), supra n 1112, p. 271. Note that the DTI noted that the use of bearer shares is deeply entrenched in the commercial culture of other MS and the anonymity such shares give is highly valued therein; see T. Boyle, 'Barriers to Contested Takeovers in the European Community' (1991) 12 Co. Law. 163, p. 166.
[1161] K. J. Hopt (2000), supra n 1156, p. 131.

the fact that several companies both in the UK and France have enfranchised their non-voting shares. In particular, in the UK, throughout the 1990s, many companies with separate voting and non-voting share classes unified their capital structure and endorsed the 'one-share-one-vote' approach[1162]. Likewise, many companies in France have abolished their double voting rights. This is fortunate, since the use of dual class share structures put companies in MS that prohibit such structures at a disadvantage. On the other hand, offeree managements are increasingly refraining from resorting to post-bid defences. This is so even in countries such as Germany where post-bid defences are more easily used. Indeed, during Vodaphone's hostile bid for Mannesmann, the offeree board did not resort to any frustrating action. The only means by which the Mannessmann board defended itself was to argue the merits of its strategy against the Vodaphone alternative[1163]. The above examples indicate that market-induced reforms actually constitute a stronger force for convergence than explicit efforts at harmonisation[1164].

The rationale underlying this voluntary process is the increasing competition among European exchanges and the increasing share of foreign institutional investors in continental capital markets. Indeed, companies have become aware that investors are increasingly attracted to exchanges which better protect shareholders' interests. Indeed, when a jurisdiction's laws or regulations offer substantial scope for self-serving managerial conduct, the shares of companies incorporated in that jurisdiction usually trade at a substantial discount[1165]. Such an outcome worries managers, as poor share price performance is likely to lead to a hostile takeover bid or to an appeal by institutional investors asking the managers to resign[1166]. As a result, companies have become aware that they will benefit from a higher premium in their share price and secure a lower cost of capital only if they take into account investors' concerns. As Mayer (2003) rightly put it

[1162] J. Palmer, 'Why EU Takeover Plans Would Freeze Europe's Markets' (2002) 21 I.F.L.Rev., p. 15.
[1163] J. N. Gordon, 'An International Relations Perspective on the Convergence of Corporate Governance: German Shareholder Capitalism and the European Union, 1990-2000' (2003), p. 35, available at SSRN website.
[1164] Ibid, p. 35.
[1165] B. R. Cheffins (1997), supra n 887, p. 445.
[1166] Ibid, p. 445.

'Strengthen investor protection and financial development will follow. This will promote external finance, which will accelerate economic growth'[1167].

As a result of this voluntary process, this author believes that even the above-mentioned path-differences between the UK and France will likely be eliminated over time by the capital markets. It is further believed that market forces will over time transform the takeover regimes of all continental European countries along the lines of that of the UK. This in turn will render the Directive's break through and neutrality rules irrelevant. Until this occurs, the UK could actually become the leading jurisdiction for European incorporations, given the high level of protection afforded to shareholders in the UK[1168]. Indeed, the Code fosters a balance of power between the offeree management and the offeror by imposing a strict neutrality rule upon the former and by severely restricting the conduct of the latter[1169].

It should be noted, however, that such *de facto* harmonisation in the field of takeovers will certainly not happen overnight, mostly due to the concentrated ownership structure of most listed companies in continental Europe. As Becht (2003) rightly puts it, widely held companies arise 'naturally' over time[1170]. The process is further complicated by the fact that ten new countries with developing capital markets have joined the EU on the 1st of May 2004. It is too early to predict whether the entry of these ten countries will significantly delay the process of *de facto* harmonisation in the field of takeovers throughout Europe. However, it is believed that, by 2011 – which is the date when the Commission will re-examine the Directive and re-evaluate the control structures and barriers to takeovers that are not covered by the Directive[1171] – at least some of these structures and barriers will have disappeared.

[1167] C. Mayer, 'Corporate Governance: A Policy for Europe' (2003), p. 1, available at http://www.sgvs.ch/ documents/Congres_2003/papers_jahrestagung_2003/ Colin- Corporate%20 Governance%20A%20Policy%20for%20Europe. pdf.
[1168] G. Hertig and J. A. McCahery (2003), supra n 1049, p. 10.
[1169] C. Kirchner and R. W. Painter, 'European Takeover Law-Towards a European Modified Business Judgment Rule for Takeover Law' (2000) 2 EBOR 353, p. 357-358.
[1170] M. Becht (2003), supra n 1154, p. 13.
[1171] Directive, art. 20.

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