The European Takeover Bids Directive and its applicability in the business groups with pyramid ownership structure

Master thesis

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Introduction

On the 21st of April 2004 the European Parliament and Council approved the Directive 2004/25/EC, The Takeover Bids Directive \(^1\) (hereafter ‘Takeover Directive’ or ‘Directive’). The purpose of the Directive was to harmonize European Union (hereafter ‘EU’) capital markets and strengthen the competitiveness on the international ground. The aims of the Directive in general are to make the EU internal market more effective and to offer more protection to weaker parties. After seven years it is unfortunately questionable whether the Directive has been serving its purposes.

Many scholars have argued about the strengths and weaknesses of the Directive. It has been said that because of too general provisions the implementation differs vastly amongst Member States, which means that the aim to harmonize EU capital markets has not been reached successfully. Another important issue that scholars have raised, is the actual counter-effect of what was first planned – namely the Directive sets some too burdensome, costly and time-consuming rules for companies (especially offerors \(^2\)), which actually in practice might have decelerating or reducing effect on takeovers and this in turn may harm the EU takeover market.

In a simplified way – the takeovers results the merging of two separate companies. When there are just two separate independent companies, the procedure can be relatively smooth. Questions arise, what happen if parties (at least the target company) are involved into the complicated corporate schemes. Due to the fact that corporate governance and ownership structures are getting more and more sophisticated and have more cross-border dimension, the harder it is for the legislator to keep up with the economy and environment around them.

In my Master thesis paper I take a closer look at the Takeover Directive. Due to the fact that there is not much research related to the application of the Directive in complicated corporate ownership structures, the main research question of this thesis paper is: *If an*

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\(^2\) Hereafter the terms offeror and bidder are being used with equivalent meaning.
offeror acquires a subsidiary in a vertical group of companies, does he/she has the obligation to make a mandatory bid to acquire the shares of other shareholders in the lower level subsidiaries?

I research the work of academics to analyze pros and cons, strengths and weaknesses of the Directive, but also different opinions and approaches to the Directive. I also research the situation of EU capital market on the world wide scale, and also the status quo of the corporate governance in EU, and find answers to what could be the best possible solution to strengthen and harmonize (if harmonizing at all!) the EU capital market and what could be positive aspects and possible downsides of this.

In this thesis paper I want to show that the European Takeover Bids Directive has not been serving its purposes because the current mandatory provisions of the Directive are too general and therefore easily avoidable or differently interpreted, and it does not provide enough harmonization and protection in the current corporate governance field. Another goal is to prove that the European Takeover Bids Directive needs serious and comprehensive revision. If regulators decide to stay on the path of having the European takeover directive, its wording should be more concrete and it should provide more solutions for current EU capital market and corporate governance needs. And most importantly, I want to show if and how the Takeover Bid Directive applies, if a party acquires a company that is a holding company at least for one corporation in a vertical group of pyramid structure companies. I question if in such cases the bidder has the obligation to make a bid to acquire the shares of other shareholders in the group subsidiaries.

The paper is divided into three main parts. In the first part I analyze what have been the Directive’s aims and consequences, and how this Directive has affected the EU internal market and companies acting in this economic environment. In the second part of this paper I take a look at the group of companies and the ownership structure in the EU, and analyze the main question of this paper – the essence and effect of the Directive in the pyramidal conglomerate. In the third part I explain if the Directive works as it was supposed to and if and to which extent the Directive needs revision. Last part concludes.

The European Takeover Directive entered into force in 2004. It ensures strict board neutrality from the board of the target company; a mandatory bid rule to avoid the situation where an offeror can obtain a controlling stake without making a controlling bid; and breakthrough rules, which stipulate that during the period of acceptance of a bid any barriers on the transfer of securities contained in the articles of association and contractual arrangements (but not in national legislation) are not enforceable against the offeror. The Directive also provides disclosure rules, according to which the offeror must announce his/her intention to make an offer and make an offer and publish document containing at least a minimum amount of necessary information, ‘squeeze-out’ and ‘sell-out’ rules that have to be exercised at a fair price, and an opt-out provision, which allows Member States to exempt companies from applying the board neutrality and break-through provisions.\(^3\) The due date to implement the Directive into the Member States’ national laws was 20\(^{th}\) of May 2006.\(^4\)

In the first chapter I introduce the Directive, its aims, means, its most important provisions and how Member States are implementing them.

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\(^4\) The Directive (n 1) Article 21.
1.1. 'The story' of the Directive

The European Takeover Bids Directive, as we can read it today, has probably been one of the most difficult legislative acts to reach in the history of EU. Despite its harsh history, some scholars still consider it as one of the strongest regulatory examples of the EU market for corporate control that appreciates fully the interrelation between EU internal corporate governance and capital market. 5 Which view is closer to the real situation, can be evaluated later on in this paper.

The first draft of the Takeover Directive was produced in 1974. Due to number of reasons the European Parliament and Council rejected it. After several years, in 1985 the Commission published White Paper on Completing the Internal Market, which also referred to harmonization of takeover regulation. 6 The second official European Commission proposal for establishing the Takeover Directive was made four years later, in January 1989. Since the presented form of the draft was not accepted, the amended proposal was presented in 1990, and discussions around it were carried out until 1991, when negotiations on the proposal were suspended. 7

In the beginning of 1996, the Commission presented a streamlined proposal of the Directive. Since there were concerns related to the important subsidiarity principle in the EU law8, this proposal was still not acceptable to the Member States. Afterwards the Economic and Social Committee worked on changing the proposal, which was published in a revised form in 1997. The proposal was rejected again. 9

In 2001, after numerous amendments by both Commission and Parliament, the Commission and Parliament reached a compromise regarding the general understanding of necessary provisions and principles, which should have been adopted with the

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7 B McCall, D Schulman, ‘Director Neutrality - An Obstacle in the Path of EU Takeover Harmonization (May 2002)
8 T G Papadopoulos (n 5) 56.
9 A Johnston (n 6) 268-280.
Takeover Directive. In 2001 the Commission proposed the third official version of the Directive to the Parliament. But since it had not followed entirely the Parliament's proposals (especially the employee protection principles\(^{10}\)), it was rejected with a tied vote of 273 votes.\(^{11}\)

After another and the biggest failure, in 2002 the Commission established an experts' team named High Level Group of Company Law Experts (hereafter ‘HLGCLE’), whose responsibility was to report and provide an independent advice on the issue of takeovers, and to assist with the presentation of a new draft of the directive, especially ensuring the concept of a 'level playing field', definition of 'equitable price', and introduction of the squeeze-out provision.\(^{12}\)

Finally, after fourteen years of negotiation and work, on the 21\(^{\text{st}}\) of April 2004, the Takeover Bids Directive 2004/25/EC was approved by the EU Parliament and Council.

During the fourteen years of disputes over the Directive, the proposed prohibition on defensive measures, the breakthrough rule, or employee protection provisions did not fit with several different EU jurisdictions or political tendencies.\(^{13}\)

One of the reasons why the Directive was approved in 2004, was a controversial compromise that guaranteed Member States the opportunity to choose if they apply the two most important provisions: Article 9 of the Directive – the board neutrality principle that prohibits target companies from taking defensive action to frustrate bids without shareholder approval; and Article 11 of the Directive – a breakthrough rule, which allows offerors to breakthrough certain target company restrictions so that they can achieve full control of the target company.\(^{14}\)

Probably another relevant reason for approving the Directive in 2004 was also the expansion of the EU. Several new (especially Eastern-European) countries entering to the internal market did not have available takeover law, practice, and even knowledge.

The result of more than 14 years of negotiations, drafting and rejections, was the Takeover Directive, which turned out to be a political compromise that tries to balance

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\(^{10}\) A Johnston (n 6) 268-280.
\(^{11}\) A Johnston (n 6) 268-280.
\(^{12}\) A Johnston (n 6) 268-280.
\(^{13}\) A Johnston (n 6) 268-280.
completely different mentalities on takeover regulation.\(^\text{15}\) What are the aims of the Directive and how they have been drafted, implemented and how they work, is being discussed in the next sections.

### 1.2. The aims of the Directive

In the most wide explanation, the main purpose of harmonization in the area of company law is the realization of an internal market as proclaimed by Article 3(c) and (h) of the EC Treaty.\(^\text{16}\) The aim of the Takeover Directive is to contribute to the harmonization of the area of company law in EU, and therefore fulfill the EU Treaty's principles of freedom of establishment (articles 49 and 50 of TFEU).\(^\text{17}\) With the harmonization it also aims to make the business activities in the EU easier, more transparent and offer more certainty. This, in turn, is expected to boost the improvement of the competitive positions of companies in Europe\(^\text{18}\). In its last proposal on the Directive to the European Parliament, the Commission pointed out that the aim of the Takeover Directive is to integrate European markets, strengthen the legal certainty, to protect minority shareholders, and to establish legal framework for Member States to adopt the detailed implementing rules.\(^\text{19}\)

Takeovers are considered as effective means to redeploy corporate assets and discipline underperforming management, to create higher benefits and returns for corporation, its shareholders, and the economy.\(^\text{20}\) The importance of (cross-border) takeovers in the EU lies in the fact that many European companies should grow to an optimal size, while the financial markets should benefit as well from the liquidity. Next to that takeovers are means for the investors to create synergies between existing businesses and target

\(^{15}\) T G Papadopoulos (n 5) 134.
\(^{16}\) T G Papadopoulos (n 5) 19.
\(^{17}\) T G Papadopoulos (n 5) 9.
\(^{18}\) T G Papadopoulos (n 5) 137.
Another important factor is the external growth of corporations, which is important to be more competitive on the worldwide level.\textsuperscript{22} As already mentioned earlier, probably one of the reasons that elicited the approval of the Directive in 2004, was also the expansion of the EU with ten new Member States. Due to the fact that some of these countries did not have any takeover regulation at all, and all the Member States had different regulatory level in this area, the establishment of at least minimum standards was crucial. For example, there were several legal, economic, and structural differences amongst Member States when it came to the defensive measures that the board of the target company could use to fight against the hostile takeover bids. This, in turn, meant that companies in some Member States were better protected than in other Member States.\textsuperscript{23} Therefore, another aim of establishing the Takeover Directive was to harmonize the company law in the takeovers field and eliminate discriminatory treatment by creating at least minimum requirements, also in the countries where there was no takeover regulation at all. It can also be believed that the harmonization attempt is a mean to prevent the Member States to regulate the takeover bids in a protectionist way by encumbering the access of potential investors from other Member States.\textsuperscript{24}

The purpose of the Directive is to establish a ‘leveled playing field’ for the takeovers in the EU internal market. The plan was to draft a kind of “EU Takeover Code” (by mainly following the UK Takeover Code), but due to the level of political compromises that were achieved by 2004 when the Directive was adopted, it is rather a framework directive that establishes certain minimum standards for the regulation of takeovers.\textsuperscript{25}

To create the ‘leveled playing field’ in the EU market for corporate control is probably the most important aim of the Directive. The theory of the leveled playing field states that regulated companies should have the same regulatory costs as those in other countries, so that the lesser regulation in one country does not give that country’s corporations an

\textsuperscript{21} T G Papadopoulos (n 5) 136.
unfair competitive advantage. The leveled playing field that the Commission wanted to achieve was that Member States should have similar regulatory grounds concerning the takeovers to avoid the unfair competitive advantage that one Member State’s company bears fewer costs than the company from other Member State. It means that companies within one Member state should be treated equally without making a distinction if they are residents of this Member State or not.  

This should comply with general EU-wide non-discrimination principle.

Due to several major corporate scandals in the beginning of 21st century, the Directive likely also aimed to react to prevent similar problems in the future. These scandals motivated the EU to seek more solutions to protect shareholders, to make corporate activities more transparent, and to strengthen the market for corporate control.

Since the EU is the union of countries and based to main extent in political compromises, the Directive was also drafted to be as flexible as possible for Member States. In the next section I give an overview of how the important provisions function and what their effects are.

1.3. The main principles of the Directive

There are several reasons that actuate mergers between companies. Mergers allow corporations to allocate assets more efficiently, to ease the entrance to the new markets, to gain access to new know-how, and to replace incumbent management teams. The latter, replacement of management, is the one that has gained a lot of heated discussions concerning the Directive.

“A takeover can be defined as a transaction or series of transactions whereby a natural or legal person or group of persons acquires control over the assets of a company, either directly, by becoming the owner of those assets, or indirectly, by obtaining the control of

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27 I.e. Parmalat, WorldCom, Enron.
"the management of the company." This Definition shows that takeovers have a wide range. In case where shares of the company are closely held, the takeover process is more simplified since it will generally need just an agreement with the majority shareholders. But when it comes to publicly held companies, the takeover process is influenced either by the agreement with the controlling shareholders of the target company or by the takeover bid.

Therefore, due to the fact that takeovers lie in the border between the capital market law and company law, it is difficult to regulate it only in the light of company law. The Directive regulates takeovers formally as a part of Company Law Harmonization Programme under the scope of Thirteen Company Law Directive, but in principle it regulates important parts of EU capital markets and the EU market for corporate control.

Sometimes it may create controversial results and outcomes. Because of the essence of the takeovers, it is important to realize that the Directive applies only for entities listed on a regulated market in the EU. Not all markets are regulated markets. For example, companies listed on the junior or high-tech markets are generally not covered by the Directive. And sometimes it may also be problematic if one of the companies in the takeover process is outside the EU.

In general, the Directive follows six principles that Members States are required to comply with. First, all shareholders of the target company with the same class shares shall be treated equally, and if a person acquires control of a company, the other holders of securities must be protected. Second, shareholders of the target company must have sufficient time and proper information concerning the bid, because they should be able to reach a well-acknowledged decision about the bid. And the board of the target company must give its shareholders its views on the effect of the bid on employment, conditions of employment and location of place of business of the target, which means that to certain extent the employee protection principle during the takeover should be followed. Third

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30 M A Weinberg, M V Blank, A L Greystoke (n 29) 3.
31 Papadopoulos T G (n 5) 99.
33 H Smith, G Lutz, Stibbe, Cuatrecasas and Gianni Origoni Grippo & Partners (n 25) 3.
general principle of the Directive states that the board of the target company must act in the interests of the company as a whole. Furthermore, the Directive prohibits the creation of false markets by the bidder, the target, or by any other company involved in the bid; meaning that the price of the securities is not allowed to be artificially raised or lowered and the normal functioning of the markets should not be distorted in any way. Another principle of the Directive also brings out the reasonableness requirement and aims to prevent the uncertain distortions in the market by stating that an offeror must announce a bid only after taking all reasonable measures to secure the offered bid can also be brought to a positive outcome. And lastly, the target company should be able to continue its work after the bid is announced, and not be hindered by a bid for its shares for longer than is reasonable.  

From the procedural perspective, the Directive follows mainly the ‘comply or explain’ principle, which also has its roots in the U.K. Cadbury code. Due to the fact that two of the provisions of Directive (Article 9 and Article 11) are optional provisions, the ‘comply-or-explain’ is being considered as a good mechanism to incentivize Member States to imply these provisions.

Next I will describe in more detail the essence and result of the main provisions in the Directive.

1.3.1. The mandatory bid rule

The mandatory bid rule is stated in the Article 5 of the Takeover Directive. In the takeover process the mandatory bid rule sets to the offering party, who acquires the control in the target company, an obligation to make an offer to all remaining minority shareholders at an ‘equitable price’. This rule plays an important role especially when the target company has a dispersed ownership structure. The aim of this provision is to

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35 Papadopoulos T G (n 5) 103-104.
provide the minority shareholders an opportunity to exit the company at the fair conditions to protect them from the offeror who may be tempted to exploit its private benefits of control at the expense of minority shareholders.  

Article 5 is mandatory for all Member States but they are free to decide how to regulate its implementation and how to define the terms. Hence, there are several issues that arise from the Directive’s text concerning the mandatory bid rule. According to the Commissions Report (2007) on the Takeover Directive, it can be seen that most of the Member States are using wide flexibility in the national law that gives the opportunity to have the exemptions to apply the mandatory bid rule.

Main issue rising from the mandatory bid rule, which shows the controversial result for harmonization attempt, is the fact that it is not defined what does the ‘control’ mean. Under the Directive, the Member States are free to determine the percentage of voting rights that should grant a ‘control’ to the shareholder, and also the method how this percentage is calculated. This has already proven to be a problem because thresholds for giving a control in order to apply of mandatory bid rule vary amongst Member States roughly. For instance, the named threshold in most EU Member States are over 30% or 33%, but for instance in Slovenia it is 25%, in Czech Republic and Lithuania it is 40%, in Estonia, Latvia and Malta it is 50%, and in Poland it is 66%. Plus there is difference in additional requirements. This leads to several issues that may appear in cross-border takeovers when offeror and target are subject to different rules. It also proves that the harmonization level is not sufficient.

Concerning the threshold of ownership, several issues may occur in case of dispersed ownership because to obtain real control over the company, the shareholder may need relatively small percentage of shares. Hence, in such cases the aim of mandatory bid is not

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that much to protect the minority shareholders but to deal with the changes in ownership structure and control, which is caused by the actions of a large blockholder. 41

According to the Article 5 of the Directive, it aims to protect the minority shareholders’ rights. But it is questionable if the minority shareholders are protected equally for instance in case the takeover is in nature value-increasing or value-decreasing. This depends on the answer to the question, what means the ‘equitable price’ that should be offered to the minority shareholders? In the Directive it is stated that the fair price for the offer is the highest price paid for the shares of the relevant class in a period of twelve months prior to the bid in the market. This leads to another concern.

There is an issue also related with the time period based on what the fair price is calculated. This is stated in the subpart 4 of the Article 5, which states that the price of the securities should be determined by the highest price paid for the same securities over the period that Member States has to determine but this period has to be between six to twelve months. The problem is that half a year is a too broad period to harmonize the area, especially when it comes to determine the share price, which is very sensitive and may change several times even during 24-hour period.

The fact is that wide discretion of the Member States grows the risk for national protectionism 42 and Commission Report (2007) on the implementation of the Directive can be understood in a way that Member States have decided to choose the most suitable regulation for their jurisdiction, which means that the main aims and principles of the Directive are being set aside.

The Mandatory bid is often seen by the scholars as a red light for the bidders because it may create too burdensome and costly transactions that they would rather avoid. This in turn decreases the likelihood of the value-creating restructuring in the EU corporate field.43

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41 J A McCahery, E P M Vermeulen (n 39) 7-10.
42 Papadopoulos T G (n 5) 117.
1.3.2. Squeeze-out and Sell-out

Article 15 of the Takeover Directive sets grounds for squeeze-out rights that aim to incentivize the takeover activity by creating the offeror the possibility that acquiring certain percentage of shares (s)he is able to require all the holders of remaining shares to sell them to offeror at a fair price. 44 Article 16 of the Directive, which sets the grounds for sell-out rights, applies *mutatis mutandis* as Article 15, and aims to protect minority shareholders by granting them the right to sell their shares to the bidder if (s)he acquires certain amount of the shares in the target company.

Articles 15 and 16 of the Directive shall apply in cases when the bidder acquires over 90% of the shares in the target company. The Member States have the right to determine the specified threshold, which has to stay between 90% and 95%.

Squeeze-out and sell-out provisions in the Takeover Directive may be two of the most positively treated provisions by the scholars and critics. Considering the general principles and aims, described in the section 1.2. of this paper, it can be concluded that these to regulations written down in Articles 15 and 16 reach the goal the most.

The HLGCLE concluded in its Report 45 that the squeeze-out provision incentivizes the takeover activity because it helps bidder to prevent the agency problems and costs. It helps the majority shareholder to simplify the managing and restructuring the company and reduce the unnecessary and troublesome costs related to minority shareholders, which in turn increase the likelihood of the value-increasing takeovers. 46

And on the other hand, sell-out provisions should also protect the minority shareholders by offering them a proper exit opportunity. Nevertheless, this at first view successful provision has its downsides. Namely, according to the Article 16(1) of the Directive, the sell-out right shall apply when the bid is made to all holders of the target company’s securities for all of their securities. Hence, this can occur as a voluntary bid or a

44 *Freshfields Bruckhaus Deringer* (n 14)
The voluntary bid should not raise significant issues, but the mandatory bid may turn out to be relatively problematic, as described in the previous section. Due to the fact that the regulation of mandatory bid rule depends mainly on the Member State regulation, it varies from state to state. Therefore, the exercise of the sell-out right may vary from case to case and it can depend on the national exceptions to the mandatory bid rule. This means that minority shareholders may not be properly protected each time.

1.3.3. Anti-Takeover devices: Board neutrality and breakthrough rule

Anti-takeover measures are defined as periodic or continual measures that a company’s management takes to discourage unwanted or hostile takeovers. In principle, takeover defenses include all the actions, taken by managers of the company, to resist having their corporation acquired by third party. Such corporate devices can be categorized into two groups: pre-bid defenses and post-bid defenses. Pre-bid defenses are measures that aim to prevent successful takeovers. Such defensive actions may be, for instance, barriers to acquire the shares or exercise control. The Directive tries to prevent such defenses with the breakthrough rule that will be discussed below. Post-bid defenses are barriers that aim to prevent the acquisition of control or increase the cost to acquire the control. Post-bid defenses are being launched after the board of the target company gets the information concerning the bid. The Directive aims to prevent such defenses with the board neutrality rule that will be discussed below.

There are many different corporate devices, which can be considered as defensive measures to protect against takeovers. For example, shareholders agreements, multiple voting right shares, non-voting shares, non-voting preferred shares, priority shares, golden

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48 T G Papadopoulos (n 5) 119.
51 Report on the implementation of the Directive on Takeover Bids (n 38) 4-7.
shares, macaroni defense, staggered board elections, poison pills, voting right ceiling, ownership ceiling, super-majority provisions, cross shareholdings, pyramid structure, etc. The reasons why shareholders of a target company may be willing to approve such (sometimes very costly) can be the motivation of the management board or a tool to negotiate upon the higher price for the bid.  

Article 9 of the Takeover Directive sets a limit that the board of the target company is not allowed to take any defensive actions to frustrate successful bid. Article 11 of the Takeover Directive sets the breakthrough rule, which prohibits using any previously existing anti-takeover measures. Under the Article 12, the Member States can opt-out (discussed below) from both of these provisions.

The board neutrality requirement, determined in the Article 9 of the Directive, states that the board of the target company is not allowed to do anything that may be harmful for the bid in the takeover process, besides looking for an alternative bid or any other measures that have prior authorization of the general meeting of the shareholders of the target company for this certain purpose. If the target company has two-tier board structure, the restriction to frustrate the bid applies to both, supervisory and management board. Some scholars argue that instead of the term ‘board neutrality rule’ the term ‘non-frustration rule’ should be used because it would be more precise since the board of the target company should just act in a manner that does not frustrate the bid and it is unreasonable to require them to be fully neutral. This rule is being seen as a way of protecting the interest of shareholders and fulfilling the aims of legal basis of Article 44(2) (g) of the EC Treaty (Article 50 of TFEU).

The breakthrough rule, determined in the Article 11 of the Takeover directive, states that any restrictions on the transfer of securities provided for in the articles of association or by other contractual agreements, shall not apply to the offeror in the takeover process during the time allowed for the acceptance of the bid, which may be between two and ten weeks, depending on the Member States decision. The concept of breakthrough rule aims

53 Freshfields Bruckhaus Deringer (n 14)
54 Freshfields Bruckhaus Deringer (n 14)
56 T G Papadopoulos (n 5) 120.
to eliminate pre-bid defenses that may cause barriers to the emergence of an efficient inter-EU takeover activity.  

The idea of the HLGCLE proposed breakthrough rule was that the shareholders should decide upon the takeover, and that the decision process should be proportional.  

A breakthrough aims to follow the principle that the bigger shareholder’s stake in the target company is, the bigger is this person’s risk and ownership and therefore (s)he should have more considerable voice in the takeover process.  

Hence, for instance all the multiple-votes securities shall carry only one vote at each when it comes to the decision regarding the takeover under the question. Mandatory disclosure rules, laid down in the Article 6 of the Takeover Directive, should create for the shareholders of the target company the presumptions to make a reasonable and well-considered decision.

The breakthrough rule causes problems for continental Europe corporate governance systems because its effect may alter the structure of ownership and concentration of voting rights of firms.  

One of the main elements of the breakthrough rule is the ‘one-share-one-vote’ principle, which says that at the shareholders general meeting that decides on any defensive measures concerning the takeover bid, multiple securities of shareholders carry only one vote each. This has gained a lot of attention in political debates because Member States are using different voting right structures.

Another problem to the European takeover activity in the internal market concerning the breakthrough rule lies in the possibility that allows Member States to opt out of this provision. This opportunity means that the Member States are allowed to decide whether control of the companies should be freely contestable, or whether control-enhancing mechanisms, such as multiple voting rights or voting caps, should be allowed to prevent a bidder who has acquired significant shareholdings from exercising control.  

This, in turn, creates uncertain situation for the possible bidders and makes the offer more risky. And this also creates a questionable situation concerning the shareholders contractual freedom. Namely, all different share types are previously agreed between the

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57 J A McCahery, E P M Vermeulen (n 39) 10-12.
60 G Hertig, J A McCahery (n 3) 565-568.
61 A Johnston (n 6) 268-280.
shareholders, or written down in the articles of association and agreed by shareholders who enter later. Therefore, it creates a situation where a Member State has a power to intervene the shareholders relationship and basically protect them from themselves. As stated above, under the Article 12, the Member States can opt-out from both of described anti-takeover defense provisions. In the next section I am going to research this opportunity and its possible downsides.

1.3.4. Opt-in and opt-out provisions

The Directive leaves Member States the possibility in several provisions to decide if they are aligning their national laws with the Directive or not. The decision to draft the Directive including such possibility was adopted mainly in response to Germany’s objections. After multiple failures having the Directive approved, the Commission had to secure the passage of the Directive through the European Parliament. 62 The main mandatory provisions of the Directive are general principles part, information provisions, disclosure provisions, mandatory bid provisions (with huge discretion rights on details and procedures), and sell-out and squeeze-out right provisions. Important optional provisions of the Directive are board neutrality principle and breakthrough rule. In case a Member State chooses to opt out from some or all of the possible provisions of the Directive, it must guarantee in its national law a possibility for the companies to implement those rules individually. Hence, Member States are free to choose if they make the Directive optional provisions mandatory for the companies, or grant the opportunity for companies to comply with these Directive provisions. This means that in the Member States, which decide to opt-out from Directive provision(s), there may be two types of listed entities – opted-in companies that apply the Directive's provisions, and the companies that do not follow the Directive provisions and are regulated only by the national takeover laws. 63 Hence, the Directive provides several opportunities to the Member States with optional breakthrough and board neutrality provisions. But probably

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62 T G Papadopoulos (n 5) 125.
63 S Bartman (n 55) 6.
it is difficult to notice at first look that with such regulation the Directive theoretically creates sixteen different takeover regulation regimes in the EU (See Table 1.). And if to add also the possibilities of individual/company level to opt into the Directive when the Member State has not done it, the variety grows even more.⁶⁴

<table>
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<tr>
<th>Different regimes that can occur in the EU takeover regulation:</th>
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<td>1. Member State has implemented only the board neutrality rule</td>
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<td>2. Member State has not implemented only the board neutrality rule</td>
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<tr>
<td>3. Member State has not implemented the board neutrality rule but ensures such opportunity on an individual company level</td>
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<tr>
<td>4. Member State has implemented only the board neutrality rule and also provides the reciprocity clause only for board neutrality rule</td>
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<tr>
<td>5. Member State has implemented only the board neutrality rule and does not provide the reciprocity clause only for board neutrality rule</td>
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<tr>
<td>6. Member State has implemented only the breakthrough rule</td>
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<tr>
<td>7. Member State has not implemented only the breakthrough rule</td>
</tr>
<tr>
<td>8. Member State has not implemented the breakthrough rule but ensures such opportunity on an individual company level</td>
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<tr>
<td>9. Member State has implemented only the breakthrough rule and also provides the reciprocity clause only for the breakthrough rule</td>
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<tr>
<td>10. Member State has implemented only the breakthrough rule and does not provide the reciprocity clause only for the breakthrough rule</td>
</tr>
<tr>
<td>11. Member State has implemented both, the breakthrough rule or board neutrality rule</td>
</tr>
<tr>
<td>12. Member State has not implemented neither the breakthrough rule or board neutrality rule</td>
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<tr>
<td>13. Member State has implemented the reciprocity for both, the breakthrough rule and the board neutrality rule</td>
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<tr>
<td>14. Member State has implemented the reciprocity for the breakthrough rule and not for the board neutrality rule</td>
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<tr>
<td>15. Member State has implemented the reciprocity for the board neutrality rule and not for the breakthrough rule</td>
</tr>
<tr>
<td>16. Member State has not implemented the reciprocity clause for neither the breakthrough rule or board neutrality rule</td>
</tr>
</tbody>
</table>


Another tricky provision that makes the takeover market in the EU even more complicated is related to the Member States' possibility to opt-out - the reciprocity rule. This rule is stated in the Article 12 of the Directive and means that Member State of a target company can grant a possibility to exempt from the Article 9 and/or Article 11 if the offering company is not opted into (voluntarily or under the national law) and the target company is.

The problematic situation arises in example when the Member State, to which jurisdiction the target company is a subject, has opted out of the Article 9 and/or Article 11.(See Table 2.) In such a case the target company still has the right to opt into these articles, and if the target company has done that, then it may frustrate a bid made by another company registered in a same Member State and that has not opted in, but it may not frustrate a bid made by a company registered in the same Member State that has opted in. The board of the target company is also prohibited to frustrate the takeover offer made by a company registered in any other Member State that is subject to the relevant Articles, either because the relevant Member State has not opted out, or because, although the relevant Member State has opted out, the bidder has opted in. 65

Table 2. The system of reciprocity rule.

Hence, the aim to harmonize the EU internal market is still not fully met, because, in order to be sure, which are the effects and procedure of the bid, a potential bidder still has to know the legal framework in which the target company is allocated to, which raises enormously transaction costs for the offeror. 66

According to the Commission Report on implementation of the Directive, eighteen Member States have introduced the board neutrality rule in their national legislation; seven Member States had opted out from this rule (not counting Romania and Bulgaria who became EU Member States in 2007). Implementation of the breakthrough rule, on the other hand, has been rejected by most of the EU countries - according to the Commission Report only three Baltic States had made this provision mandatory for the companies. 67 This is probably because Member States have not wanted to intervene the shareholders contractual freedom, described above. Why Baltic states have implemented breakthrough rule, is questionable. Probably they aimed to foster the foreign investment inflow, or wanted to support the general harmonization of the EU takeover market. But the fact is that by doing so they may put their investors unfavorable situation, which may have negative effect on their economic situation and competitiveness. Also the importance of capital markets that three Baltic states is minor to harmonize the whole EU markets in general.

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67 Report on the implementation of the Directive on Takeover Bids (n 38) 7.

<table>
<thead>
<tr>
<th>Member State</th>
<th>Board neutrality rule</th>
<th>Breakthrough rule</th>
<th>Reciprocity option</th>
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</thead>
<tbody>
<tr>
<td>Austria</td>
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<td>No</td>
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<td>No</td>
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<tr>
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<td>*68 Probably no</td>
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<tr>
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<tr>
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<tr>
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<td>Yes</td>
<td>No</td>
<td>Yes69</td>
</tr>
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<td>No</td>
<td>No</td>
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<tr>
<td><strong>Romania</strong></td>
<td>*70 Probably yes</td>
<td>*70 Probably no</td>
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<tr>
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<td>No</td>
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<tr>
<td><strong>Total</strong></td>
<td>19 Yes / 8 No</td>
<td>3 Yes / 22 No</td>
<td>14 Yes / 11 No</td>
</tr>
</tbody>
</table>


69 Only for the board neutrality rule

1.4. The implementation and interpretation of the Directive

As briefly already mentioned in the previous sections, the Directive sets certain rules and requirements but due to the political compromise, it is too general and leaves many specifications in the discretion of the Member States. It aimed to boost the value-adding takeovers and create a leveled playing field to raise the competitiveness of the EU and its market. The effect of the Directive depends purely on the Member States and their reaction to it. In its 2007 Report, which provided an evaluation on how the Member States are implementing the Directive, the Commission had to face the fact that the Directive has not been used as expected.

As already mentioned in previous sections, eighteen Member States had implemented the board neutrality rule but it is important to mention that seventeen of them had already before such provision in their national law. The breakthrough rule was implemented only by three Member States, which were Baltic States – Estonia, Latvia and Lithuania. This means that two of the most important provisions of the Directive have not been fully approved by the Member States. Hence, the opportunity to still have these provisions working and serving their aim would be the case when companies opt into them individually. But opting in and opting out leads to another issue, which is the uncertainty and confusion, which in turn creates enormous transaction costs. Especially noteworthy is that fourteen Member States allow their companies to use the reciprocity exemption, and this, as already explained, leads to even less certainty in the takeover market.

The Mandatory bid rule is also creating concerns. As described above, Member States are using as much as possible the flexibility of the Directive in this matter. This means that Member States have implemented the mandatory bid rule but the additional nuances and definition of crucial terms, such as ‘control’ and ‘equitable price’, differ vastly. Therefore the implementation is not in a way as was expected, and it may even affect the takeover market contrary to the aim (discussed below).

There is also still an unanswered question, how the Takeover Directive applies in cases where target company has its seat in the EU but it is listed in the regulated market outside

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71 Report on the implementation of the Directive on Takeover Bids (n 38) 7.
EU. The current regulation of Directive already leads even inside the EU to situation where a takeover can be regulated by the rules of two different Member states. This situation may occur because the Directive states that a takeover is to be regulated by the supervisory authority where the target company has its registered office if its shares are admitted to trading on a regulated market in that member state, and if the company has incorporation and registration on a stock exchange in different Member states, the both regulation apply. Such a situation happened for instance in Deutsche Börse and the New York Stock Exchange’s battle for Paris-listed Euronext, which is incorporated in The Netherlands.

Even though, the Directive has not been welcomed by the Member States as wished by the Commission, the good thing about the Directive is that it sets to companies an obligation to disclosure more information, which should make the takeovers and the EU takeover market more transparent.

73 The Takeover Bids Directive (n 1) Article 4 (2) (a)
74 H Smith, G Lutz, Stibbe, Cuatrecasas and Gianni Origoni Grippo & Partners (n 25) 3.
2. The Takeover Directive and the group of companies

In the first chapter I introduced the European Takeover Directive, its aims, means and functions. As described, this Directive has not been very successful and it creates a lot of confusion and uncertainty in the EU takeover market. Nevertheless, this Takeover Directive has entered into force and therefore it brings legal obligations and consequences.

One of the principal aims of this thesis paper is to find out if and how the Takeover Bid Directive applies, if a person acquires a holding company in a vertical group of pyramid structure companies, then how the mandatory bid rule applies in such case. In the first part in this paragraph I will examine the structure of the companies group, which has a vertical pyramidal ownership structure and which is therefore controlled by an ultimate owner. Second half of this paragraph is dedicated to the application of the Directive in such cases.

2.1. Group of companies

A group of companies is a general term for companies, which ownerships and controlling power are somehow connected and related to each other. In the corporate world exists, for example, a horizontal structure corporate group that is being used to control the group’s member firms, or a company with the vertical pyramidal ownership structure that is controlled by one ultimate owner via several layers, or a business group that is directly controlled by the same owner. In this paper I concentrate on the vertical pyramidal ownership and its special features.

In this section I will introduce briefly the essence of a pyramidal ownership structure and status of group of companies in the EU.

2.1.1. The economics of pyramid ownership structure

A pyramidal ownership structure exists when the group of companies has an ultimate owner who controls via several hierarchically situated layers of companies, which has a separate legal entity status\(^ {76}\), and of which at least one of the companies in the hierarchy is publicly traded\(^ {77}\). The concentration of ownership is an opposite ownership concept for the dispersed ownership.

A pyramid ownership structure is considered to be one of the three main controlling-minority structure mechanism next to cross ownership and dual class equity systems.\(^ {78}\)

The legal status of the companies situated in a group can be explained with several different theories depending, for instance, on the statutory incorporation country and laws of the companies, the fiduciary duty of the dominant shareholder (parent company), or if the company is a separate entity (in some cases with exceptions where the veil of corporateness is pierced), or how to approach the situation from insolvency law angle.\(^ {79}\) It cannot be said immediately what theory should apply in takeover cases because it depends on the specific features of every case.

A company with concentrated ownership is controlled by an ultimate owner. The scholars distinguish five main categories of owners: 1) a family or an individual, 2) the State, 3) a widely held financial institution such as a bank or an insurance company, 4) a widely held corporation, or 5) miscellaneous, such as a cooperative, a voting trust, or a group with no single controlling investor.\(^ {80}\)

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\(^{76}\) K Gugler, 'Corporate governance and economic performance' (Oxford 2001)


\(^{78}\) R La Porta, F Lopez-De-Silanes, A Shleifer (n 77) 34-35.

\(^{79}\) C M Schmitthoff, F Wooldridge, 'Groups of Companies' (Queen Mary and Westfield College (University of London), Center of Commercial Law Studies, Sweet & Maxwell 1991) xiv.

\(^{80}\) R La Porta, F Lopez-De-Silanes, A Shleifer (n 77) 9.
In a company that has a pyramidal ownership structure, a shareholder, who is an ultimate owner, holds a controlling stake in a holding company that in turn holds a controlling stake in another company. Such chain system may continue via many corporations. Usually the last 'chain' or 'layer' of a pyramid structure is an actually operating company. Pyramids are the most widely used mechanisms for concentrating the control without having to make large equity contributions.

The pyramid ownership structure enables the ultimate owners (the actual controllers of the companies in a pyramid structure) to separate the ownership and control of the companies involved in a pyramid by establishing control disproportionately to the amount of ownership (s)he has in every lower layer company. This enables the ultimate owner to have the control even in the lowest layer of the group and meanwhile having relatively small economic stake, and therefore also less risk, in this company (See Table 4). Hence, pyramid structure dilutes the actual minority shareholders ownership, which in turn harms the interests of minority shareholders. Noteworthy is that in every layer usually there are always non-controlling minority shareholders. This, for instance, is also one of the reasons why the Takeover Directive requires strict information disclosure also about the ownership structure.

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82 R La Porta, F Lopez-De-Silanes, A Shleifer (n 77) Table 1 and 2.
84 J Winter et al (n 45) 6.
Table 4. Simplified example of the pyramid structure. The scheme shows that Ultimate Owner has hidden direct voting rights in every layer in the hierarchy, and since it actually controls all the companies in the pyramid that has the majority shares in different companies, it also controls the whole pyramid.

2.1.2. The ownership structure in the EU

To prove the importance and actuality of the research topic of this thesis paper, I examine in this section the status quo of the ownership structure and the legal framework that regulates the group law. Many scholars have conducted surveys to find different patterns for describing ownership structures around the world and in EU.
For example, La Porta et al\textsuperscript{85} examined in 1998 the corporate ownership around the world and found that even the largest firms in the big economies tend to have a controlling shareholder, who very often is a family. They also found that the pyramids have a huge stake in wealthy economies. Faccio and Lang\textsuperscript{86} researched 5,232 companies concerning the ultimate ownership in Western European companies in 2001, and had to conclude that about 37 percent of the companies were widely held and 44.3 percent of the companies were family-controlled, whereas stating that widely-held companies were more common in UK and Ireland and continental Europe had more concentrated ownership structure. Grant and Kirchmaier\textsuperscript{87} analyzed in 2006 the corporate ownership structure and performance in Europe and found similarly that in continental Europe the concentrated ownership is predominant, even though it is important to note that they included only 100 public firms in five major European economics. Sherman and Sterling\textsuperscript{88} conducted a research in 2007 and despite the small number of companies included to the research (464), they had to conclude that usage of pyramid structures is very widespread in the EU. According to the Report on the Proportionality Principle in the EU\textsuperscript{89}, the pyramid structure is available in all EU Member States and their actual use as control enhancing mechanism is 75%.

\textsuperscript{85} R La Porta, F Lopez-De-Silanes, A Shleifer (n 77)
\textsuperscript{86} M Faccio M, L H P Lang, ‘The Ultimate Ownership of Western European Corporations’ Journal of Financial Economics (October 2001)
\textsuperscript{87} J Grant, T Kirchmaier, ‘Corporate Ownership Structure and Performance in Europe’ CEP Discussion Paper No. 0631 (July 2005)
\textsuperscript{89} ‘Report on the Proportionality Principle in the European Union. Proportionality Between Ownership and Control in EU Listed Companies’ (n 88) Figure 3.4.
Table 5. The usage of pyramid structure in the 16 EU Member States in 2007. Source: External Study Commissioned by the European Commission, 'Report on the Proportionality Principle in the European Union. Proportionality Between Ownership and Control in EU Listed Companies' (ISS Europe, ECGI, Shearman & Sterling, 18 May 2007) [Author’s note: this data is based only 464 listed companies in total, therefore it can be assumed that in reality these percentages are even higher.]

Even though the statistics does not show the usage of pyramid structures in all EU Member States and in all companies, it does not mean that all the member states and the whole internal market are not affected by this. EU internal market is an open area and aims the freedom of establishment and freedom of movement, and many companies involved to the pyramid structure have a cross-border dimension.

As showed, the groups of companies are very common corporate mechanism in the EU. Tables and data above show that even looking at the small stake, the EU has in general dominantly concentrated ownership structure and wide usage of pyramids. Despite this fact, not all the countries in the EU have the separate group law. Only Germany, Portugal and Slovenia have a codified law of groups. In other Member States the regulation of the group of companies is mainly regulated in general company law act and other laws. 90

There is no harmonization concerning the group law in the EU. Some aspects related to the group of companies are regulated, in example the so-called Seventh Company Law Directive that regulates the consolidated accounts of companies with limited liability. In the next section I show how does the Directive apply in previously described structures.

2.2. How does the Directive apply for the group of companies?

The main research question of this paper is that if an offeror acquires a control of the pyramidal group, then how far the mandatory bid requirement reaches. It is questionable that if an offeror acquires a control at some level (which is not the bottom layer) in the hierarchy of the pyramidal group, then does (s)he has an obligation to make the offer to buy the securities of the minority shareholders in directly acquired company and also shareholders in the companies that this target company controls.

Concerning the groups of companies, especially pyramid structures, the HLGCLE stated in one of their Reports 91 that for instance the breakthrough rule should remain outside the scope of Directive, since in case if it would apply on the pyramid, it would apply to the

90 S Grundmann, F Möslein (n 22) 626.
91 J Winter et al (n 45) 6, 38.
whole network and therefore it would be complicated, costly and also harmful for the
(especially minority) shareholders. As mentioned above, the ultimate owner in a pyramid
structure may have the control over the company by having relatively small economic
stake in it; therefore such disproportional situation may often be solved with multiple
voting rights shares.\footnote{\textit{J Winter et al} (n 45) 38.} Hence, allowing breakthrough rule that includes one-share-one-vote principle is harmful for minority shareholders. Another thing that the HLGCLE
mentioned concerning the pyramid structure was the necessity of the reasonable
disclosure about the ownership structure.

The HLGCLE raised concern that the pyramid structure companies may be harmful for
the takeover market, since they show the ownership structure of the publicly traded
companies less transparent. In addition, the HLGCLE also believes that the pyramid
structures affect the pricing mechanism of the listed shares at all layers in the structure
hierarchy, and they address the risk that controlling shareholders take to the minority
shareholders who are unable to exercise control at any level.\footnote{\textit{J Winter et al} (n 45) 39.}

Hence, the HLGCLE pointed out the complex situation related to the pyramid structure.
Yet, the Directive itself, which actually has the legal consequences, does not deal with the
issue (at least not understandably). This leads to the problem, how should the Directive be
interpreted in cases related to the pyramid structure? This is not an easy question to
answer, because it can be viewed and argued from several point of views.

General requirements for Directive to apply are that the target company has to be covered
by the laws of the EU Member State, and that it is a listed company on the regulated
market in the EU. And for mandatory bid rule to apply according to Directive a bidder
should acquire securities in the target company, that gives him/her directly or indirectly a
specified percentage of voting rights in that company, and giving therefore him/her the
control of the company. If this is accomplished then the bidder must make a bid as a
means of protecting minority shareholders of that company, therefore this mandatory bid
must be made to all the holders of those securities for all their holdings at equitable price.

\footnote{\textit{The Takeover Directive} (n 1)
As explained in the previous chapter, the aim of mandatory bid is to provide the minority shareholders an opportunity to exit the company at the fair conditions to protect them from the bidder who may be tempted to exploit its private benefits of control at the expense of minority shareholders. Therefore, the same principle should apply in the group of companies because if the bidder acquires control in the company that in turn holds control in the lower level company or companies, then the minority shareholders face the same situation – the person, who has the control in an entity where they have taken a risk to invest, changes if they want it or not.

Thus, according to the aim and the text of the Directive, it can be said that if an offeror acquires a control at some level, which is not the bottom layer, of the pyramidal group, then (s)he theoretically should have an obligation to make the offer to buy the securities of the minority shareholders in directly acquired company and also shareholders in the companies that this target company controls. This approach, of course, raises several concerns.

First issue would deal with the jurisdiction and applicable law. Namely, if a bidder has to make an offer to companies in different countries and they have different national requirements for mandatory bid; for instance, if Member States have different threshold and additional requirements for defining ‘control’. As showed in the second chapter of this paper, the definition of 'control' varies significantly amongst the Member States. Or what is the situation if concerned lower level companies are not listed? The Directive applies only to the companies that are listed on the regulated market in EU. Which in turn would lead again to already raised questionable situation - what if some involved companies are not covered by the law of some EU Member State or what if they are listed in the regulated market outside EU?

Probably these raised questions could be solved in theory. Concerning the applicable law, it would be reasonable to assume that the whole takeover process allocates to the laws of the Member State under which the target company is regulated. This would be rational since the takeover process involves mainly the target company and the mandatory bid offer would just aim to protect the minority shareholders in all levels. And by following this explanation, it would also answer the question if the lower layer companies are listed.

95 M Goergen, M Martynova, L Renneboog (n 37) 248-250.
or not – this just would not have significant importance. Concerning the applicable law in worldwide level, the international private law should lead to some answers or compromises.

The positive side of applying the mandatory bid rule in the group of companies more extensively would be the ultimate protection of minority shareholders because in such situation they would have appropriate and fair exit opportunity. But this theory also has its negative side.

Namely, such process would raise the transaction costs and the actual cost of the bid tremendously. It would also raise more the uncertainty related to an offer because bidder do not always know the structure of the pyramid in the lower level since the reasonable information disclosure information mainly comprises the structure and information about the pyramid in the levels that are higher from the target company. This in turn would very likely harm the EU takeover market because as explained in the second chapter, large number of the companies operating in the EU market has concentrated ownership and pyramidal ownership structure. Accordingly, it would also have negative effect for the EU market for corporate control, which would probably also diminish the competitiveness of the EU companies on the worldwide scale.

Therefore, considering all the negative effects that could occur, it can be argued that if an offeror acquires a control at some level, which is not the bottom layer, of the pyramidal group, then (s)he does not have an obligation to make the offer to buy the securities of the minority shareholders in directly acquired company and also shareholders in the companies that this target company controls. This theory would create more certain situation in the takeover market and the takeovers would include less risk and transaction costs than in contra verse situation. Hence, the general aim of the company law regulation in the EU would still have its meaning. On the other hand, the minority shareholders would be protected less effectively.

There is no clear answer if and how the mandatory bid rule should apply for the bidder who acquires a holding company in a pyramid structure. If the offeror would be required to make a bid in equitable price to all the minority shareholders in a lower layer

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96 If the concept of ‘equitable price’ is actually fair and reasonable in the meaning of the Directive, is still not clear. See above, Chapter 1.
subsidiaries of the pyramid, it would have a negative effect for the offeror because (s)he should bid for several companies rather than for only one of them because of sophisticated corporate links. This, in turn, may lead to failure of the bid, which in turn would have again a negative effect on the EU takeover market. It would lead bidders to more risk adverse behavior, which will have an effect on the corporate control and corporate governance in EU.

On the other hand, if the Directive would not apply to the offeror in a way that (s)he would be required to make a bid in equitable price to all the minority shareholders in a lower layer subsidiaries of the pyramid, then the aims of the Directive would not be followed because the minority shareholders would not be protected enough according to the Directive.

Taking into consideration described theories and positive sides and negative aspects, it would be more rational to conclude that the takeover directive with its mandatory bid rule applies only in relationship two certain parties - the bidder and the target. Even though this would be more harmful situation for the minority shareholders in the lower level subsidiaries in a pyramidal group, it would be less harmful for the whole takeover market and economy.

In the next paragraph I try to find an answer what and how should be changed to make the situation better.
3. Revision of the Directive

The Member States’ motives are controversial to the aim of harmonization (especially in the current economic and unstable Euro area situation). Member States are trying to survive the crisis. Their motives currently are, first, to improve their business environment to attract more foreign investors and businesses. Secondly, states are interested in promoting the competitiveness of indigenous industries by forming the most favorable business form. And thirdly, countries seek to find ways to respond to competitive threats posed by offshore jurisdictions, especially when it comes to tax matters. 97 Hence, according also previously described situation, it is relatively clear that the Directive is not in compliance with the current needs of the situation. In this paragraph I will explain if and why the revision of the Takeover Directive is necessary. Due to the fact that many scholars have researched and shared their opinion of the necessity of the general revision of the Directive, I will not go to the details of general revision of the Directive, but rather have a look on if and how it should be reviewed in the light of the main research question of this thesis paper.

3.1. The necessity of the revision of the Takeover Directive

The current Directive is mainly based on the UK Takeover Code and the UK has the market-based system of corporate governance, which means that it relies on legal rules that are mainly based on the case law and is dependent on the legal enforcement of shareholders rights, and it is based on a theory that capital markets have a control over the corporation’s management. The characteristics of this kind of systems are usually: dispersed equity holding with portfolio orientation, higher power, discretion and the

97 G Hertig, J A McCahery (n 3) 547.
responsibility of the management board, strong fiduciary duties, and shareholders protection from abuse.  

Continental Europe is following the blockholder-based system, therefore they have codified civil law rules and they also emphasize protection of different stakeholders (i.e. creditors and employees). Following of the usage of these two systems, it is also better to understand the data, which was presented in the previous section and which shows the different situation in the ownership structure in the UK and in Continental Europe. It is reasonable to conclude that these two scenarios need also different approach. Even if the English approach might be more competitive, as some scholars argue, it may not necessarily suit into the Continental Europe’s systems. There are many heated discussions concerning the best corporate governance system but there is no clear answer for that yet.

As explained in the previous chapter, the big percentage of the companies in the EU is involved in the pyramid structure. Therefore, the supranational harmonization plans should meet also this need. Yet, currently there is no clear answer if and how the Takeover Directive applies in the cases where a company of such ownership structure is involved. Hence, the revision of the Directive in that light is necessary.

In 2007, after the publishing the Commission’s Report concerning the implementation of the Directive by the Member States, the Internal Market and Services Commissioner Charlie McCreevy stated: "Too many Member States are reluctant to lift existing barriers, and some are even giving companies yet more power to thwart bids. The protectionist attitude of a few seems to have had a knock-on effect on others. If this trend continues, then there is a real risk that companies launching a takeover bid will face more barriers, not fewer. That goes completely against the whole idea of the Directive." Also this statement shows the concern around the Directive and its consequences.

As already explained in the first chapter, takeovers are considered as important tools to provide the companies to more effective management. In companies with dispersed

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98 S Haller, J A McCahery, L D R Renneboog, P Ritter (n 28) 582-583.
99 M Goergen, M Martynova, L Renneboog (n 37) 243-244.
101 Press Release Corporate governance: Member States reluctant to give a greater say to shareholders in the context of takeover bids, says Commission report. IP/07/251 (Brussels, 27 February 2007)
ownership the main effect of the takeover would be the better functioning of the management and less opportunistic behavior of managers. Whereas, in companies that have concentrated ownership structure, the managers’ opportunistic behavior is less likely since the controlling shareholders have more incentive and power to monitor and lead them. The issue that takeover regulation in a concentrated ownership cases should aim at, is the protection of the minority shareholders because they have no real power to protect their rights against dominant shareholder.\(^{102}\) And if supporting a theory that in a group of companies the mandatory bid rule should not apply to lower lever subsidiaries shareholders (as explained in the chapter 2.2), this aim is currently not met.

The current Directive contains several important protection mechanisms, such as the mandatory bid rule, the sell-out right and the equal treatment principle, to safeguard the position of the minority shareholders. Board neutrality rule and breakthrough rule can, to certain extent, reduce the agency problems between shareholders and the (opportunistic) management. Therefore, one may assume that when drafting the Directive both, the issues related to the concentrated ownership structure and also dispersed structure, were kept in mind. Unfortunately the outcome has not been as expected. According to the implementation of the Directive and the approach of the Member States (explained in the first chapter), the situation seems to be a *Pyrrhic victory*\(^{103}\).

The harmonization of the takeover regime in the EU is rather positive step, but the question in current case is the method of harmonization. The fact is that the current Directive creates more differences than harmonizes the EU takeover market, as showed, for instance, in the Table 1.

Takeover regulation, as a matter of fact, has a huge impact on the corporate governance system. Even few changes in the takeover regulation may have a significant effect on the investor protection and the takeover market of the state in general. It may also affect the ownership and control structures of the companies in a state.\(^{104}\) As the takeover regulation has a significant impact on the whole economy of the internal market, it is important that such a regulation is effectively working.

\(^{102}\) M Goergen, M Martynova, L Renneboog (n 37) 248-249.

\(^{103}\) *A victory with such a devastating cost that it carries the implication that another such victory will ultimately lead to defeat* [http://en.wikipedia.org/wiki/Pyrrhic_victory]

\(^{104}\) M Goergen, M Martynova, L Renneboog (n 37) 262-263.
As showed above, the current situation is not as it could be expected. In addition the costs of the consequences of the Directive are bigger than the benefits. In the light of current economic crisis it is essential to have a corporate law that rebuilds the trust of the investors. Another important aspect to approach more critically about the current Directive is that, even though, takeovers are mainly seen as corporate value creation activities, it may be set under the question in the current economic crisis, where many companies become bidder or the target purely for financial reasons. Therefore it may turn to be questionable, if the boost of takeovers in EU in current situation with the aims that Directive has, is reasonable.

Hence, the European Takeover Directive needs a revision, or at least explaining guidelines with new and fresh approach. In the next section I will explain briefly the changes that the Directive should have. Due to the fact that the takeover market and corporate governance system is a very wide area, the main focus still remains on the previously aforementioned issues.

### 3.2. Possible solutions to reach the aims of the Directive

In April 2011, European Commission opened a corporate governance consultation procedure to find out if, which areas, and to what extent the general company law regulation on the EU level should be renewed.  

| European Commission press release Corporate governance reform - consultation (27/04/2011) |
or the guidance should be provided. Until now the Commission has not announced its further steps concerning the Takeover Directive and its revision.

Even though the Commission does not want to, dare to, or just cannot take any further steps to improve the takeover regulation in the EU, the problem exists and it needs an attention. The Takeover Bid Directive is not offering solutions and strong solid ground for competitive EU internal market, as it was planned. Therefore the most important step to finding solutions would be the critical and solutions-seeking/offering approach to the takeover market and regulations from the European Commission, Member States and all the affected market players.

First, and probably the most pragmatic proposed change to the Directive, which is also offered by many scholars, would be the revised text that would be conducted by simplicity and transparency. Current situation is that there are many unanswered questions in the field of takeover market and the text of the Directive is too broad, which leaves a lot of room for different interpretations. To achieve the real harmonization in the EU, the mandatory provisions of the Directive should be less avoidable and provide more certain thresholds.

It is important also to solve the problems concerning the shared jurisdiction of the bid. As explained in the first chapter, even within the EU there may be situations where two different regimes apply to process. The problem may arise when the regulations have contradictions. And another issue is when there is a non-EU party involved into the takeover. I would suggest solving the problem by applying mainly the jurisdiction of the center of main interest and business operations regulations of the target company.

It is understandable that, for instance, opt-out and opt-in provisions are in the Directive as a result of a political compromise because it has to fit to many different jurisdictions and the diversity of the corporate governance in the EU is unavoidable. But the fact is also that a directive in such an important and sensitive field cannot work effectively when it is based mainly on the political considerations and opportunistic behavior of the Member States. Even though subsidiarity principle has an important role in the EU supranational

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legislative level, the current Directive leaves even more freedom to Member States, which creates more disruption than harmonization.

In the national level there is no special interest to harmonize the takeover area in the EU level, and therefore the European Commission has to create a regulation that is acceptable an effective for the whole internal market. Some scholars state that the reason for the optional provisions is the inability of the EU-level lawmakers to resolve a legislative conflict.\textsuperscript{108} But drafting a working effective directive cannot be an easy task, especially in circumstances where there are many economies with different legislative, political and cultural backgrounds.

When it comes more specifically to the group of companies and the Takeover Directive, it is necessary to create more certainty in the question if and how the Directive applies. The HLGCLE concluded in one of its Reports that the pyramid structures should have a special attention and it should be dealt with as a separate legal issue. They pointed out that such difficult structures should be regulated in group law, in listing rules or otherwise. The HLGCLE recommended that, in the context of the Directive, it should be reviewed whether and how the pyramid structures should be regulated and what could be the adequate measures to protect the minority shareholders to be enforced in all Member States.\textsuperscript{109} Such leading guidelines would create more certainty and therefore also protects the parties more. Better investor protection encourages confidence, which in turn boosts the willingness to invest.

At the moment there is still no certainty what could be the acceptable answer for the application of the mandatory bid rule in a group of companies. It is possible to think that the European Commission did not see any questionable aspect when it comes to the mandatory bid rule and the pyramidal group. Since this is still unanswered question in practice, the clarity may arrive when European Courts could state their standpoint. Yet, it is relatively unlike that such a question reaches to these instances in the near future.

The fact is that one directive cannot solve all the necessary aspects in such a big union of the variety of economies, like it is the EU. This is the reason why there are several directives to harmonize EU company law. Hence, it is relevant to explain what would be

\textsuperscript{108} J A McCahery, E P M Vermeulen (n 39) 2-5.

\textsuperscript{109} J Winter et al (n 45) 39.
the possible changes in the EU company law in general from the perspective of the group law and previously explained (in the second chapter) takeover issue. Current thesis paper concerns the European Takeover Bids Directive but this Directive is a part of the EU company law reforms.

Some scholars have also raised the concern that the general corporate law harmonization in the EU is a negative approach since an attempt to harmonize such a large variety of national corporate laws is almost impossible and therefore those regulations are ineffective because EU regulation does not have such a strong binding power and mainly they duplicate already existing national regulation. In addition, it does not reach their aims and may even bring negative consequences, such as higher transaction costs.  

Hertig and McCahrey suggest in their paper four changes to make the EU company law regulation more effective. They indicate that there should be no threshold on the amount of shares for shareholders to be recognized standing to sue, that Member States should provide special commercial courts, that there should be established lawful contingent fees, and that the mobility and simplicity of the cross-border (mass) litigation should be established. Even though, it can be agreed that such changes would make the EU company law more effective and foster therefore better economical activity, and would also make European companies and economic area more competitive in the worldwide scale, it is unlikely to happen in the near future.

Two main factors that hinder the development and usage of such ideas are currently economic crisis and lack of knowledge. In the current harsh financial situation, the whole Europe's attention is focused on other matters than developing the company law to more effective direction. Another, and maybe even more cogent argument is that in the general picture the legal institutions in the EU Member States are in lack of knowledge how to form, implement and enforce an effective business law. Many practitioners may not even see the importance of that. Therefore, I would suggest to the European Commission to create clearer image of the importance of company law reforms and also create guidelines in this field.

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110 G Hertig, J A McCahery (n 3) 556-559.
111 G Hertig, J A McCahery (n 3) 558.
Concerning the groups of companies, I would suggest also that the European Commission works out non-binding guidelines that explains how should the European company law regulations apply in such complicated legal corporate mechanisms should. Drafting separate European group law regulation would probably be even bigger failure than the Takeover Directive.
Conclusion

In my Master thesis paper I took a closer look at the European Takeover Bid Directive. The main research question of this thesis paper was: *If an offeror acquires a subsidiary in a vertical group of companies, does (s)he has the obligation to make a mandatory bid to acquire the shares of other shareholders in the group’s lower level subsidiaries?*

Based on the research of the work of academics I explained strengths and weaknesses of the Directive. I also explained the situation of EU capital market on the world wide scale, and *status quo* of the corporate governance in EU. In addition, I searched for answers to what could be the best possible solution to strengthen and harmonize the EU corporate field and what could be positive aspects and possible downsides of this.

This thesis paper showed that the Takeover Bids Directive has not been serving its purposes. Main reasons for that are too general and easily avoidable mandatory provisions that can be (and in fact, are) differently interpreted. This does not provide enough harmonization, effectiveness and protection system in the EU corporate governance field. Therefore, revision of the Directive is needed.

I proved in my thesis, that the Directive does not provide enough harmonization because Member States use the options they have been given to implement the Directive into their national legislation very differently. For example the definition of acquiring 'control', which is important when triggering the mandatory bid obligation, varies from 25 percent to 66 percent. Also the optional provisions of the Directive create a situation where in the EU there can be more than sixteen different legal regimes for takeovers. This creates for example very high transaction costs and reduces the takeover activity.

I also showed that the vast majority of the EU companies have concentrated ownership. The scholar's collected data show that many companies have a pyramidal ownership structure, which is controlled by an individual or a family. This information had a meaning in two aspects of this thesis paper. I researched if the Directive deals with such ownership structure, and also how it should be implemented in such cases where
complicated legal mechanisms are being used. More specifically, I had a look how the mandatory bid rule applies in the pyramidal group.

I concluded that in theory the mandatory bid rule of the Takeover Directive could apply in different levels of pyramidal company, but considering the practical reasons, it should not. In theory the Directive could apply in a pyramidal group of companies in a way that if an offeror acquires a control in the holding company then (s)he should make a mandatory bid to acquire also the shares of the minority shareholders in lower layer. This would be the result of the text of the Directive and also complies with the important aim of the Directive - to protect minority shareholders. But due to the fact that it would be catastrophic for the takeover market in the EU, I further found that this would not be the aim of the Directive as a whole.

Therefore, even though the Directive could be interpreted in a way that the answer to this paper research question is 'yes', it would not correspond with the aim of the Takeover Directive and general company law reforms in EU. Hence, the reasonable answer to the research question is 'no' - if an offeror acquires a subsidiary in a vertical group of companies, (s)he has no obligation to make a mandatory bid to acquire the shares of other shareholders in the group’s lower level subsidiaries. The reason for this outcome is that if the offeror would be required to make a bid in equitable price to all the minority shareholders in a lower layer subsidiaries of the pyramid, it would have a negative effect for the offeror because (s)he should bid for several companies rather than for only one of them because of sophisticated corporate links. This, in turn, may lead to failure of the bid, which in turn would have again a negative effect on the EU takeover market. It would lead bidders to more risk adverse behavior, which will have an effect on the corporate control and corporate governance in EU. This, in turn would also have negative effect for the EU market for corporate control, which would probably also diminish the competitiveness of the EU companies on the worldwide scale.

This thesis showed that the current Takeover Directive has many different questionable aspects and it does not comply with the needs of the EU corporate governance. Therefore, it needs revision in suggested parts - more concrete wording and provisions and less 'playing room' for the Member States. This could provide more harmonization and
certainty, and also disables States to protect their own companies and economy by discriminating other EU companies.

In addition, the European Commission should give more guidance to the relevant parties, concerning the takeover market and company law reform aims and means. It would also be reasonable to concentrate more on the group of companies and define their status in EU company law in different situations. Otherwise any action from the Commission's side would lead to even more loose ends and creates conflicts instead of harmonization.

This paper showed that there are several issues in the EU company law, especially in the takeover regulation field. I provided few possible answers to problematic questions. Probably the most important outcome of this research work is that this field and legal issues need more acknowledgement, attention and certain solutions.
European Union documents:

4. Press Release: **Corporate governance: Member States reluctant to give a greater say to shareholders in the context of takeover bids, says Commission report**. IP/07/251 (Brussels, 27 February 2007)


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50. Schmitthoff C M, Wooldridge F, 'Groups of Companies' (Queen Mary and Westfield College (University of London), Center of Commercial Law Studies. Sweet & Maxwell 1991)


