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PASSIVITY RULE: A COMPARISON BETWEEN EUROPEAN UNION, UNITED STATES AND CHINA.

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INTRODUCTION

A takeover bid, which could be considered as an offer made to the holders of a company's securities, is likely to bring several positive effects to target companies. In fact, in most cases takeover bids represent somewhat able to allocate the company resources more efficiently and to create synergies between target and bidder companies. In particular, the so-called "hostile takeover bids", which are tender offers in which bidders directly refer to target shareholders, on the one hand, permit to replace inefficient management teams; on the other hand, they are able to stimulate the management team to run the company more efficiently.

However, in case of hostile takeover bids, the board of directors is likely to be in conflict of interests, being it aware that, in case the hostile bid succeeds, the new controlling shareholder would replace the management team. Thus, for this reason, the board of directors is induced to try to defeat the bid, even if its terms and conditions are valuable for the target company and its shareholders.

Therefore, in light of the fact that, on the one hand, tender offers usually bring positive effects and, on the other hand, the board of directors is likely to be in conflict of interests, the launch of a tender offer should be regulated, stating who should be the driver of this procedure and which powers it should have been provided with.

The aim of this thesis is to provide for a clear view on this topic, *i.e.* to state all the several aspects of a takeover bids regulation, starting with the analysis of the European Directive 25/2004/EC, which has established the passivity rule. I argue that the passivity rule represents a current topic, since, notwithstanding the European Directive has been adopted in 2004 and implemented by Member States in 2006, the most effects of this regulation will be seen in the years to come, when the financial crisis will be passed and the merger and acquisitions market will come back to work.

The structure of this work is based on three chapter plus a final chapter in which I will express my belief on the passivity rule.

Chapter I concerns the several reasons at the basis of the European Directive on Takeover Bids (Directive 25/2004/EC), which could be considered as the necessity (i) to provide for a more open market for corporate control and (ii) to provide target companies with the same safeguards and powers in facing hostile tender offers within European Union. Thus, European Commission decided to intervene in this delicate topic, in order to permit the replacement of non-efficient management team that an open market for corporate control could allow, and in order to provide for a harmonized takeover bids regulation within European Union.

European Directive (Directive 25/2004/EC), in order to achieve those aims, has provided for a passivity rule, which is based on three main provisions, such as: (i) the board neutrality rule, (ii) the breakthrough rule, and (iii) the reciprocity rule.

The board neutrality rule, which has been provided for in Article 9 of the Directive, prohibits the target board of directors to take any defensive measures or to engage in frustrating operations against a hostile tender offer, unless it receives a previous shareholders meeting' authorization.

The breakthrough rule, which has been provided for in Article 11 of the Directive, states that any restriction on the transfer of shares or on voting rights, should they be provided for in the company's bylaws, as well as by contractual agreements, will not work *vis-à-vis* the bidder in the period of acceptance of the bid. The above mentioned restrictions will also not apply in the first general meeting after the success of the hostile bid.

The reciprocity rule, which has been provided for in Article 12 of the Directive, allows companies that are subject to the board neutrality rule and to the breakthrough rule, to misapply them, should they become target of a company that it is not subject to the same or corresponding rules.

Thus, the decision of the European Commission in regulating takeover bids has been to deviate powers from the board of directors to the shareholders' meeting. In fact, European Directive (Directive 25/2004/EC), regulating pre and post-bid defensive measures, has prohibited the board of directors to act against a hostile tender offer, leaving the decision as to the possibility to accept the bid or eventually to defeat the bid in the hands of shareholders, considering them the owner of the company.

However, as we will have the possibility to see in Chapter I, European Directive (Directive 25/2004/EC) has provided for the above mentioned three main provisions as optional and not mandatory, leaving any Member State and national company free to decide whether to implement the passivity rule's provisions ("opt-in") or not ("opt-out"). Moreover, it should be noted that Member States and companies are also allowed to partially adopt the Directive, being they not required to decide to implement or not all the passivity rule's provisions. Indeed, Member States and companies could for example decide to subject themselves to the board neutrality rule and to the reciprocity rule, misapplying the breakthrough rule.

This optional feature has been caused by the huge resistance of Member States in approving a European directive on takeover bids, which has lasted almost twenty years.

Chapter II concerns the implementation of the European Directive (Directive 25/2004/EC) by Member States, which were required to adopt the passivity rule's provisions by May 20th, 2006. I argue that this assessment represents a fundamental step, due to the possibility for Member States and companies to decide whether to adopt the three main provisions or not.

In particular, it will be analyzed the implementation of the European Directive by the major Member States, such as Italy, Germany, and United Kingdom. This study will be useful in order to assess whether or not the European Directive (Directive 25/2004/EC) establishing the passivity rule have achieved its purposes of harmonization.

Anticipating the conclusions that will be reached, it is possible to state that if German companies are subject to the most protectionist and patriotic regime, and that UK companies are subject to the most open regime, Italian Legislator decision could be considered as the middle ground between the UK and the German regulation. In fact, it should be firstly said that Germany have decided to totally not implement the European Directive (Directive 25/2004/EC), leaving the decision on the adoption of the three provisions in the hands of German companies. United Kingdom and Italy have instead partly implemented the Takeover Bids Directive. In fact, with reference to the board neutrality rule, United Kingdom decided to impose it as mandatory, whereas Italian Legislator decided to provide for it as a default system, leaving Italian companies free to opt-out Article 9 of the Directive. With respect to the breakthrough rule, both Italy and United Kingdom have decided not to implement the Directive. Finally, Italian Legislator have implemented the reciprocity rule, whereas United Kingdom have decided not to provide its companies with the possibility to benefit from its adoption.

Finally, it will be analyzed the US and Chinese takeovers regulation, in order to be able to identify what defensive measures European companies are allowed to adopt in case of tender offers by US and Chinese companies. Moreover, this comparison would permit us to understand the resistance of Member States against the European Takeover Bids, which was mainly based on the fear to allow US companies to easily take European companies over. At the same time, the assessment of the Chinese takeovers regulation may permit us to understand how European companies will be able to defend themselves against hostile offers launched by Chinese companies, which are always more likely to try to externally explain their business taking over European companies.

Now, having a brief look at the US takeover bids regulation, it is possible to say that US target board of directors is allowed to use defensive measures and entrench itself. In fact, in running the company, the board of directors is covered by the business judgement rule, which states that in case of rational basis of the board's behavior, courts are not allowed to challenge its decisions. However, in facing hostile takeover bids, and after the *Unocal Corporation v. Mesa Petroleum Corporation* case in 1985, the Delaware Supreme Court have stated that in order to be protected by the business judgement rule, the board of directors must satisfy an enhanced scrutiny, passing two tests. First, the board of directors has to prove the detrimental effects of the hostile tender offer, because of its possibility to affect the company's business. Second, the board of directors has to prove that the actions taken were reasonable with the detrimental offers and that they have been taken in order to achieve the company's interests. However, as we will more detailed see, the board of directors could easily meet this enhanced scrutiny, simply establishing the low price of the offer, and stating that the actions taken were not coercive or totally preclusive of the success of the offer. Thus, it is possible to say that US takeovers regulation is totally opposite to the European Directive (Directive 25/2004/EC), allowing the target board of directors to adopt defensive measures, such as poison pills and staggered boards.

Furthermore, I will take into account the Chinese takeovers regulation. It should be said that Chinese takeover bids regulation is based on the belief that the board of directors has to run the company, and has the possibility to adopt defensive measures against hostile tender offers. In fact, the board of directors is allowed to adopt defensive measures, with the only need to meet its fiduciary duties showing that the measures were adopted in order to satisfy the company's interest. Thus, Chinese companies have a huge possibility to defend themselves against hostile tender offers, and in fact, in the last years many Chinese companies have introduced some antitakeover provisions in their bylaws. Therefore, it is possible to assess the Chinese takeovers regulation as closer to the US regulation than to the European passivity rule.

Chapter III is focused on the analysis on whether the passivity rule represents the best way to regulate takeover bids or not. The aim of this chapter is to firstly provide for the theoretical implications of the passivity rule and of an opposite regime based on the possibility for the board of directors to adopt defensive measures in facing hostile tender offers. Then, I will try to analyze whether or not these theories are confirmed by empirical data.

Therefore, it will be taken into account the theory of Bebchuk, Coates IV, and Subramanian, according to which, any attempt to allow the board of directors to decide on the merits of the bid and to decide how to face hostile tender offers could be detrimental for the company. In fact, they argue that hostile tender offers are always beneficial for target companies and its shareholders. According to these three academics, target companies would benefit from a more efficient board of directors, and target shareholders would benefit from a premium paid over the shares value.

Conversely, some academics are against the passivity rule, stating that this rule is able to bring some negative effects that a regime allowing the board of directors to act against tender offers could bridge. The theories against the passivity rule state that its most detrimental effects rely on the *bargaining power hypothesis* and to the *rational myopia hypothesis*. According to the *bargaining power hypothesis*, the board of directors would be able to get a higher shares price, due to its wider knowledge of the company business. According to the *rational myopia hypothesis*, if the board of directors was allowed to adopt defensive measures and to defend the company from hostile tender offers, it could be less accountable to shareholders and it could make more long-term investments.

However, as we will see in detail, empirical data does not confirm these two hypothesis. Conversely, the theory favorable to the passivity rule has been confirmed from empirical data showing that takeover defensive measures lead to a reduction on the target shareholders' returns of 8-10%. Thus, as it has been shown by empirical data, defensive measures are likely to be detrimental and the passivity rule should be preferred to the system allowing the board of directors to act against hostile tender offers.

Chapter IV concerns the weaknesses of the European Directive (Directive 25/2004/EC) and of the passivity rule, in order to propose some solutions to the issues that the European Commission have still not solved. In my opinion, the most important weaknesses of the European Directive concern its optionality feature, the reciprocity rule, the monetary compensation provided for in Article 11 of the Directive, and the possibility for the board of directors to seek alternative bids and to provide shareholder with a report with its opinion on the bid.

In fact, the European Directive provided Member States and companies with a too huge freedom concerning the implementation of the passivity rule's provisions. Thus, a solution could be to restrict the Member States and companies freedom, allowing them to totally apply or misapply the Directive: *i.e.* requiring them to implement or not both the board neutrality rule, the breakthrough rule, and the reciprocity rule, so creating more harmonization within European Union.

Moreover, trying to explain the weaknesses concerning the reciprocity rule, I argue that companies could be stimulated to implement the passivity rule's provisions only when they plan to launch a tender offer. In fact, this abuse could permit the bidder to take advantage from the reciprocity rule prohibiting the target company to defend itself. Thus, in order to avoid this misconduct I will propose to apply the reciprocity rule only in case the bidder is subject to the same or corresponding rules for 6 or 12 months.

With reference to the issue concerning the monetary compensation provided for in Article 11 of the Directive (Directive 25/2004/EC), in my opinion, it should be taken into account the distinction between the Member States implementation and the companies implementation of the breakthrough rule. It will be proposed to establish the right to receive a monetary compensation only in the first case, since in case in which the company had voluntarily adopted the breakthrough rule, its shareholders would have knowingly subject themselves to such rule.

Moreover, Article 9 of the Directive, which established the board neutrality rule, expressly states that the board of directors is entitled to seek alternative bids and to provide shareholders with a report with its opinion on the merits of the bid. In my opinion, being the board of directors in conflict of interests, it could be stimulated to create an unfair competition and to provide shareholders with a report totally disparaging the hostile bid, even if its terms and conditions were valuable for the company and its shareholders. Thus, it will be proposed to make in charge of these two activities independent directors, whose appointment will be proposed to be amended, or the statutory audit.

Furthermore, I will explain that, even if the European Directive (Directive 25/2004/EC) had provided for mandatory provisions, the passivity rule itself presents some further weaknesses. In fact, in my opinion, the passivity rule could induce the board of directors to be too much focused on the short-term investments, and that leaving shareholders the total possibility to decide on the merits of the bid could put aside the interests of other company's constituencies, such as employees and creditors. Thus, I argue that the board of directors, whose compensation should be formed of stock options, could be able to solve these issues, taking into account the other constituencies' interests and making longer investments.

Finally, I will explain the use of some unregulated defensive measures and their implications. In fact, I will focus on the possibility for the board of directors to insert some change of control clauses in the agreements entered into by the target company. These clauses are able to allow the parties to immediately terminate the agreement in case of change of control of their counterpart. Thus, the target board of directors could defend itself from inserting these clauses in the contracts entered into by the company, which clauses could result to be even more detrimental than the classic defensive measures that the passivity rule prohibits, since they would reduce the company' value should they be triggered.

In light of this, I will conclude that, even if I agree with the passivity rule and its purposes, I argue that the European Directive (Directive 25/2004/EC) have not achieved its purposes to create a more open market for corporate control. In fact, in my opinion, the board of directors is able to bypass passivity rule's provisions, for example by adopting change of control clauses in the agreements entered into by the company.

CHAPTER I – PASSIVITY RULE: ORIGIN AND REASONS. THE ADOPTION OF THE EUROPEAN DIRECTIVE 25/2004 AND ITS PROVISIONS

PARAGRAPH I – ORIGIN AND REASONS OF PASSIVITY RULE

The launch of a tender offer, which could be considered as a voluntary or mandatory public offer made to the holders of a company's securities because of or following the acquirement of control of that company, is a crucial moment in the life of a company. It is a general belief that a successful takeover bid has positive effects on the target company, allocating the company resources more efficiently and creating synergies between companies. Takeovers can increase shareholders' value significantly and this has long been supported by research. There is clear evidence that takeovers have a positive effect on the shares price of the target company and the corresponding substantial gains of target shareholders[1]. Conversely, it was shown that the failure of a takeover could lead to a decline in the shares price of the company if, in the near future, the latter does not receive new offers.

In light of these important outcomes, one of the most discussed topic about corporate governance in general, and about tender offers in particular, is the one concerning how tender offers should be faced and who should be the main character.

First, in examining this matter, it should be kept in mind that the separation between ownership and management of the firm always causes an agency problem between managers and shareholders. Agency problems are those borne in any relationship in which a person ("principal") delegates another person ("agent") to perform certain activities in its interest. An agency problem is always present in the relationship between managers and shareholders, an issue raised by their different role within the company and by different knowledge and

[1] WEI CAI, *Anti-takeover provisions in China, how powerful are they?*, in *Company and Commercial Law Review*, 2011, 22, pp. 311-317.

information between the two categories, so creating a conflict of interests. This kind of issue often lets managers act opportunistically, with the possibility to put their interests in advance of shareholders' ones. Thus, mainly due to their positions, there is always the threat that agents may act with self-interested motives[2].

Moreover, the above mentioned conflict of interests is still higher in case of receipt of a tender offer. It is easy to understand that the two categories have different aims and different ways to face this event. In fact, the aim of shareholders could simply be considered the maximization of their economic investments, and then they are interested in getting the highest possible shares price, whereas the managers' aim is quite different and it could be in contrast to shareholders' one. Indeed, managers and directors are aware that if the takeover succeeds, they would lose their job, so they are stimulated to try to defeat the bid. Thus, managers could consider the offer of interest for the shareholders and for the company but not for themselves, so their best decision could be to make the bid more expensive and difficult. Thus, managers often start telling the shareholders that the bid is not a fair one, since it is not evaluating well the shares value, in order to direct their opinion and lead them to reject the bid and so maintain their office[3].

In this case, namely the case in which managers are against the bid, we face a hostile bid, *i.e.* a bid in which the bidder directly refers to shareholders, without the mediation of managers.

It must be noted that the management and shareholders of a company may sometimes find necessary to defend themselves from a hostile takeover bid. There may be several reasons for needing this behavior, such as to get a higher price for

[2] J. UEDA, *Modernizing Company Law and Regulatory Competition: Some Economic Implications*, in *Statute Law Review*, 2008, 29, pp.154-172.

[3] M. TRONCOSO REIGADA , *Razionalità ed efficienza delle misure antiopa*, in *Giureta – Rivista giuridica on line*, 2008, http://www.giureta.unipa.it/phpfusion/readarticle.php?article_id=96.

the shares, or because of the honest belief that the bidder will harm the corporation and its future business[4].

However, in most cases hostile takeovers are considered somewhat able to play a key role in making managers accountable to dispersed shareholders. In fact, a properly functioning takeover market enhances corporate governance in two different ways. First, if the bidder improves the target's performance by reconfiguring its assets or exploiting synergies between the two firms, it directly brings benefits for the company. Second, hostile takeovers have an indirect benefit, since managers have usually reason to suspect that a hostile bidder will take control of the company if they run it badly, so the prospect of a takeover can keep the managers on their toes[5]. Thus, hostile takeovers could be beneficial being an instrument to replace inefficient managers or threatening them with the fear to be replaced. This threat should induce managers to run the company more efficiently, to make more shareholders-oriented choices, and to keep their misconducts, since they are threatened by the shadow of a future takeover bid.

Due to the above mentioned possible benefits of the successful hostile takeover bids and the usually frustrating behavior of the managers against those, the discussion as to who should be the driver of a takeover process and how to get the maximum value from this event became somewhat truly important.

The aim should be the creation of an open market for corporate control, since efficient markets constitute the backbone of efficient takeover operations. This belief is based on the rational behavior of investors on the stock market, which brings the shares price to reflect the company's performance and prospects. It follows that, in case of lowered shares price, the management of the company

[4] S. GUPTA, *Regulation of takeover defenses: A comparative study of buyback of shares as a takeover defense*, in *Student Bar Review*, 2007, 19, pp. 68-83.

[5] J. ARMOUR AND A. D. SKEEL JR., *The Divengence of U.S. and UK Takeover Regulation*, in *Regulation*, 2007, 30, pp. 50-59.

may be replaced through a takeover performed by another company, whose purpose is to use the target's assets more efficiently and make it profitable[6].

A key factor in this field, and in order to make the market for corporate control more open and efficient, is represented by the necessity to prohibit managers of the target company to be the driver of a takeover and have the possibility to act against it. However, the regulation on hostile takeovers treatment and on the defensive measures permitted to the target company management is somewhat delicate, because of its ability to effect the distribution of powers within the company.

In the past years, once it became clear the impossibility to align the managers and shareholders' interests, a regulation on takeovers process has been adopted, namely a passivity rule, with the general goal of protecting shareholders.

As generally accepted, the passivity rule prohibits managers to take any actions that could frustrate a takeover bid, unless a prior shareholders' approval is obtained. This rule is really linked to the UK regulation, *City Code on Takeover and Mergers*, from which the ideas and the purposes have been taken. As I will explain in the next paragraphs, most policy-makers decided to divert powers from managers to shareholders, which are now entitled to decide on whether or not allow any frustrating action. Currently, shareholders play the most important rule during a takeover bid, whereas managers are simply executors of shareholders decisions. Then, the reason of this choice, *i.e.* the choice to put the power in the hands of the shareholders, relies on the consideration that shareholders are the owners of the company. Therefore, shareholders should have the possibility to allow managers to act against a takeover when they think fit, as well as to deny managers this possibility and accept the takeover bid when they assess it as a valuable one.

[6] G. TSAGAS, *A Long-Term vision for UK Firms? Revisiting the Target Director's Advisory Role since the Takeover of Cadbury's Plc*, in *Journal of Corporate Law Studies*, 2014, 14, pp. 214-275.

PARAGRAPH II – EUROPEAN DIRECTIVE 25/2004 AND ITS PURPOSES

In light of the previous explanations, *i.e*. the advantages of a successful takeover bid (as well as a hostile takeover bid) and the conflict of interests between managers and shareholders within a company with dispersed ownership (which is enhanced in case of a takeover), European Union was aware of the significance of the above mentioned issue and of the necessity to intervene and provide some common rules on that topic.

The idea to adopt a European Directive (Directive 25/2004/EC) has been in mind of the European Commission for a long time, which decided to intervene for several reasons and with several purposes.

One of the main aim of a directive on takeovers was to coordinate the safeguards that Member States require to listed companies in order to protect shareholders, and therefore to make such safeguards equivalent throughout the European Union. Indeed, it should be easy to understand that without any kind of harmonization between the national takeovers regulations in Member States, any company would have to fulfill different mandatory rules, depending on the state of incorporation. Therefore, the idea of European Commission has always been to create a level playing field for takeovers bid, so that takeover bids could be undertaken with the same expectations of success throughout European Union, thus providing shareholders with the same chances to sell their shares, and bidders with the same possibility to succeed in their goal to take the target company over[7].

European Union's efforts have been made also in order to make the market for corporate control open through its regulatory intervention. Finally, it should not be forgotten another important purpose, *i.e.* the purpose to facilitate the aim of the Treaty on the Functioning of the European Union (TFEU) to create an internal

[7] B. CLARKE, *Articles 9 and 11 of the Takeover Directive (2004/25) and the market for corporate control*, in *Journal of Business Law*, 2006, pp. 355-374.

market without barriers in which the free movement of capitals is ensured[8]. Thus, taking into account this relevant issue, the Directive tried to comply the takeovers regulation with Article 63 of the TFEU, and so its efforts have been made in order to prevent any action that could directly frustrate a takeover bid and indirectly impose restrictions on the free movement of capitals.

The plan of the European Union was to take example from the UK takeovers regulation, *i.e. City Code on Takeovers and Mergers* (also known as London City Code), which was a non-statutory regulation in power in United Kingdom since 1967, and thus to make the European Directive modelled on it.

Those were the most important and declared purposes of European Commission. Quite different was the outcome of the European Commission's efforts, since the final text of the Directive (25/2004/EC), whose works took so many years, turned out to be very different from its initial ideas. The huge difference between the initial project and the final outcome, which I will explain in the paragraphs to come, could be explained through the enormous resistance and criticisms that any proposal of European Takeovers Directive faced in the moment of receiving the approval by European Parliament. Those resistances and reluctances on the approval justify why a common legislation throughout European Union on takeover bids was born only in 2004, and why this is so different from the inspirations of the Legislator. In fact, due to the above mentioned obstacles, European Commission in order to receive the approval by European Parliament and in order to reach a minimum goal, had to come to terms and accepted a compromise with resistant Member States.

A brief description of the history of the approval and born of the European Takeovers Directive should clear the point.

A Takeovers Directive is an idea first discussed with the so-called Pennington proposal in November 1973, but due to the historical situation and to the absence

[8] J. MUKWIRI, *Free movement of capital and takeovers: a case-study of the tension between primary and secondary EU legislation*, in *European Law Review*, 2013, 38, pp. 829-847.

of a high number of hostile takeover bids in Europe, a takeovers directive was considered unnecessary.

The first draft for a European Takeovers Directive was proposed to the Council in January 1989, a proposal modelled on the UK *City Code on Takeovers and Mergers*. Reflecting the initial ideas and referring to securities in public companies, that proposal required Member States to impose some obligations for the bidder and for the target company's management. The draft directive restricted the possibility for the board of directors of the target company to take any action that could frustrate a takeover bid, prohibiting managers to engage in frustrating operations without the consent of the shareholders' meeting. Moreover, the board of directors was required to distribute the offer document to shareholders, and to provide them with its own report on the merits of the bid, taking into account its position and its duty to act in shareholders' interest[9].

European Commission, due to several amendments suggested by the Parliament and to the first criticisms by Member States, presented an amended proposal in 1990. The amended proposal referred to listed companies and required the bidder to present some offer documents in order to disclose the future position of indebtedness of the company and the explanation of the bidder plan to conduct the future business of the target company.

The proposal was faced with hostility by some Member States, mainly by United Kingdom. The UK hostility was based on the different nature between the UK takeovers regulation and the proposed directive. In fact, it is worth to remind as London City Code was a non-statutory regulation, and as Takeover Panel was considered particularly flexible and able to adapt the rules and to promote the necessary changes in response to any market development. In light of these issues, it should be easy to understand the United Kingdom fear. Indeed, the approval of the Directive would have conferred to the takeovers regulation the force of law, and according to UK Legislator, this would have increased the possibility for

[9] V. EDWARDS, *The Directive on Takeover Bids – Not Worth the Paper it's Written On?*, in *European Company and Financial Law Review*, 2004, 1, pp. 416-439.

parties to make recourse before a court, thus bringing some delays to the bid process. Due to these resistances, this proposal failed.

In 1996, European Commission proposed a new version of the directive, which could be considered roughly the same of the previous version, with the difference that the new draft didn't require Member States to implement a mandatory bid rule in case a person obtain a certain percentage of shares. Once again, UK was against the draft directive, because of the same issue related to the nature of non-statutory regulation of London City Code. Moreover, other Member States were also against the proposal, such as, for example, Netherlands, which had a managers-friendly regulation, leaving them free to act against a takeover bid, and Germany and Sweden, which had just introduced a non-statutory system on takeover bids. Furthermore, the draft directive generated fears that US companies, which were not subject to corresponding rules, being managers free to frustrate a hostile takeover bid, would have gained an unreciprocated advantage when attempting to take control over their European competitors[10].

In 1997, UK asked the Commission to abandon the project or to make the provisions non-binding. European Commission decided to ignore the UK advice and introduced in the text of the proposal some provisions related to the employees category, whose interests the board of directors should have taken into account in preparing its report for shareholders on the merits of the bid. In 1998, after a three-days meeting, Member States didn't accept the proposal, due to some jurisdiction issues. In fact, for about a year, discussions were stopped because the UK and Spain disagreed on who should have jurisdiction over takeover bids in Gibraltar[11].

In 1999, the then German presidency partially amended the text, introducing the possibility for Member States to maintain the power to regulate whether and in

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[10] A. JOHNSTON, *The European Takeover Directive: ruined by protectionism or respecting diversity?*, in *Company Lawyer*, 2004, 25, pp. 270-276.

[11] C. CLERC, *After All, is the Takeover Bids Directive worth the paper is written on?*, in *Journal of International Banking and Financial Law*, 2013, 7, pp. 444-448.

which cases it is possible to act before a court. Thus, a political agreement was reached on that proposal, and in 2000, the Parliament approved a common position with fifteen amendments. The problem was represented by the amendment to Article 9. In fact, the new text stated the prohibition for the board of directors to use “poison pills”, which are shareholders’ rights plan used as defensive measures, often used in order to dilute the stake that a bidder obtain when the takeover bid succeed. This prohibition was seen as the first real obstacle set up on the path and behavior of the board of directors, which was indeed against this solution. Conversely, Member States claimed to let supervisory authorities the possibility to permit managers to act against a hostile takeover bid, without the shareholders’ consent. This proposal seemed really strange, since on the one side, Commission decided to restrict the possibility for the board of directors to act against a takeover bid, forbidding the use of the most used defensive measure, and on the other side, the counterpart claimed to have still more freedom to act. Thus, parties were walking away rather than trying to find a compromise.

In this context, Germany changed its opinion, due to some issue that it was facing in the domestic industry (i.e. Volkswagen and BASF), and proposed to require the shareholders’ meeting to allow managers to take any frustrating action by a fixed date. Finally, on July 5, 2001, the Parliament and the Council found a compromise, providing Member States with the possibility to postpone the application of Article 9 for one year after the deadline for the implementation of the directive. What left was the majority vote in Parliament and Council, which seemed to be already reached through the conciliation, but somewhat unpredictable happened. The proposed directive did not receive the necessary majority of vote, due to the rejection of the proposal by Germany and Spain, widely thought to be due to the restriction on poison pill arrangements and to the fears as to the opportunity for United States companies to take advantages from their more liberal legislation.

Thus, Commission decided to rule out the possibility to adopt a takeovers directive, having lost any hope to success. However, some months later, the then Internal Market Commissioner, Frits Bolkestein, declared his will to present a new draft directive, and in September 2001, Commission set up a group of experts ("High Level Group") led by Jaap Winter, a professor and a legal adviser of Unilever, with the aim to independently adviser the Commission.

The group of experts sent the report in January 2002. The Winter report was mainly focused on one point, *i.e.* the belief that the "shareholders decision-making view" should have prevailed, so that the board of directors should not be able to take any action in order to frustrate a bid, even if in order to protect the employees position. Following this idea, the advice of the Winter report to the Commission was not to entitle the board of directors to take any action without a shareholders' authorization[12]. Moreover, the High Level Group proposed to introduce a breakthrough rule, under which should someone reach a certain percentage of shares, eventual restrictions on transfer shares and voting rights would have not be applied in order to permit the bidder to gain the control of the company.

Taking into account the Winter report, the Commission proposed a new version of the Directive, which included the possibility for Member States to postpone for three years the implementation of Article 9, so granting managers with the possibility to act against hostile bids without prior shareholders consent for another three years. After a first moment of support by most Member States, United Kingdom decided to withdraw its support to the proposal, so standing up with Germany for the inclusion of multiple voting rights in the not permitted defensive measures.

Then, the most important and determinant contribution was provided by Portugal, which suggested the possibility to make the provisions related to the permitted defensive measures optional and not mandatory, so leaving Member States free to decide whether apply them or not within their countries. After some months of silence, another determinant suggestion was provided by Italy, which proposed the so-called "reciprocity rule", under which managers have the ability to defeat a

[12] For a review on the Winter report on the lack in the level playing field see M. MENJUCQ, *The European Regime on Takeovers*, in *European Company and Financial Review*, 2006, pp. 222-236.

hostile takeover bid in case the bidder is not subject to the same passivity regulation.

The Commission took into account the Portugal and Italian advices and proposed a new version of the takeovers directive on November 27th, 2003. At the end of the related discussions, Sweden proposed to introduce a clause of revision, which stated the necessity to reexamine the Directive in five years after the deadline for its implementation, in order to eventually introduce the needed revisions.

Before the vote, the then Internal Market Commissioner Frits Bolkestein showed against the Council his disappointment for the proposed version of the Directive, stressing his opposition to the compromise on the optionality of Article 9, since he thought this should have emptied the directive of its contents.

Despite the Internal Market Commissioner's warning, all Member States, with the exemptions of Spain, agreed with the Directive and voted for it, with a finally adoption on April 2nd, 2004, when the Directive on Takeover bids was born (2004/25/EC), after many years of negotiations.

Thanks to the exposition of the troubled historic development for the adoption of the Takeovers Directive, everyone could assess the difficulties that European Commission had to face in its hard work. The problem was represented by the necessity to put to a vote several topics with a lot of economic implications, mainly for the life of managers, who made so many efforts in order to prevent the adoption of a directive against them.

Reading the final text of the Takeovers Directive (25/2004/EC) it should be easy to realize the difference between the approved text and the first draft and how far it is from the Commission's idea. The approved version could be considered a diluted version of the European Commission's initial proposal, a dilution due to a complicated optional system and to the reciprocity rule[13]. The adopted Directive (25/2004/EC) could be seen as a victory for Germany, since it was the only

[13] THOMAS PAPADOPOULOS, *Cyprus*, in *Journal of International Banking and Financial Law*, 2013, pp. 257-258.

Member State against a stronger version of the directive in 2001, due to its necessity to prevent the success of the takeover on Volkswagen.

In light of the above mentioned difference between the first version and the adopted directive (25/2004/EC), we need to assess whether the Commission have reached its goals, and then whether the final text is able to create a level playing field and to make the control of listed companies more contestable. However, as I stated before, it should be noted the hard work of the Commission due to the huge opposition from many Member States. For the moment, it is worth to know as the Application Report of June 28th, 2012, *i.e.* the report for the first assessment on the application of the Takeovers Directive (25/2004/EC), stated that the provisions of the Directive could remain optional, with the Commission commitment to conduct further researches as to the protection of employees' rights[14].

PARAGRAPH III – THE THREE PILLARS OF PASSIVITY RULE

The Takeover Bids Directive (25/2004/EC), adopted in 2004 after so many troubled years of controversies, due to the resistance and the opposition of some Member States, such as United Kingdom and Germany, provides EU Member States with some common principles and minimum requirements in order to implement takeovers regulation. As we have seen in the previous paragraph, the Directive has been modelled on the UK *City Code on Takeovers and Mergers*, but it should be noted that the Directive remarks some provisions from the US Williams Act.[15] For example, the following are just some of the common provisions: (i) bidders must announce their bids as soon as possible and inform the supervisory authorities, (ii) all holders of securities must be treated equally

[14] K. J. HOPT, *European takeover reform of 2012/2013 – time to re-examine the mandatory bid*, in *European Business Organization Law Review*, 2014, 15, pp. 143-190.

[15] G. FERRARINI and G. P. MILLER, *A Simple Theory of Takeover Regulation in the United States and Europe*, in *Rivista delle società*, 2010, pp. 680-719.

during the bid, (iii) all shareholders must be offered the highest offer price. However, the Directive (25/2004/EC) have been so beyond the US Williams Act, providing some further restrictions, which are instead permitted under the US Williams Act.

The core regulation of the takeover bids process is based on two main rules and a closing statement. The first main provision is the “board-neutrality rule” (Art. 9, Takeover Bids Directive), which requires the board of the target company to remain passive during a takeover bid and to obtain the prior consent of the shareholders’ meeting before taking any action, which could frustrate the hostile takeover bid. The second fundamental rule is the “breakthrough rule” (Art. 11, Takeover Bids Directive), under which any restrictions on the transfer of securities or on voting rights working in the target company shall not apply *vis-à-vis* the bidder during the time for the acceptance of the takeover bid.

With a rapid look at the two main rules, it is possible to state as the board-neutrality rule tries to prevent the use of post-bid defensive tactics, and the breakthrough rule is in order to avoid the possibility to use pre-bid defensive tactics, with the distinction based on whether the tactics are used in order to frustrate an already existed or about to be announced bid, or in order to frustrate future eventual hostile bids.

The Commission, also due to the Member States reluctance on the acceptance of the directive, decided to make these provisions, *i.e*. the board-neutrality and the breakthrough rules, only optional and not mandatory, leaving Member States a large room to move, being free to opt-in or to opt-out both the rules. Thus, the Commission decided to provide for a flexible regulation, with a system based on a double optionality.

In fact, any Member States is in charge of the first decision, the one as to impose (opt-in) the board-neutrality and the breakthrough rules as mandatory provisions or not (opt-out). The default system is represented by the obligation for companies to fulfil both the board neutrality and the breakthrough rules, so in case a Member State decided not to intervene, that non-intervention would correspond to the opt-in decision, so making national companies incorporated in that Member State subject to the passivity rule. Then, if Member States intend not to implement the rules, they have to expressly opt-out them. The second decision refers to the opportunity for companies whose Member states decided to opt-out the rules, to opt-in them again. Thus, it is possible to know how the optionality system created an articulated scenario, with a wide freedom for Member States and companies. Indeed, Member States have the possibility to make different choice: (i) making both the board-neutrality and the breakthrough rules mandatory; (ii) making both the board-neutrality and the breakthrough rules optional; (iii) making the board neutrality rule mandatory and the breakthrough rule optional; (iv) making the board neutrality rule optional and the breakthrough rule mandatory.

It is possible to understand that both the board neutrality and the breakthrough rules, if implemented by Member States, could be able to represent an important element in the outcome and in the harmonization of hostile takeover bids. However, the above mentioned optional regime, more than trying to harmonize the takeovers regulations within European Union, makes it possible to have different regulations, with some Member States deciding to provide companies with the possibility to defeat hostile takeover bids, and then in favor of a more protectionist regulation, and some Member States deciding to put more obstacles on the possibility of target's board of directors to frustrate a hostile takeover bid.

The last provision provided by the Takeovers Directive (25/2004/EC) is a closing statement, the so-called "reciprocity rule", which refers to the possibility for companies which are subject to one or both the board neutrality and the breakthrough rules, to opt-out these rules, should they be the target of a bidder which is not subject to the same rules. Thus, a company subject to the passivity rule regulation could decide to misapply it, in case the bidder is not subject to the same provisions, so permitting managers to defeat the hostile bid and applying the restrictions on voting rights and securities transfer.

SUB PARAGRAPH I – BOARD NEUTRALITY RULE (ARTICLE 9)

The board neutrality rule, also called "non-frustration rule", as well as passivity rule, which is provided for in Article 9 of the Takeover Bids Directive (25/2004/EC), represents the cornerstone of the takeover bids regulation. The board neutrality rule prohibits the board of directors of a target company to take any action that could frustrate a hostile takeover bid, before it receive a prior authorization of the shareholders' meeting[16].

As I explained in the previous pages, the Takeover Bids Directive (25/2004/EC) did not provide the board neutrality, such as the breakthrough rule, as a mandatory provision, but it allows Member States and companies to decide whether to opt-in or to opt-out these rules. Thus, firstly Member States have the possibility to decide whether to opt-in (making the board neutrality rule mandatory) or to opt-out (making such rule not mandatory). Then, being passivity rule opted-out by Member States, companies are allowed to opt-in the board neutrality rule in their bylaws.

The rational of this rule is based on the awareness of the situation of conflict of interests that the board of directors faces in case of a hostile takeover bid, and with reference to the general belief that the success of a hostile takeover bid depends on the possibility for the board to engage in pre and post-bid frustrating actions or not. As we previously noted, Article 9 and its board neutrality rule has been thought to be able to prevent the possibility to engage in post-bid defensive tactics, which could be considered as the defensive tactics that managers are motivated to use when a tender offer has already been launched or is about to be launched[17].

[16] M. GATTI, *Scelte opzionali e reciprocità nella direttiva in materia di offerte pubbliche di acquisto,* in *La Nuova Giurisprudenza Civile Commentata*, 2005, pp. 416-433.

[17] F. M. MUCCIARELLI, *Il principio di reciprocità nella Direttiva comunitaria sull'opa*, in *Giurisprudenza Commerciale*, 2005, 6, pp. 830-ss.

Article 9 of the Directive, which as I said, provides for the board-neutrality rule or passivity rule, forbid managers to take any action that could frustrate a bid, so reducing their powers to entrench themselves and permitting them only to take non-frustrating actions. In this topic, the two terms “board neutrality” and “passivity” rule are used as synonyms, but the term “neutrality” is better than “passivity” in reflecting the board of directors’ situation. Indeed, the term passivity should represent the situation in which a subject, in this case a company and its management, is required to be passive, *i.e.* to take no action and with no possibility to engage in any operation. Thus, if we have a look at Article 9, we can easily find that “passive” is a wrong term. Article 9 does not require managers to be passive, but just not to engage in frustrating actions, therefore it exactly requires board of directors to be neutral, not to be passive[18]. It requires managers to be neutral and to act taking into account the shareholders’ interests, whose goal they should try to meet. Moreover, the board neutrality rule does not require the company as a whole to be passive; the prohibition refers only to the board of directors, whereas companies have the possibility to try to defeat a hostile takeover bid, through a shareholders’ meeting resolution that allows managers to engage in frustrating operations. Thus, the target company is not required to be passive and to suffer the hostile takeover bid, but Article 9 only imposes an alteration in the distribution of powers from the management to the shareholders’ general meeting, which is so in charge of the decision concerning the merits of the bid and how to face it.

Furthermore, Article 9 did not provide for a list of what the management is entitled to do without a prior shareholders’ meeting authorization, and what is entitled to do only after receiving that consent, and it is therefore necessary to proceed with a case-by-case evaluation.

With reference to the nature of neutral position of the directors, it should be noted that there is only one activity that the board of directors is directly entitled to engage in, and this is the possibility to seek alternative bids, due to the expressed

[18] M. MENJUCQ, *The European Regime on Takeovers,* in *European Company and Financial Law Review*, 2006, pp. 222-236.

prevision of the directive (25/2004/EC). Thus, since a hostile takeover bids has been launched, the board of directors is entitled to (and maybe is in charge of this activity too) try to seek alternative bids, without waiting for the shareholders' authorization. The reason of this provision could be easily noted, since it is possible to understand as the ability to seek alternative bids might set up a competition, and competitive offers are likely to bring advantages for shareholders. In fact, in order to compete and win the competition, a bidder should offer better terms and conditions (as well as a higher price) than its competitors[19].

In addition, in case of a takeover bid, the board of directors is required to prepare a document containing its advice on the acceptance or the rejection of the bid, and to provide shareholders with it. The board of directors must provide the shareholders with its evaluation on the merits of the bid, on the effects of the bid on the company's interests, on the future business of the bidder, and on the implications of the future business also on the employment situation.

In light of these two above mentioned examples, *i.e.* the possibility for the board of directors to seek alternative bids and the obligation to create a report with its opinion on the merits of the bid, it should be clear that the position and the behavior that the board neutrality rule requires to the directors is not a passive one but it requires a neutral position. Indeed, the board of directors is only entitled to engage in non-frustrating situation, while the shareholders' meeting has the ability to decide on the merits of the bid and whether to promote defensive tactics or not.

We need to remember that, due to the assumption that the board neutrality rule prevents post-bid defensive tactics, the shareholders' meeting is required to take a decision on the possibility to act against the bid only when a bid has already been launched, and when shareholders have already been informed on the terms and conditions of the offer. Thus, with respect to the actions initiated before the launch of the bid, which could frustrate the bid, the board of directors needs to be authorized by the shareholders' meeting that has then the power to ratify their

[19] A. ANGELILLIS and C. MOSCA, *Considerazioni sul recepimento della tredicesima direttiva in materia di offerte pubbliche di acquisto e sulla posizione espressa nel documento della Commissione Europea*, in *Rivista delle società*, 2007, pp. 1106-1170.

acts. This solution, namely the need to receive the confirmation by the shareholders' meeting for the acts taken before the launch of the offer, could be somewhat very intrusive of the managers' work, since it could represent a huge obstacle on their business. In order to bridge this problem, the Directive (25/2004/EC) stated that only activities and acts that cannot be considered usual and inherent with the conduct of the business of the board of directors have to be ratified by the shareholder's meeting. This solution gives the managers the possibility to go on conducting their business, with no fear for the inefficacy of its operations, at least for those that could be considered usual and within the ordinary activity of the board of directors.

Focusing the time when the board neutrality rule begins to work represents a crucial issue in this matter. In fact, if the target board of directors had the possibility to act, even if for a little period, the aim of the takeover bids regulation to prevent the agency problem between shareholders and directors, trying to prohibit directors to engage in operations that could frustrate the bid, would be far from being achieved. Article 9 can be interpreted as this time beginning in the instant when the board of directors of the target company receives the necessary information by the bidder, so even before the publication of the offer document, and until the result of the bid has been published or the offer has expired. Thus, pursuant to Article 9 of Takeover Bids Directive, since the board of directors receives the needed information by the bidder, and until the publication of the result of the bid or its expiration, the board of directors is not entitled to take any frustrating action without the shareholders' consent.

SUB PARAGRAPH II – BREAKTHROUGH RULE (ARTICLE 11)

The second fundamental provision of the passivity rule is provided in Article 11 of the Takeover Bids Directive (25/2004/EC), and it is known as "breakthrough rule" or neutralization rule. The usefulness of this provision is based on the neutralization of a variety of corporate law strategies usually used and provided for in the article of association as well as in contractual agreements. Indeed, pursuant to Article 11 of the Directive, during the time allowed for the acceptance of the bid, (i) restrictions on the transfer of securities provided for in the article of association of the target company, or in contractual agreements between the company and shareholders or between shareholders themselves, will not apply and will have no effect *vis-à-vis* the bidder; (ii) restrictions on the voting rights provided for in the article of association or in contractual agreement will not apply in the general meeting called in order to decide on the permission of defensive measures and any share carries one-vote[20].

The granting of these provisions starts from the assumption that the above mentioned clauses, on the one side, could reduce the number of shares that bidders may buy, and on the other side, could prohibit the bidder who has gained a controlling stake to get the control of the company, due to the existence of different categories of shares with different voting rights (such as in the case of dual class shares structure). The Commission doubted whether totally prohibit the use of these structures in the article of associations as well as in contractual agreements, or to permit their use and only neutralize them in pendency of a takeover bid. Also due to the belief that the first decision would have been too expensive and too intrusive on the contractual freedom, and taking into account the *High Level Group* advice, the Commission opted for the statutory and contractual ability to set up these structures, but with the neutralization of the latter during the period of the acceptance of a bid.

With a look at the restrictions of Article 11, it is possible to understand their aim. In fact, the provision on the neutralization of the restrictions on the transfer of shares, making shareholders free to decide whether or not to tender their shares, sought to support the bidder making him more likely to succeed in its goal to gain the majority of shares. Instead, with reference to the provision under which in the general meeting for the decision on the authorization of defensive measures any share carries one vote, the Directive tried to prevent the possibility for a materially

[20] L. SCIPIONE, *Le regole in materia di misure difensive tra vecchia e nuova disciplina dell'opa*, in *Le Società*, 2009, 5, pp. 581-595.

controlling shareholders to take advantage of the discrepancy between shares and voting rights and so tried to prevent its ability to authorize detrimental defensive measures.

Furthermore, it is worth to know as the breakthrough rule doesn't work only during the period of acceptance of the bid, since the fourth paragraph of Article 11 provided for post-bid neutralization provisions. Indeed, the fourth paragraph of Article 11 states that, in case a bidder holds 75 per cent or more of the capital carrying voting rights, in the first shareholders' meeting called in order to amend the bylaws and to appoint and remove directors, any restriction on voting rights will not apply[21]. With this final provision, the will of the Takeover Bids Directive (25/2004/EC) was to provide the bidder who gain at least 75 per cent of shares with the ability to make the necessary amendments on the bylaws and to appoint and remove directors in the first shareholders' meeting for those purposes called. This solution should permit bidders to make the needed changes and obtain the effective control of the company.

As I explained in the past paragraphs, the breakthrough rule is a provision able to defeat pre-bid defensive measures, and it could represent the most influencing and useful provision in the takeovers regulation. Indeed, post-bid defensive measures that the board could be motivated to engage in are somewhat very evident, and for this reason they could be easy to assess and prohibit. Instead, pre-bid defensive measures are tactics brought in a period when no hostile bids have been launched. For this reason, it could be more difficult to notice pre-bid defensive measures and then it could be difficult to prohibit them. The most used pre-bid defensive measures, at least in the past, were the poison pill arrangements and the staggered board[22]. Poison pill arrangements, which could be set up in several ways, have all the same purpose to dilute the stake that a bidder obtain after a takeover bid. In fact, through a poison pill, shareholders who did not sell their shares to the bidder

[21] J. MUKWIRI, *Takeovers and Incidental Protection of Minority Shareholders,* in *European Company and Financial Law Review*, 2013, 10, 3, pp. 432-460.

[22] G. FERRARINI and G.P. MILLER, *A Simple Theory of Takeover Regulation in the United States and Europe*, in *Rivista delle società*, 2010, pp. 680-719.

are granted with the possibility to buy new shares for a favorable price, in case the bidder should gain a certain percentage of the shares, so diluting its stake and prohibiting him to take over the company. Instead, staggered board tactics create a staggered expiration of directors from their office, so that the new controlling shareholder would need more terms of office to remove the directors, so limiting its possibility to exercise the control over the company, notwithstanding its majority of shares. In light of this, the breakthrough rule, if well implemented, could bring a real obstacle in the inducement of the management to entrench its position, and so could represent a real change in the creation of a more open market for corporate control.

Unfortunately, we need to remind that the Directive (25/2004/EC) made this provision optional and not mandatory, with a double opt-in system. Thus, first of all Member States have to decide whether to make this provision mandatory (through an opt-in decision) or not (through an opt-out decision). When the Member State decided to opt-out the breakthrough rule, it must allow national companies to opt-in again the provision in their bylaws. Thus, any national company has the possibility to subject itself to a similar breakthrough rule, in case the Member State has decided to let it be optional.

However, the possibility (and also strange and difficult decision) for national companies to opt-in the breakthrough rule in their bylaws, and unlike the private opt-in of the board neutrality rule, doesn't allow national companies to exactly emulate the Directive provisions. Indeed, it would be possible to neutralize the effect of restrictions on the transfer shares and on voting rights in the general meeting for the authorization of defensive measures and in the first meeting after the success of a bid to remove and appoint board members and to amend the bylaws, when these clauses are present in the bylaws. However, it would be impossible, or at least complex, to provide for a statutory clause able to make some shareholders' contractual agreements ineffective, because they have power only between the shareholders that have entered into the agreement, while the statutory clause would have influence on all shareholders[23].

The last issue I would like to talk about represents a principle of compensation, under which in case of neutralization of the previous seen rights, *i.e.* in case of the neutralization of multiple voting rights for the authorization of defensive measures, the shareholders who have seen its right broken should be compensated. Indeed, Article 11 provides for the obligation to compensate the shareholders holding particular rights with a monetary compensation, whose amount and terms and conditions of the payment any Member State should implement. Thus, the Directive decided to create a flexible system, granting Member States with the decision on all the necessary terms of the payment, without providing them with any guideline. The Commission decided for this kind of solution, in order to let Member States free to create the best monetary compensation system for their national situation.

On this matter, there was an issue on the interpretation of the directive, which was not clear with reference to the possibility to consider this implementation mandatory only for Member States that have opted-in the breakthrough rule. However, in light of the possibility for national companies to introduce in their bylaws some provisions emulating Article 11 of the Directive, the most accepted interpretation of the directive requires all Member States to implement the fifth paragraph of Article 11. Thus, any Member State has to provide for some instructions for the establishment of the amount and the terms and conditions of the monetary compensation, so protecting the position and the rights of the shareholders who suffered the neutralizing provisions of Article 11 of the Takeover Bids Directive.

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[23] F. M. MUCCIARELLI, *Il principio di reciprocità nella Direttiva comunitaria sull'opa*, in *Giurisprudenza Commerciale*, 2005, 6, pp. 830-ss.

SUB PARAGRAPH III – RECIPROCITY RULE (ARTICLE 12)

The final rule provided for in the Takeover Bids Directive (25/2004/EC) is represented by a closing statements, which provides a reciprocity feature, the so-called "reciprocity rule", provided for in Article 12 of the Directive. According to the reciprocity rule, Member States are entitled to exempt companies which apply Article 9 (board neutrality rule) and Article 11 (breakthrough rule) from applying those articles if they become the target of an offer launched by a company that does not apply the same articles as they do, or by company controlled, directly or indirectly, by the latter[24].

The introduction of the reciprocity rule requires a double decision by Member States and national companies. Indeed, any Member State must decide whether to implement this provision or not. However, Member State opting-in, the reciprocity rule will not work automatically, but a decision of the company is required. Thus, in case the Member State decides to introduce the reciprocity rule, then national companies have to decide to take advantage of it and apply it through a general meeting resolution, which should be made no earlier than 18 months before the launch of the offer[25]. Therefore, when there is this general meeting decision, the board of directors is entitled to take any permitted action in order to frustrate the hostile bid, as well as any restriction on the voting rights or on the transfer of shares will apply. As I said, in order to have the possibility to use the reciprocity rule and be subject to the exemption, the general meeting's decision on the introduction of the reciprocity rule must be taken no earlier than 18 months before the launch of the bid, and this obligation brings some issues. In fact, first, national companies and their shareholders' meetings have to decide every 18 months for the renewal of the reciprocity rule. Then, shareholders'

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[24] F. WOOLDRIDGE, *Some important provisions, and implementation of, the Takeovers Directive*, in *Company Lawyer*, 2007, 28, pp. 293-296.

[25] M. Gatti, *Scelte opzionali e reciprocità nella direttiva in materia di offerte pubbliche di acquisto*, in *La nuova giurisprudenza civile commentata*, 2005, pp. 416-433.

meeting cannot decide with reference to one bid, but it has to grant board of directors with a large freedom to act in frustration of an eventually future takeover bid. The shareholders' meeting would have no information about the future bid, and then no possibility to assess if the permission to engage in frustrating actions could bring advantages for shareholders or could be detrimental for their welfare. Finally, the shareholders' meeting resolution would not generally permit the board of directors to act against a bid. However, due to the impossibility for shareholders' meeting to be more precise, it is not required to point out what defensive measures and what operations board of directors is exactly entitled to use.

If the two main provisions of the Directive on the permitted defensive measures, *i.e.* the board neutrality and breakthrough rules, are important for the purpose to prevent post and pre-bid defensive measures, Article 12 of the Directive, which states the reciprocity rule, may be considered fundamental in order to achieve the aim of the creation of a level playing field. In fact, the confusing system based on optional rules may create everything but a level playing field, if a reciprocity rule is not introduced. Thus, notwithstanding the possibility for Member States to decide for the best system of permitted defensive measures depending on their traditions and economic situation, companies incorporated in different Member States will be subject to the same prohibitions or will benefit from the same freedoms, at least in the transactions between themselves.

It could be interesting to analyze what are the subjects affected by this rule. First, we could begin pointing out that the reciprocity rule, being the most important provision for the creation of a level playing field, is supposed to work in a takeover between companies incorporated in different Member States. Moreover, it should be noted as it is possible for a company to trigger the reciprocity rule even when the bidder is a company established in the same Member State. The case I am talking about is that in which, for example, the Member State decided to opt-out the board neutrality rule, and in which the target company decided to introduce a corresponding provision in its bylaws, while the bidder company decided not to implement it. In this case, notwithstanding the companies are established in the same Member State, the target company could trigger the reciprocity rule, and then misapply the restrictions provided by the board neutrality rule in Article 9 of the Directive.

It is worth to know as the text of the reciprocity rule is not that clear, so bringing some interpretation issues.

First, the fact that the directive (25/2004/EC) provided Member States and companies with the possibility to alternatively opt-in the board neutrality rule or the breakthrough rule raised the issue relating to the possibility for the target company to trigger the reciprocity rule with relation to both the rules or just to the same rule not applied from the bidder company. Thus, being a bidder subject to only one of the two provisions (e.g.: only to the board neutrality rule), a question is raised as to whether the target company, which is subject to both the provisions, is entitled to exempt itself from both the rules or only from the same provision not applied from the bidder *(*in this case the breakthrough rule). Taking into account the aim of the reciprocity rule to give the possibility to companies to be subject to the same provisions, this issue has been solved interpreting the text as providing the target company with the ability to exempt itself only from applying the same rule not applied by the bidder[26].

Furthermore, another issue raised by the ambiguous text of the Directive (25/2004/EC) is the one related to the situation in which a company is the target of two or more bidders. For example, what if a company is the target of two bidders, where only one is subject to the same provisions of the target? It is not clear from the text whether the target company may trigger the reciprocity rule vis-à-vis both bidders or only vis-à-vis the bidder that is not subject to the same provisions. Also in this case, the predominant interpretation is for the second solution, so reflecting the ideas and the aim of the rule, so permitting the target company to trigger the reciprocity rule only vis-à-vis the bidder which is not subject to the same restrictions.

[26] F. M. MUCCIARELLI, *Il principio di reciprocità nella Direttiva comunitaria sull'opa*, in *Giurisprudenza Commerciale*, 2005, 6, pp. 830-ss.

Finally, the last issue raised by the confusing text is the one as to the territorial validity of the directive, *i.e.* whether the Directive has effects only within the European Union or whether it has extra-community effects. The issue is relevant in order to understand whether a target company, which is subject to the passivity rule, is able to trigger the reciprocity rule only if the bidder is a company established in a Member State, or if it would have the ability to oppose the reciprocity rule vis-à-vis an extra-community bidder company. The text is not clear on this point, but it would be surprising if this rule, written into the Directive to ensure the level playing field in Europe, did not apply to foreign companies in such cases where a level playing field does not exist[27]. Moreover, it should be noted as this solution, *i.e*. the possibility for companies to trigger the reciprocity rule and defend themselves vis-à-vis extra-community companies, is coherent with the history of the adoption of the Directive, with the fears of some Member States to allow companies established in United States to easily take over European companies.

It is possible to conclude that, because of the reciprocity rule, the Directive would restrict the group of potential bidders to listed companies that are themselves subject to the board neutrality and breakthrough rules, and then to bidders open to hostile bids. However, the possibility to use the reciprocity rule could be against the promotion of a more open market for corporate control[28]. Conversely, the reciprocity rule could represent an incentive for companies to subject themselves to the passivity rule. Indeed, if a company expects to be a credible bidder in future and in order to benefit from the passivity of its target company, it should decide to establish itself in a Member State that decided to opt-in the board neutrality and the breakthrough rules, or if this is not the case, it should introduce them in its bylaws.

[27] M. MENJUCQ, *The European Regime on Takeovers*, in *European Company and Financial Review*, 2006, pp. 222-236.

[28] M. GATTI, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, in *European Business Organization Law Review*, 2005, pp. 553-579.

CHAPTER II – THE ADOPTION OF THE EUROPEAN DIRECTIVE BY MAJOR MEMBER STATES AND PASSIVITY RULE IN USA AND CHINA

After so many years of negotiations, resistances, and reluctances by Member States in accepting the various drafts of Directive, the European Directive on Takeover Bids was finally adopted in 2004 (Directive 25/2004/EC). The Directive established a framework based on common principles and minimum requirements that any Member State had to implement through national legislations by May 20th, 2006.

In light of the optional system provided by the Directive, the implementation by Member States represents a crucial and fundamental act in the European Union Takeovers regulation. In fact, as we have seen in the previous paragraphs, European Commission, due to the above mentioned resistances, provided Member States with a huge freedom to decide on whether or not to implement the Directive, allowing them to decide what restrictions their national companies should be subject to. Thus, the takeovers regulation within European Union depends on a double decision. First, any Member State has to decide whether to intervene or not, deciding to impose the passivity rule as a mandatory provision (opt-in), or an optional one (opt-out). In case of opting-out, Member States have to allow their national companies to voluntarily introduce again the rules (opt-in) in their bylaws.

It should be easy to understand that, due to the optional system, in order to assess the implications of the European Directive (Directive 25/2004/EC), we need to have a look at the Member States' implementation, and then at the national companies' voluntary adoption of the passivity rule's provisions. In fact, without such fundamental analysis we would not be able to understand whether the Directive has influenced the market for corporate control, making it more contestable and open, or not. Moreover, we would not have the possibility to realize whether or not the board neutrality rule, the breakthrough rule, and the reciprocity rule, are able to create a level playing field within European Union. In other words, we would not be able to totally comprehend how hostile takeover bids are faced across Member States. Therefore, in order to acknowledge what defensive measures the target company is entitled to use within European Union, and in order to understand who the main character between shareholders and the board of directors is, we need to analyze how any Member State decided to implement the European Directive.

The European Commission published some data concerning the Member States' implementation in 2007. According to these data, for a first brief assessment of the implementation of the Directive (25/2004/EC), it is possible to say that the majority of Member States decided to opt-in the board neutrality rule. In fact, 18 Member States out of 25 decided to introduce Article 9, and this means that about 75% of European listed companies are subject to the board neutrality rule, with no possibility for the board of directors to engage in defensive tactics without the previous shareholders' meeting authorization[29]. Thus, in light of the data concerning the implementation by Member States, and taking into account the possibility for national companies to voluntarily introduce the rule, it is possible to notice the high contestability of the control of companies within European Union, at least with reference to the board neutrality rule and the post-bid defensive measures.

Conversely, the European Commission's publication has shown as only three Member States – and no major Member State among them - have implemented the breakthrough rule, , so that only a very limited number of European listed companies is subject to Article 11 of the Directive.

Furthermore, according to Commission data, the most part of Member States decided to implement the reciprocity rule. However, this does not mean that all companies established in Member States that have implemented the reciprocity rule are subject to it, because as we have previously seen, a company's decision to take advantage of this possibility is needed.

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[29] A. ANGELILLIS and C. MOSCA, *Considerazioni sul recepimento della tredicesima direttiva in materia di offerte pubbliche di acquisto e sulla posizione espressa nel documento della Commissione Europea*, in *Rivista delle società,* 2007, pp. 1106-1170.

Now, I propose to have a more detailed look at the decision on the implementation of the Directive (25/2004/EC) by three major Member States, *i.e.* Italy, United Kingdom and Germany, in order to have a better view of the effects of the Takeover Bids Directive. Then, I propose to have a look at the defensive measures regulation in USA and China, in order to acknowledge how the issue concerning the conflict of interests between the board of directors and shareholders during a hostile takeover bid is considered outside Europe, and how other major countries have decided to solve it. In fact, in light of the reciprocity rule, the comparison with the takeovers regulation in force in US and China is fundamental in order to understand what restrictions European companies are allowed to neutralize, should they became target of companies established in those countries.

PARAGRAPH I – ITALY

SUB PARAGRAPH I – HISTORICAL DEVELOPMENT

Before analyzing how Italy have implemented the European Directive on Takeover Bids (25/2004/EC), it should be interesting to have a look at the long and troubled historical development of Italian regulation concerning the passivity rule and the permitted takeover bid defensive measures. In fact, the first intervention in this matter was made in 1992, when Italian Legislator, out of nowhere, imposed for the first time a passivity rule. In fact, in contrast to the then absolute freedom for directors and managers to act against a hostile takeover bid, Italian Parliament imposed the passivity rule, through the adoption of the Law 18 February 1992, n. 149. That law imposed an absolute passivity, according to which, on the one side, the board of directors had to be passive *vis-à-vis* a hostile takeover bid, being it not allowed to engage in any operation that could frustrate the bid; on the other hand, the shareholders' meeting had no ability to authorize the board of directors to act[30]. That solution lacked of flexibility, since it did not take into account the several disadvantages of an absolute passivity. In fact, a so rigid system represented a huge fear for Italian companies, which have been induced to delist themselves from the Italian Stock Exchange.

This reason and the fact that a so strong regulation was present only in Italy within European Union have been the basis of the second intervention in 1998. Indeed, Italian Legislator, by Article 104 of the d. lgs. 24 February 1998, n. 58 (the so-called "Testo unico delle disposizioni in materia di intermediazione finanziaria" or "TUF"), and following the debate on the European Union field where the discussions on the adoption of the Directive were consistent, decided to partly amend the previous provision. Thus, Article 104 of TUF granted shareholders' meeting with the ability to authorize the board of directors to take defensive measures, when shareholders consider the hostile bid and its success as detrimental for the company. Therefore, the new rule imposed a board of directors' passivity, with a distribution of power from the board to the shareholders' meeting, whereas the previous law adopted in 1992 imposed a passivity behavior for the whole company, which was not able to protect itself *vis-à-vis* a speculative bidder. The system imposed by the intervention of 1998 seemed to be coherent with the then legislation of other Member States. However, the issue of Article 104 of TUF was represented by the obligation for the shareholders' meeting to reach a *quorum* of 30% of the company's capital in order to allow directors and managers to defeat the bid, which was higher than the general quorums required for ordinary and extraordinary meetings, provided for in the then Article 126 of the TUF. In fact, this discrepancy between the two articles brought some interpretation issues, making the application of Article 104 of TUF complicate and problematic[31].

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[30] E. ROSATI, *La nuova disciplina delle tecniche di difesa nelle opa ostili*, in *Le Società*, 2009, 5, pp. 567-574.

[31] For a general review on the issue as to the calculation of the achievement of the quorum see R. LENER, *Basta passività, difendiamo l'italianità! L'OPA obbligatoria dinanzi alla crisi dei mercati*, in *Analisi Giuridica dell'Economia*, 2009, 1, pp. 53-66.

It is worth to know as Article 9 of the Directive adopted in 2004 (25/2004/EC), is quite similar to the then Article 104 of TUF, because it required the board of directors to stand still during the period of acceptance of a tender offer. However, the Directive went little beyond the Italian TUF, stating that the issue of shares that could have the effect to impede a takeover bid has to be considered as a defensive measure that require the shareholders' meeting authorization. Moreover, for the first time, the Directive provided the board of directors with the possibility to seek alternative bids without the prior shareholders' meeting authorization. This has represented an important change in European Union and in Italian jurisdiction too, since the search for alternative bids was not possible in Italy before the Directive. In fact, it is possible to remind the Olivetti-Telecom case, in which the activity of the management of Telecom in order to seek alternative bids has been very criticized, while it now represents a lawful activity.

As we know, the Directive (25/2004/EC) had to be implemented by Member States, and Italy implemented it through the adoption of d.lgs. 19 November 2007, n. 229. The decision of Italian Legislator was very stern, since it decided to opt-in both the board neutrality and the breakthrough rules, opting for a totally contestable and open market for corporate control.

After the implementation of the Directive (25/2004/EC), Article 104 of TUF still did not expressly state what was to be considered as a defensive measure that the shareholders' meeting had to permit, and what operations the board of director was instead able to engage in before any authorization. However, a help came from Consob ("Commissione Nazionale per le Società e la Borsa"), that is the regulatory authority of the Italian Stock Exchange, which gave a series of guidelines. In fact, according to Consob, mere declarations of knowledge, as well as expressions of opinions, were not to be considered as a defensive measure and the board of directors was allowed to provide them without any shareholders' consent. Conversely, Consob considered as prohibited defensive measures: (i) any activity that could increase the costs for the bidder; (ii) any operation able to change the financial and business structure of the target company and (iii) any action brought from the board of directors with the purpose to make the success of the hostile takeover impossible or at least more difficult.

Finally, the d. lgs. n. 229/2007 introduced the possibility for national companies to adopt the reciprocity rule, according to which Italian companies were not subject to the restrictions imposed by the board neutrality rule and the breakthrough rule, in case the bidder was not subject to the same or corresponding rules.

However, in 2008 Italian Legislator overturned the situation, being it afraid of the low shares price of Italian companies due to the financial crisis. In fact, by d. l. 29 November 2008, n. 185, which was converted by l. 28 January 2009, n. 2, Italian Legislator made the board neutrality rule and the breakthrough rule only optional. Thus, by this intervention Italian companies were allowed to decide whether to introduce the passivity rule's provisions in their bylaws or not.

Furthermore, through this intervention, Italian Legislator did not only make the passivity rule's provisions optional, but it brought many amendments able to affect the openness of the market for corporate control. Indeed, one of the most debated amendments has been the decision to delete the provision concerning the necessity to achieve a quorum of 30% in order to allow directors to engage in frustrating operations. In fact, in the previous text, the requirement of a quorum of 30% of the company's capital was able to, or at least was trying to, limit the possibility for controlling shareholders to take autonomous decisions and then permit defensive measures in order to entrench their position and the position of their directors. With the removal of this higher quorum and the adoption of the lower general quorum, controlling shareholders could be allowed to decide on merits of a bid, even with a percentage of stake less than 30 per cent[32].

Furthermore, it has been enhanced the possibility for the controlling shareholder to entrench its ownership without require him to launch a tender offer to all the holders of the company's shares. In fact, the possibility for the controlling shareholder who already has a percentage of shares higher than 30 per cent to buy

[32] CIRCULAR OF APRIL 15TH, 2009, N. 18, *Le modifiche alla disciplina sull'opa: regola di passività, regola di neutralizzazione e reciprocità (decreto anti-crisi n. 185 del 29 novembre 2008)*, in www.assonime.it.

shares without the obligation to launch a tender offer passed from 3 per cent to 5 per cent.

Finally, the intervention of 2008 doubled the possibility for the company to buy-back own shares, whose limit passed from a maximum of 10 per cent to a maximum of 20 per cent of shares. It should be noted as the buy-back of own shares represents one of the most successful defensive device, which gives the controlling shareholder the possibility to enhance its position and to make more difficult for a bidders to take control over the company[33].

To conclude, the declared rational of this so wide revision of the decision taken in implementing the European Directive in 2007, was the necessity to make Italian companies able to face the financial and economic crisis that affected the financial market. In fact, the above mentioned financial crisis, brought a drop in the price of the shares of Italian companies. In this situation, the fear of Italian Legislator was related to the negative possible event of a speculative behavior of abroad investors, which could have been stimulated to take over Italian companies, due to their low price. Another explanation of this change could be considered the fact that Italian government realized to be one of the few Member States that had implemented the Takeover Bids Directive in that strong manner.

SUB PARAGRAPH II – CURRENT LEGISLATION

In 2009, by d.lgs. 25 September 2009, n. 146, which went into effect on July 1st, 2010, Italian Legislator brought the last amendment on the takeovers regulation, providing for the text of Article 104 of TUF that is now in force. With this final change, Italian Legislator decided to amend again the nature of the passivity rule, at least with reference to the board neutrality rule. Indeed, nowadays, through the Decree of 2009, the board neutrality represents again the default system of the passivity rule, with the possibility for national companies to opt-out it again.

[33] F. MAZZINI, *Strategie di rafforzamento e misure antiscalata per gli assetti di controllo delle società quotate*, in *Guida al Diritto*, 2009, 24, pp. 27 ss.

Thus, Italy's decision has been to introduce the board neutrality rule in its legislation, with the possibility for companies to totally or partly opt-out it in their bylaws. The new regime did not affect the breakthrough rule, since it is still subject to an opt-in decision by national companies that have the possibility to introduce it in their charters[34].

The Italian Legislator have officially justified this new Decree and the decision to opt-in the board neutrality, with the necessity to create a level playing field in Europe Union. In fact, this intervention has been stimulated by the will to subject Italian companies to the same regulation of companies established in other Member States[35].

The new regime could be considered as a middle system between the two previous extreme decisions, *i.e.* the mandatory passivity rule in the implementation in 2007, and the total overturn in 2008 when, due to the financial crisis, the Italian Legislator decided to make it optional. It is easy to know as in only three years, Italian Legislator have changed three times its view, going from a mandatory passivity rule to an only recommended regulation. In fact, the last regime could be seen as a set of recommendations that Italian companies have the possibility not to follow.

As we have previously seen, the new text of Article 104 TUF provides Italian companies with the power to totally or partly misapply the board neutrality rule. Thus, Italian companies have a large room to maneuver, with the ability to make three different choices: (i) being totally subject to the board neutrality rule; (ii) totally misapplying it; (iii) partly misapplying it, so having the chance to set up the system that better meet their needs. In case Member States decide for the third option, *i.e.* the possibility to partly misapply the board neutrality rule, they are entitled, for example, to decide what acts require the shareholders' prior

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[34] G. FERRARINI and G.P. MILLER, *A simple Theory of Takeover Regulation in the United States and Europe*, in *Rivista delle società*, 2010, pp. 680-719.

[35] A. MORELLO, *Scalate ostili e misure difensive: dalla Direttiva OPA al Decreto 146/09*, in *Le Società*, 2010, 2, pp. 158-166.

authorization, and what acts the board of directors is entitled to adopt, even if they could be against the success of a hostile takeover bid.

With respect to the breakthrough rule, the new regime did not affect the previous one, since the new Article 104 have confirmed this rule as only optional for companies, who have the possibility to opt-in it in their bylaws. In this field, it was not sure whether the possibility for companies to introduce the breakthrough rule in their bylaws could be considered as large as for the board neutrality rule. It is not clear whether companies are entitled to partly introduce the breakthrough rule, but through interpretation, the possibility for companies to set up the best regime for their needs is considered to concern both the board neutrality and the breakthrough rules[36].

Finally, with reference to the reciprocity rule, Italian Legislator decided to introduce it and to make it mandatory. In fact, there is no ability for Italian companies to decide whether or not to implement it. Thus, should an Italian company be the target of a bidder that is not subject to the same or corresponding rules, the board neutrality rule and the breakthrough rule will not apply. The assessment on whether or not the bidder is subject to the same or corresponding rules than the target company, is an activity carried on by Consob.

To conclude, since due to these several interventions of Italian Legislator the situation could be not very clear, a brief summary of the rules that Italian companies are subject to, should help us to understand what defensive measures the target board of directors is entitled to use.

Therefore, as a matter of summary, the current text of Article 104 of TUF states that: (i) Italian companies are subject to the board neutrality rule, with the possibility to opt-out it by a statutory amendment; (ii) Italian companies are not subject to the breakthrough rule, unless they voluntarily implement it; (iii) Italian companies are subject to the reciprocity rule.

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[36] A. MORELLO, *Scalate ostili e misure difensive: dalla Direttiva OPA al Decreto 146/09*, in *Le Società*, 2010, 2, pp. 158-166.

PARAGRAPH II – UNITED KINGDOM

SUB PARAGRAPH I – THE CITY CODE ON TAKEOVERS AND MERGERS AND THE PANEL ON TAKEOVERS AND MERGERS

As we have already seen, the Takeover Bids Directive has been modelled on the United Kingdom takeovers regulation. Thus, it is worth to have a look at how this regulation worked since its adoption and how United Kingdom Legislator had to amend it in order to implement the European Directive (25/2004/EC).

The UK takeovers regulation has always been based on the *City Code on Takeovers and Mergers*, which came into effect in 1968 under the support of the Bank of England and with governmental approval, and which was established in order to defeat some abuses raised in the 1950s and 1960s. However, Takeovers Code did not have the force of law, and in fact it was enhanced by the Takeover Panel (the "Panel"), which was established in order to supervise the administration of the Code and in order to give authoritative rulings and advice on its application. Thus, the Panel was in charge of the interpretation of the Takeovers Code, and its interpretation was useful in order to follow the spirit of the Code and avoid legalistic interpretations[37].

The advantage of this regime was based on its nature of self-regulatory system, which allows it to be quicker cheaper and more flexible than a statutory system. This regime was preferred for its ability to prevent any tactical litigation, which could bring delays in the takeover process. Moreover, the Panel has never been a formal part of the wider statutory-based regulation of the financial services or capital markets sectors, and it was independent from the Government, the Financial Services Authority (FSA) and the Stock Exchange[38].

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[37] A. JOHNSTON, *Takeover Regulation, Historical and Theoretical Perspectives on the City Code*, in *The Cambridge Law Journal*, 2007, 66, 2, pp. 442-460.

[38] G. MORSE, *Self regulation of takeovers in Great Britain after the thirteenth directive*, in *Company Law Newsletter*, 2005, 10, pp. 1-6.

Historically, the Panel derived its authority from financial communities and mainly from its representative bodies, who decided to support its activities, and who made a lot of efforts in order to encourage their members to adhere to the code[39].

Notwithstanding several amendments occurred since its adoption, the United Kingdom approach to takeover bids has never changed. In fact, the UK regime, through its City Code and its Panel, has always been based on the belief of the supremacy of the shareholders decision-making view. We may summarize the UK regime as having four fundamental aims: (i) equal treatment of shareholders during the period of the acceptance of the bid; (ii) adequate and timely advice and information for shareholders in order to enable them to decide on the merits of a bid; (iii) the need to prevent the creation of false market of shares; (iv) prohibition for the board of directors of target companies to engage in frustrating operations without prior shareholders' meeting authorization, which is considered the centerpiece of the whole regulation[40]. Thus, it is possible to note as the entire UK takeovers regulation has been always based on the assumption that the board of directors is in a situation of conflict of interests during a hostile takeover bid, and that shareholders should be granted with the ability to decide on the merits of the bid and to decide what defensive strategies they would like to undertake.

SUB PARAGRAPH II – TAKEOVERS DIRECTIVE IMPLEMENTATION

The European Directive on Takeover Bids was adopted in 2004, and its Article 21 required Member States to implement its provisions by May 20th, 2006. Notwithstanding the Directive was mainly based on *City Code on Takeovers and*

[39] D. CALCUTT QC, *Keeping track of takeovers – the work of the Takeover Panel*, in *Law Society Gazette*, 1993, 11, p. 90.

[40] J. MUKWIRI, *The Myth of Tactical Litigation in UK Takeovers*, in *Journal of Corporate Law Studies*, 2008, 8, pp. 373-388.

Mergers, UK Legislator had to adopt some amendments in order to implement the Directive.

The most important amendment that United Kingdom was required to undertake was related to the nature of self-regulatory body of the Code and the Panel on Takeovers and Mergers, which was unacceptable for the text of the Directive (25/2004/EC). It is worth to remember as this issue was at the basis of the United Kingdom resistance during the years before the adoption of the Directive. The fear of UK Legislator was related to the negative implications of the Directive on the Panel, which could have lost its strengths, losing its nature of a cheap, quick and flexible regime. Then, United Kingdom feared for the possibility of the new regime to stimulate a culture for tactical litigations, which was seen as somewhat able to cause an increase in the costs and in the length of the takeover process. In order to bridge this fear, the European Directive has been implemented in UK in such a way as to allow the Panel and its system to maintain their strengths related to the nature of self-regulatory board, notwithstanding it became a statutory system. In fact, the autonomy of the Panel on Takeovers and Mergers has been saved with seven statutory restricting provisions that protected the Panel from prosecutions, except in case of bad faith.

The European Directive has been adopted in United Kingdom by two acts, firstly by the Takeovers Directive Regulations 2006, which was an interim implementation made in order to implement the Directive by May 20th, 2006, and then by the Part 18 of the Companies Act 2006, which definitely implemented the European Directive and came into effect on April 6th, 2007[41].

The board neutrality rule has always been the cornerstone of the UK takeover bids regulation. In fact, in implementing the Directive, UK Legislator decided to maintain the board neutrality rule and to continue it as the core of its regulation. Thus, the board neutrality rule has been opted-in, with no possibility for national companies to derogate to it.

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[41] P. DAVIES, *An Introduction to the New UK Companies Act: Part II*, in *European Company and Financial Law Review*, 5, 3, pp. 239-279.

With reference to Article 11 of the Takeover Bids Directive (25/2004/EC), the UK Legislator decided to opt-out the breakthrough rule in order to prevent the risk to seriously affect market transactions. However, pursuant to the European Directive, should a Member State decide not to impose the breakthrough rule as mandatory, it must allow national companies to introduce it in their bylaws. In fact, in UK legislation any company may opt-in the breakthrough rule by a special resolution, but only if three conditions are met. First, the company must have voting shares admitted to trading on a regulated market. Second, its articles must not contain the provisions and restrictions provided for in Article 11 of the Takeovers Directive, or in case its articles contain those restrictions, they should state that such restrictions would not apply in cases and under the circumstances provided for in Article 11 of the Directive. Finally, its articles must not contain any provision or restriction that could be in contrast with the text of Article 11 of the Takeover Bids Directive[42].

Finally, with reference to Article 12 of the Directive (25/2004/EC), UK Legislator's choice was not to implement the reciprocity rule, since it was considered to be too complex and in contrast with an open market for corporate control, and then detrimental for companies.

In order to make a first comparison between the current takeovers regulation in Italy and United Kingdom, it is possible to assess as UK Legislator decided for a less protectionist regime. In fact, with reference to the board neutrality rule, UK Legislator decided to provide for it as a mandatory rule, with no possibility for UK companies to depart from it, and then any UK company is subject to the board neutrality rule. Conversely, Italian Legislator decided to provide for it as a default regime, granting Italian companies with the ability to opt-out the board neutrality rule.

With respect to the breakthrough rule, both UK and Italian Legislator decided not to implement it, allowing national companies to introduce it in their bylaws, but as

[42] F. WOOLDRIDGE, *Some important provisions, and implementation of, the Takeovers Directive*, in *Company Lawyer*, 2007, 28, pp. 293-296.

we have just seen, UK Companies Act requires stricter requisites to be allowed to voluntarily implement the breakthrough rule.

Finally, with reference to the reciprocity rule, Italian Legislator decided to allow Italian companies to benefit from that provision, whereas UK government, once again, opted for a more open and contestable market for corporate control, deciding not to implement Article 12 in its takeovers regulation.

PARAGRAPH III – GERMANY

SUB PARAGRAPH I - THE TAKEOVER CODE AND THE ACT ON THE ACQUISITION OF SECURITIES AND TAKEOVERS

To begin the analysis concerning how Germany have implemented the European Directive on takeover bids (25/2004/EC), it is necessary to analyze the previous German takeovers regulation.

Before 2001, Germany did not have a legal regulation on takeover bids, because the German Takeover Code was only a voluntary self-regulation, which has been in force since 1995 and partially amended in 1998. The application of the Code depended only on its formal acceptance by companies. In fact, it contained some provisions that any national companies was free to adopt or not. Its nature of self-regulation, and the freedom that any company was granted in the decision on whether to adopt it or not, was the main issue of its application. In fact, as of April 11th, 2000, 540 companies listed in Germany out of 933 acknowledged the Code[43]. In light of the unsuccessful of this voluntary self-regulation, it was a general belief that a statutory regulation on takeover bids was needed, in order to make it mandatory and in order to bridge the issues related to the voluntary nature of the Takeover Code.

[43] P. MENNICKE, *A new takeover regime for Germany: the Act on the Acquisition of Securities and Takeovers*, in *Company Lawyer*, 2003, 24, pp. 26-32.

Thus, in order to set up a legal framework on takeover bids, and taking into account the need to provide minority shareholders of target companies with some protective device, the German Federal Parliament, the *Bundestag,* adopted the Act on Acquisition of Securities and Takeovers (WpÜG) on November 11th, 2001, which have entered into effect on January 1st, 2002.

The aim of this regulation, at least at the beginning, was to require the board of directors to be neutral in case of a takeover bid, with the prohibition to take any action that could result of a takeover be frustrated. However, during the long journey for the adoption of this regulation, this view was stopped by the fear of German companies to be taken over by US companies. Thus, the final text of the Act on Acquisition of Securities and Takeovers has been far from its initial ideal. In fact, according to the then German takeovers regulation, first, the management team was allowed to autonomously engage in several frustrating operations, such as the search for alternative bids (the so-called search of "white knights") and any measures which would have been taken even by a prudent and conscientious manager. Second, with reference to defensive measures that was not possible to consider within the previous operations, the management was required to obtain the supervisory board's consent, and not a shareholders' meeting authorization, which was required only in some cases directly subject to the authority of the shareholders' meeting[44]. If we remember the role and the composition of the supervisory board in German legislation, it should be clear as the management team of the target company had a large freedom to defeat a hostile bid. In fact, the supervisory board is in charge of the control over the management conduct, and in the bigger corporations (corporations with more than two thousands employees), the employees are entitled to appoint half of the directors. Thus, it should be easy for the board of directors to obtain the authorization for defensive tactics by the

[44] F. WOOLDRIDGE, *France and Germany: defences to takeover bids*, in *Company Law*, 2003, 24, pp. 121-124.

supervisory board, since it is mainly formed by employees, a category that in case of a takeover bid is usually against the offer[45].

SUB PARAGRAPH II – THE DOUBLE OPT-OUT

It should not be forgotten that Germany, in couple with United Kingdom, has represented the bigger obstacle during the last twenty years for the adoption of a takeover bids directive. Its opposition to the directive on takeovers bids and mainly to the board neutrality rule was based on three assumptions. First of all, Germany argued that the board neutrality rule would have avoided the board of directors from the possibility to engage in frustrating operations, with no possibility for shareholders to timely call a shareholders' meeting in order to decide whether to permit any defensive tactics or not, and this even in case of detrimental hostile takeover bids. Second, this prohibition was thought not to permit directors to create a competition and to gain a higher shares price. Finally, it was believed that the above mentioned rules would have made the board of directors accountable to shareholders, prohibiting the board from the possibility to take into account other company constituencies' interests during a hostile tender offer, such as employees and creditors[46].

In light of these believes, Germany implemented the Directive on Takeover Bids on July 2006, and decided for a double opt-out. In fact, German Legislator decided not to introduce the board neutrality rule and the breakthrough rule in its legislation. Thus, German companies are subject to the lighter WpÜG regulation, unless national companies voluntarily decide to opt in both the rules or only one of them, providing for them in their bylaws. Finally, should a company decide to

[45] C. STEINHAUER, *La nuova legge tedesca sulle offerte pubbliche di acquisto*, in *Giurisprudenza Commerciale*, 2002, 1, pp. 391-416.

[46] M.T. REIGADA, *Razionalità ed efficienza delle misure antiopa*, in Giureta – Rivista giuridica on-line, http://www.giureta.unipa.it/phpfusion/readarticle.php?article_id=96, 2008.

opt-in the provisions provided for in Article 9 and 11 of the European Directive, the reciprocity rule would not automatically work, but it would be necessary a shareholders' meeting resolution.

At the end of this analysis about how the three major Member States have implemented the Directive (25/2004/EC), it should be noted that, if German companies are subject to the most protectionist and patriotic regime, and that UK companies are subject to the most open regime, Italian Legislator adopted a regime that could be considered as the middle ground between the UK and the German regulation.

PARAGRAPH IV – UNITED STATES OF AMERICA TAKEOVERS REGULATION

United States of America have always been characterized by the highest number of merger and acquisition transactions, and for this reason it should be helpful to analyze how the federal and the several states legislators decided to regulate them.

In fact, takeover bids in US are subject to several regulations, with a tension between federal and states jurisdictions. It should be noted that US Constitution has limited the jurisdiction of the federal law to the matters it has been directly granted with. In the past years, the Federal Legislator tried to bypass this obstacle, and tried to have jurisdiction on takeover bids legislation, since it has power to act in case of interstate commerce[47]. Through this power, Federal law and the Securities and Exchange Commission ("SEC") regulate takeover bids, but only with reference to the necessary disclosure activity. Therefore, in order to be aware of the takeover bids process in US, we should analyze the states regulations, and it should be worth to have a look at the Delaware Law, since Delaware, for several reasons, represents the place where most United States' largest corporations

[47] C.M. SLAUGHTER, *Rights offerings, takeovers and U.S. shareholders: Part 2*, in *Company Lawyer*, 2002, 23, pp. 72-83.

decided to incorporate. Thus, Delaware law governs the behavior of the board of directors in the most part of United States transactions. The Delaware regulation is mainly based on the decisions of the Delaware courts, and the Delaware Court of Chancery is considered the most efficient and sophisticated one.

First, it should be reminded that the Delaware model has a board-centered approach, in fact, pursuant to Section 141(a) of the Delaware General Corporation Law ("DGCL"), the board of directors is entitled to run the company and to carry on its business and affairs. However, the board of directors, in running the corporation's business, has been charged of fiduciary duties owed to the company and its shareholders. Thus, in case of a hostile takeover bid, on the one hand, target directors are entitled to face it, and on the other hand, they have to take into account their fiduciary duty of care *vis-à-vis* the company and its shareholders. However, directors are provided with a huge parachute, in fact in managing the hostile bid they are protected by the *business judgement rule*. According to the business judgement rule, in making a business decision, the board of directors is presumed to be well informed, in good faith and that it honestly believes that the actions taken were the best possible in order to meet the company's interests. Thus, a court will not have the ability to substitute the board's discretion, and then, if this decision could be justified with a rational business purpose, a court will not be able to decide on the merits of the board of directors' decision. In *Smith v. Gorkom*, in 1985, the Delaware Supreme Court, which is the ultimate appellate authority, stated that in order to show that the action taken is based on a rational business purpose, and then to be protected by the business judgement rule, directors must be informed on the merits of the bid hiring investment bankers in order to advise them on the adequacy of the offer[48].

The above mentioned discussion could lead us to believe that the board of directors is allowed to decide how to face a hostile takeover bids and allowed to entrench itself. However, the Delaware Supreme Court, in several cases, has

[48] A. O. "CHIP" SAULSBURY IV, *The availability of takeover defenses and deal protection devices for Anglo-American target companies*, in *Delaware Journal of Corporate law*, 2012, 37, pp. 115-161.

explained the size of the directors' power and has put some limits on it, prescribing some cases in which the board of directors is not entitled to act in order to frustrate the bid.

In fact, in *Unocal Corporation v. Mesa Petroleum Corporation*, in 1985, the Delaware Supreme Court, taking into account the possible conflict of interests that directors could face in managing a hostile takeover bid, stated that the business judgement rule was not enough in order to induce the board of directors to make the right decision for the company. Thus, for the first time, the Supreme Court imposed an "enhanced business judgement rule", working in case of hostile takeover bids. According to this enhanced requirement, the board of directors, in order to be protected by the business judgement rule, is subject to a stronger burden of proof, with the necessity to provide for more than a simple rational basis of its behavior. Thus, directors must satisfy an enhanced scrutiny in order to have the possibility to benefit from the presumptions of the business judgement rule[49]. In fact, In *Unocal*, the Supreme Court imposed and created a double test that the board of directors have to pass. Indeed, first, the board of directors is required to prove that the hostile tender offer is detrimental for the company as a whole, being it able to affect its corporate policy and effectiveness. Second, once it has passed this first test, it must prove that the actions taken were reasonable with reference to the detrimental effects of the eventually successful hostile takeover bid. Despite the text of this Supreme Court decision and the enhanced scrutiny that directors are subject to in facing a hostile bid, we sincerely have to say and explain how directors could easily meet this enhanced burden of proof. In fact, with respect to the first test, in which the board of directors has to show the eventual detrimental effects of the hostile tender offer, the board could meet its burden of proof simply stating the inadequacy of the price offered, the nature and the timing of the offer, or the detrimental effects to categories other than shareholders, such as creditors, employees, customers, and the society as a whole. Then, in order to pass the second test, the one in which directors have to

[49] G. H. WHITE and A. PW KONEVSKY, *The battle for ABN AMRO and certain aspects of cross-border takeovers*, in *Journal of International Banking and Financial Law*, 2008, 23, 4, pp. 171-ss.

demonstrate the reasonableness of the actions taken with respect to the hostile bid, the board of directors could meet its burden of proof stating that its behavior was neither coercive nor preclusive, and so establishing that it acted in order to satisfy the shareholders' interests[50].

As we have seen in *Unocal* case, the board of directors could easily meet its burden of proof with the possibility to use a large variety of takeover defensive measures. However, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, in 1986, the Delaware Supreme Court reminded that the power of directors to frustrate a hostile tender offer is not indefinite and it made clear when takeover defenses are prohibited. In fact, in *Revlon* the Supreme Court established that in some cases the role of the directors changes and goes from prevent some hostile detrimental takeover bids to try to get a higher shares price. This change will occur when the company receives multiple fair and adequate offers. Indeed, in case of multiple adequate offers, the company is not subject to a risk for its corporate policy and effectiveness, and then the directors are no longer required to defeat any detrimental offer. Then, directors are no longer entitled to engage in frustrating operations, and if any, it would not covered and protected by the business judgement rule, being its act in breach of its fiduciary duties. Thus, we could see a different situation and a different mode in Unocal and in Revlon. The dividing line could be represented by the number of tender offers received by the target company. In fact, in case the board of directors is facing only one hostile tender offer, even if it is valuable, the Unocal mode is on and so directors have the possibility to defeat the bid and be protected by the business judgement. Instead, in case the company receives multiple valuable tender offers, the Revlon mode is on and the role of the board of directors changes to auctioneers charged with the need to get a higher shares price. The defining moment is considered the one when a corporation undertakes a transaction which will cause a change in

[50] WAI YEE WAN, *The Validity of Deal Protection Devices in Negotiated Acquisition or Merger Transactions Under Anglo-American Law*, in *Journal of Corporate Law Studies*, 2010, 10, 1, pp. 179-217.

corporate control, or a dissolution or a break-up of the corporate entity. In these cases, the board of directors cannot use takeover defensive measures.

Now, it should be interesting to briefly analyze the most common and strong antitakeover devices used in US, *i.e.* poison pills and staggered boards.

A poison pill can be structured in many ways, but it mainly comprehends an unilaterally decision of the target board of directors based on a shareholders' right plan, which allow shareholders to acquire company's shares for favorable terms and conditions, with the aim to dilute the hostile bidder's ownership[51]. Instead, the staggered board of directors is a device used in order to prevent a bidder to obtain the control over the company, avoiding its possibility to remove all the directors in case it gains a certain percentage of shares, through staggered expiration dates of the directors' office. Through this device, the bidder would usually need at least two terms of office to gain the control of the board of directors.

As we have seen, notwithstanding the enhanced business judgement rule, the board of directors is able to entrench itself engaging in several frustrating operations against a hostile tender offer. The question is whether or not the board of directors is provided with so much power to have the ability to use a "just say no" defense. A "just say no" defense, also known as the "Nancy Reagan Defense", could be considered as a board of directors' refusal to positively answer to an all cash, all shares tender at a reasonably good price, during an unlimited time, and without providing the shareholders with another alternative[52]. In light of the huge freedom that the board of directors has in facing a hostile takeover bid, I argue that it has the ability to defeat a hostile takeover bid, even opposing to the bidder a "Nancy Reagan Defense". My personal belief is that this will be possible as long as some defensive measures, such as poison pills and staggered boards, will be permitted. In fact, in my opinion, poison pills and staggered boards, if used

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[51] J. CRIVELLARO and M. MORGUT, *The end of nocuous relations? New shareholders, poison pills and markets for corporate control*, in *International Business Law Journal*, 2012, pp. 349-355.

[52] J. P. LABROUE, *Directors' fiduciary duties in hostile takeovers and the "just say no" defense*, in *International Business Law Journal*, 1995, pp. 821-838.

together, are able to create very high obstacles on the path of hostile tender offers, so that the possibility for target board of directors to defend itself is so huge as to allow them to use a “just say no” defense.

Thus, after all these statements, it should be clear as the United States takeover defensive measures regulation is at odds to the European regulation. In fact, due to a different culture based on a managerial view, United States provides the board of directors with huge powers in facing a hostile takeover bid, allowing directors to adopt some antitakeover devices that totally prevent shareholders from the possibility to decide on the merits of a hostile tender offer. Conversely, as we have seen in the previous pages, the European regulation, at least on the text, is based on the belief that the board of directors would need the previous shareholders’ meeting authorization in order to take any action that could frustrate a bid.

PARAGRAPH III – CHINESE TAKEOVER DEFENSIVE MEASURES REGULATION

The People’s Republic of China Law (PRC) does not provide for any prohibition of defensive takeover measures. Thus, in order to understand how hostile takeover bids are treated in China, we need to have a look at three acts, *i.e.* (i) the Securities Law of the People’s Republic of China (the “Securities Law”); (ii) the Company Law of the People’s Republic of China (the “Company Law”); and (iii) the Procedures for the Administration of Listed Companies (the “Takeover Code”). However, it should be noted that most of the Chinese regulations governing the defensive measures permitted against a tender offer are not very detailed, so that it is not sure what behaviors the target management is entitled to adopt and when it is instead in breach of the law. However, analyzing the related provisions could be of help to better understand the Chinese Takeover Bids regulation.

According to Article 8 of the Chinese Takeover Code, in case of a takeover bid, the board of directors of the target company, (i) has to fairly treat shareholders;

(ii) in taking the decision on the merits of the bid and on defensive measures to be adopted, it must take into account the need to consider the interests of the company and its shareholders' as the ultimate goal to reach; (iii) must not abuse of its powers creating obstacles to the success of the bid, using company's resources in order to assist a bidder, and harm the company and its shareholders. Thus, any defensive measure must be adopted by the target board of directors in the interests of the company and its shareholders. The board of directors must assume a neutral position, and in adopting defensive measures it has to meet its fiduciary duties owed to the company and its shareholders, and must not create inappropriate obstacle on the future success of the bid[53].

Moreover, article 33 of the Chinese Takeover Code establishes that the board of directors of the target company may not carry out any disposal of the company's assets, outward investment, adjustment to the major business of the company or any guarantee or loan that have a major impact on the assets, liabilities, rights and interests or business results of the company, without the approval of the shareholder's general meeting.

Notwithstanding this previous restrictions, the board of directors is free to carry on its normal business activity, taking into account the prohibition to issue shares or sell the company's "crown jewels" in order to frustrate a hostile takeover bid, unless the board of directors is authorized to do it by a shareholders' meeting resolution.

It should be noted as in the uncertain interpretation of the Chinese takeovers regulation, in recent years, some listed Chinese companies have modified their articles of association, adding some antitakeover provisions. In fact, the previous rules would apply when a bid has already been announced, leaving companies free to introduce some antitakeover provisions in their articles of association before the launch of a hostile bid.

[53] C. RIZZI and LI GUO, *Entering the Chinese market through "Takeovers". Listed Company Acquisition and M&A: a new form of investment and a new method to expand a presence in China*, in *Diritto del commercio internazionale: pratica internazionale e diritto*, 2010, 24, 2, pp. 281-308.

Thus, Chinese companies have recently introduced some takeover defensive measures. First, some Chinese companies have provided for restrictions on the possibility to appoint directors and supervisors, which state that any shareholder or group of shareholders who already hold 10% of the shares must communicate this holding to the company within three days and present a plan for the future development, in order to have an approval by the board of directors; otherwise it will not be able to appoint the candidates for directors or supervisors. Second, it has been established the possibility to require minimum terms of office on the board to assume certain office such as directors, chairman and vice chairman of the board. Third, the use of staggered boards became very common. Forth, it has been established the possibility to provide for golden and silver parachutes in case of firing of directors, supervisors and managers. Finally, some Chinese companies have introduced restrictions on transfer of shares that requires the approval by the company and by the People's Bank of China to be able to possess more than 10% of the total shares[54].

In order to assess Chinese takeovers regulation, it is possible to say that Chinese rules on this matter are not very clear. As we have seen, it seems that Chinese companies have a large room to move into and to defend themselves from hostile takeover bids. In fact, taking advantage of the uncertain text of the regulation, some antitakeover provisions have been recently introduced in the article of association of Chinese companies, and only few of them have been required to be amended and removed by the China Securities Regulatory Commission (the "CSRC"). In light of the above mentioned situation, it is possible to consider the Chinese takeovers regulation as more similar and close to the US takeovers regulation than to the European Takeover Bids Directive (25/2004/EC).

[54] WEI CAI, *Anti-takeover provisions in China: how powerful are they?*, in *International Company and Commercial Law Review*, 2011, 22, pp. 311-317.

CHAPTER III – THE ECONOMIC CONSEQUENCES OF PASSIVITY RULE

In the past chapters, we had a brief look at the reasons justifying a regulation on the behavior of directors and managers during a hostile tender offer, and we have taken into account the long historical development leading to the adoption of the European Takeovers Directive (25/2004/EC) and its purposes and principles. After that, it should be necessary to assess the economic implications of passivity rule.

The passivity rule regulation has represented one of the most debated matter on corporate governance in the past years, and it is an issue in which the thoughts on the outcomes of such a regulation are mixed. The choice to let managers and directors free to act against a takeover bid, as well as the opposite choice to oblige them to be passive within a takeover process, is considered as somewhat able to bring significant economic implications towards several company constituencies. Indeed, even if shareholders and directors represents the two constituencies most affected by a tender offer, the latter could be beneficial or detrimental for other subjects too, such as creditors, employees, and the whole social community.

In the previous pages, we analyzed the purposes and the principles of the European Directive (25/2004/EC), that is based on the assumption that, on the one side, directors and managers are often in a situation of conflict of interests in facing a hostile takeover bid; on the other side, requiring the board of directors to be passive during the tender offer could result to be detrimental too, avoiding directors and managers from using some powers and knowledge that could benefit the corporation and its shareholders. Passivity rule regulation and its economic effects is a strongly debated issue. Moreover, in light of the optionality system provided for by the European Directive (25/2004/EC), requiring Member States first and companies then to decide whether to introduce the passivity rule or not, it becomes still more interesting to assess the economic implication of this tough choice. In fact, in order to make the best possible choice, Member States and companies should be aware of the several implications of their decision and should try to set up a regulation able to create an open and contestable market for corporate control.

For a better and more detailed analysis on this important topic, in this chapter I intend to show what are the theoretical economic implications according to some most important academics of the passivity rule, and what should be the most widely held regime according to them. Then, I will try to confirm or reject their theories through empirical data.

PARAGRAPH I – WHY PASSIVITY RULE IS EFFICIENT

Some academics and practitioners argue that the passivity rule, which prescribes the impossibility for directors and managers to engage in frustrating actions during a hostile takeover bid, should be the default and the mandatory rule in corporate governance.

Such an opinion is based on the general belief that takeovers, as well as hostile takeovers, are directly beneficial for the target company and its shareholders and indirectly beneficial for the whole community and the financial market. The beneficial effects of hostile takeovers could be of two kinds. First, hostile takeover bids are considered to be able to bring indirect beneficial effects to the target company, by monitoring the performance of the target board of directors. In fact, the threat of a hostile takeover bid should stimulate the board of directors to run better the company and to take more care about the shareholders' interests. The effect of this monitoring view could be explained by the fact that everyone, and in every field, works harder and better if he is stimulated by the possibility to gain more benefits or by the threat to lose his current ones[55]. In this case, the threat brought by the possibility to receive a hostile takeover bid and then to lose their jobs, could represent the most effective influence on the management team's

[55] F. H. EASTERBROOK and D. R. FISCHEL, *The proper role of a target's management in responding to a tender offer*, in *Harvard Law Review*, 1981, 94, 6, pp. 1161-1204.

performance. Second, a hostile takeover bid, if succeeds, is able to remove an underperforming management team with a better performing one.

Thus, a successful tender offer could benefit the company in two manners. First, with the appointment of a more performing board of directors, with the possibility to better use the existing resources and knowledge of the target company. In fact, if the takeover bid succeeds, the target company could improve its performance thanks to the synergies between that and the acquirer company. Indeed, it should be easy to understand as a bidder, before to launch an offer on a company's shares, often performs a search in which it tries to realize its best target company, which depends on the possibility to identify an underperforming management team, and a company that work in the same industry or in an industry related to the bidder one, in order to benefit from the possible synergies between the two companies. Second, the threat of a hostile takeover bid should represent an efficient motivation for directors and managers to pursue shareholders' aims. Due to these beneficial effects on the target company and its shareholders, some academics, such as Easterbrook, Fischel, and Lucian Bebchuk, , argue that any attempt of the management team to obstruct the path of a hostile takeover bid is detrimental for the company's welfare. Thus, they have always suggested to oblige the management team to be passive and neutral in facing a hostile takeover bid, and to allow shareholders to decide on the merits of a bid.

This is believed because a cash tender offer is usually launched at a price above the market price, so offering shareholders the possibility to gain a return higher than the current market value of the shares, so benefiting of a premium due to the takeover bid. In fact, the bidder, being confident with the possibility to increase the future shares value with its changes on the structure of the target company and with the synergies with the its company, is likely to launch a bid for an amount higher than the current market value. This offer, due to its premium over the current market value of the shares, would benefit the shareholders. This beneficial effect is based on the assumption that the market value of the shares exactly reflect its value, being the capital market efficient. In fact, if the stock did not reflect well the shares value, with significant differences between its real value and its current price on the capital market, investors would benefit from this situation by selling the overpriced shares and by buying underpriced shares. This ongoing process would go on until no differences between the market price and the real value of shares exist, or at least, until the bargain would be less than the costs for the search that a bidder should bear in order to find some misprice[56]. In this case, with any shares being corresponded their real value on the capital market, it should be easy to understand as everyone will benefit from hostile tender offers, which are usually launched at a price higher than the market price. Furthermore, the bidder could gain a premium too, whose amount must be calculated taking into account the difference between the future market price of the company shares, which could raise due to its strategies and synergies, and the price paid to the tendering shareholders. Finally, shareholders who decide not to tender their shares, would benefit for a raised price of their investments thanks to the performance of the new management team. Thus, it has been shown that the hostile takeover could benefit all the company constituencies, and that a passivity rule that permit these transactions could be preferred to the management power to defeat a hostile takeover bid.

Moreover, in order to make sure that passivity rule is efficient, it must be noted that the passivity rule is considered still more beneficial in case a company operates in an industry where its competitors have antitakeover provisions. This situation represents an important things that any company must take into account in deciding whether to allow directors and managers to defeat a bid or not. In fact, it has been shown that companies without takeover defenses are more likely to receive tender offers if their competitors use takeover defenses: the higher the number of companies allowing managers to use takeover defensive measures, the higher the price that bidders are willing to pay to acquire companies without anti-takeover provisions[57]. Thus, using takeover defensive measures divert takeovers activity to companies without the same defensive measures. The reason of this

[56] F. H. EASTERBROOK and D. R. FISCHEL, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, in *The Business Lawyer*, 1981, 36, pp. 1733-1750.

[57] S. HANNES, *The Market for Takeover Defenses,* in *North Western University Law Review*, 2007, 101, 1, pp. 125-189.

assumption should be easily identifiable. Indeed, it is presumed that any bidder performs some researches before launching a bid, comparing not only the underperformance and the possible synergies with a target, but also making a search on what defensive measures any target board of directors is allowed to use. In fact, takeover defensive measures are supposed to increase the difficulty and the expensiveness of an acquisition, and so any bidder tries to understand which target would be more easy and cheap to acquire. Thus, companies that prohibit the board of director to act against takeover bids, receive more attention by bidders, which attention would lead to a higher number of received tender offer, which usually lead to a higher price of the bid. Then, it should be said that, the higher the number of companies with antitakeover provisions, the higher the tender offers that companies without antitakeover defenses receive, and the higher the price that they gain. Thus, once again, passivity rule prevails on the board of directors freedom.

After having analyzed the possible beneficial effects of hostile takeover bids, and therefore of the adoption of the passivity rule, in order to enhance our confidence concerning the belief that the passivity rule works better and maximizes the company welfare than the board of directors freedom, it is interesting to analyze what would be the economic implications of leaving managers this possibility.

In order to make this assessment, first of all, we need to better comprehend what is the behavior of the board of directors in facing a hostile takeover bid. The use of takeover defensive measures is widely considered to be able to increase agency costs between shareholders and the board of directors, and to be used by the latter with the egoistic purpose to entrench its position. This belief corresponds to the "management entrenchment hypothesis", according to which directors and managers having the possibility to use several defensive measures, are stimulated to use them in order to defeat takeover bids of interest for the company and its shareholders[58]. According to this theory, and as we have previously seen, directors and managers are likely to have this self-interested behavior since they are aware

[58] R. DAINES and M. KLAUSNER, Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs, in *Journal of Law, Economics and Organizations*, 2001, 17, 1, pp. 83-120.

that in case the hostile bid will succeed, they will lose their job. Thus, they are in a conflict of interests in facing a hostile takeover bid, and they are more worried to preserve their positions and benefits than to act with the goal to maximize the company welfare. Then, this self-interested way of acting, could lead managers and directors to use their powers in order to defeat hostile takeover bids, using some entrenching devices, and so making impossible for shareholders to gain the above mentioned beneficial effects of hostile takeovers.

Moreover, it should be noted that the strong resistance opposed to hostile takeovers by the board of directors is detrimental for the financial situation of the target company. In fact, the defensive measures that managers usually adopt facing a hostile bid are able to spend a lot of company resources. Thus, it is not rare that, in the few cases in which a hostile takeover bid succeeds, the new controlling shareholders and the new board of directors is forced to face a difficult financial situation, a crisis brought by the costly resistance of the previous board of directors.

Now, after having realized the delicate situation that the board of directors faces during a hostile tender offer, we need to evaluate the detrimental effects of the most used defensive measures, *i.e.* “poison pills” and “staggered boards”.

The so called “poison pills”, which have been invented by Watchell, Lipton, Rosen & Katz, an American law firm, are arrangements used in order to dilute the stake that a bidder gains after the success of the hostile bid, should this bidder obtain a certain percentage (usually 10-15%). There are two main kinds of poison pills. First, the flip-in poison pills, giving target shareholders the faculty to buy shares of the target company for favorable price (often two shares for the price of one). Second, flip-over poison pills, giving target shareholders the faculty to buy shares of the bidder company, should the bidder company merge the two companies. Thus, as it is possible to understand, these two arrangements are able to dilute the stake of a bidder and to prevent its possibility to gain the control of the company. However, poison pills do not totally prevent bidders from taking over the company. In fact, the only way that bidders have to take the company over is gaining the control on the board of directors before launching the tender offer and then remove the poison pill. Thus, bidders should win a proxy fight, addressing shareholders' vote by its commitment to launch a valuable tender offer. Thus, if poison pills do not totally prevent takeovers, they require bidders to win a proxy fight and such activity brings delays, which are costly for bidders. In fact: (i) market conditions could change in the meanwhile; (ii) the management team has to spend a lot of resources to win the proxy fight, and (iii) the timing of the proxy fights could create a competition, and this could be detrimental for the first bidder.

Unlike poison pills, staggered boards do not avoid bidders from taking a company over, but mainly make this gained control useless. In fact, with a staggered board, directors are divided in several classes (usually three), and it is possible to remove one class of directors per year. Thus, should a bidder obtain a controlling stake in a target company, it could remove only one third of the members of the board, and could so gain the control on the board of directors only if it wins two proxy fights. Then, as well as with poison pills, the bidder is forced to face some costly delays, and will be subject to the uncertainty of the risk based on the necessity to win two proxy fights.

The situation becomes still worse in case a company provides its management team with the possibility to use poison pills and staggered boards together. Indeed, while the single device could only impose delays on the success of a hostile takeover bid, the two arrangements together are able to make a hostile takeover bid impossible. In fact, with these two provisions, a bidder could not gain a controlling stake, because of the dilution effect of the poison pill, as well as it could not redeem the pills gaining the control of the board of directors, due to the staggered boards. Thus, the use of poison pills and staggered boards together are considered the most strong possibility for the board of directors to entrench itself, and the most detrimental defensive measures too.

As it should be clear, directors and managers having the ability to use some defensive tactics in facing a hostile tender offer is rather detrimental for the company and its shareholders, and maybe also for the capital market and the whole community. The analysis on the detrimental implications of antitakeover provisions shall begin with the studies performed by Bebchuk, Coates IV, and Subramanian, who tried to assess the economic implications of permitting board of directors to defend itself and entrench its position, mainly by using staggered boards, which represents one of the most strong and used defensive devices. The event studies have been performed evaluating the outcome of the use of staggered boards in a set of hostile bids in a five-years period. These studies have shown that: (i) companies using staggered board are more likely to remain independent; (ii) remaining independent is detrimental; (iii) staggered boards provide for little increase in the price of a successful tender offer, and (iv) companies with staggered boards receive a lower general return than companies without them.

These empirical data firstly show a strong difference on the possibility to success of a hostile tender offer. In fact, it has been shown that the possibility for companies with antitakeover measures to remain independent is equal to 60%, whereas for companies without takeover defenses is equal to 34%. Moreover, the data show that protected companies are less likely to sell to initial bidders (equal to 16%) than unprotected companies (a percentage of 32%). Finally, companies using defensive measure are less likely to be sold to a white knight (24%) than companies without those arrangements (34%). Thus, it is possible to say as companies that allow directors and managers to defeat a bid using some defensive measures and in particular staggered boards, have a double possibility to remain independent than companies with no antitakeover provisions. In fact, it has been shown as companies within the first category are less likely to be sold both to initial bidders and to white knights than companies of the second category. Moreover, the empirical data have shown that companies with defensive measures remain independent not only in short-term (nine months after the launch of the hostile takeover bid), but they show as this independent position is maintained also in the long-run (thirty months). In fact, the three academics have provided us with the evidence that target companies permitting takeover defensive measures are likely to remain independent in the thirty months after the launch of the takeover bids in the 47% of the case, whereas just the 23% of companies with no permitted defensive measures remains independent in the long-run[59]. Thus, it has been shown that the fact that a company contains in its bylaws provisions concerning the possibility to act against a hostile bid using several defensive tactics, would lead the company to be less likely to be sold and then less likely to permit its shareholders to benefit from the premium over the market price, in the short and in the long-run.

Second, we have to stress as remaining independent is often detrimental for shareholders in those companies which are sold. In fact, academics are generally for this theory, considering that returns for shareholders in independent companies are lower than that of shareholders in companies that have been sold. This theory has been demonstrated taking into account aggregate data on average returns for shareholders in companies remained independent and companies sold. The empirical data have shown a large difference in the outcomes of the bids. Companies remaining independent received in the short run (nine months) an average return for shareholders lower of 37% than companies that are sold both to an initial bidder and to a white knight. At the same time, companies remaining independent received in the long run (thirty months) an average return for shareholders lower of 55% than companies that are sold, so that the costs that shareholders bear in the long run are higher than in the short run. To summarize, it should be clear that companies using several takeover defensive measures and that remain independent receive less benefits than companies that are sold. These losses are reflected both in the short run and in the long run, with really higher costs for shareholders in protected companies, in terms of very lower average returns, mainly in the long run.

Third, we need to make a further check on the price received by companies with takeover defenses that have been sold. In fact, this evaluation starts from the general belief that companies with takeover defenses, when sold, receive a higher price than companies without them. However, such a belief is not confirmed by empirical data, at least not by our event studies. Indeed, our analysis shows that

[59] L. A. BEBCHUK, J. C. COATES IV, and G. SUBRAMANIAN, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, in *Stanford Law Review*, 2002, 54, pp. 887-951.

companies with strong defensive measures, when sold, receive a price of 54.4% over the then current market price, whereas companies unprotected receive a price of 49.6% over the market price. Thus, companies with defensive measures, when sold, are likely to get a higher price than companies without defenses. However, the difference is not so huge, being of only 5%, in comparison with the negative differences above shown in case of remaining independent. Thus, it is possible to conclude that protected companies could be sold for a higher price than unprotected companies, but this outcome does not justify the introduction of these defensive tactics, since it does not cover the huge costs that shareholders have to bear in the usual situation when the company remain independent.

Finally, in order to provide for a summary of the previous evidences, our empirical studies have calculated the overall outcomes of the data. Thus, it is possible to argue that companies using takeover defensive measures reduce the overall target shareholders' return at the extent of 8-10% in the nine months after the launch of a hostile tender offer[60].

It is now possible to evaluate and summarize the results of the evidences and give a first assessment on whether the passivity rule is to be preferred to the possibility for directors and managers to act against a hostile takeover bid or not.

The empirical data have demonstrated several detrimental effects that companies with strong defensive arrangements usually bear. First, it has been shown as these companies are more likely to remain independent both in the short run and in the long run. Then, we have analyzed the impact of remaining independent on the shareholders' returns, discovering as companies remaining independent obtain lower returns than companies sold. Moreover, our analysis has shown that companies permitting the management team to defeat a hostile takeover bid are likely to get a little higher price than companies without this ability. At the end, our study has provided us with the evidence that takeover defensive measures lead to a reduction on the target shareholders' returns of 8-10%.

[60] L. A. BEBCHUK, J. C. COATES IV, and G. SUBRAMANIAN, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to a Symposium Participants*, in *Stanford Law Review*, 2002, 55, pp. 885-917.

The result of the previous analysis is the evidence that using takeover defenses is likely to make companies and their shareholders bear some relevant losses, in terms of lower average returns in both the short and long run. Thus, passivity rule shall be considered to be more efficient - and then preferable - than a more liberal regime.

PARAGRAPH II – WHEN ANTITAKEOVER PROVISIONS ARE BENEFICIAL

A rule imposing board of directors and managers of target companies to be neutral in facing a hostile takeover bid usually brings a great deal of benefits for target companies and their shareholders.

However, some academics, honestly less than the number of academics in favor of the passivity rule, are against this rule and in favor of the possibility for directors and managers to act against a bid, without a prior shareholders' meeting authorization. One of the most important supporter of this view has been Martin Lipton, a lawyer of the American law firm accredited to have invented poison pills. According to Lipton, hostile takeovers are somewhat detrimental for the company and the capital market, since the bidders often try to obtain the control of companies for a price lower than its value, and management team could benefit the company by prohibiting these speculations. Moreover, he argues that defensive measures are beneficial for the company, explaining that usually the shares' price rises over the price of the unsuccessful hostile tender offer.

Notwithstanding the numerous negative effects that defensive measures are able to bring to companies and shareholders, it should be noted that, if correctly used, they could benefit target companies in several ways. Indeed, according to its supporters, a liberal regime is able to bring some positive effects, such as: (i) independence and stability of the board of directors; (ii) "bargaining power hypothesis"; (iii) "rational myopia hypothesis"; and finally (iv) lower board of directors' compensation.

(i) Independence and stability of the board of directors.

Takeover defenses are considered beneficial for the company, being they able to confer the board of directors' independence and stability[61]. These two benefits could be mainly explained taking into account the use of staggered boards. In fact, if independent directors have a term of office of three years instead of one year, executive directors could less influence them. In fact, having a term of office of only one year could represent a threat for independent directors, which could have fear to not be renewed at the end of their annual term of office. Moreover, the use of staggered boards, reducing the annual turnover of the members of the board, could confer stability to the work of the board of directors. In fact, staggered boards could permit to have always some experienced and seasoned directors in the board, allowing a change of only one-third of the board of directors every year, and so permitting the company to have a linear economic policy. This could be difficult to have in case every year the company entirely changes its board of directors.

Now, we may agree with the first potential positive effect, *i.e.* the possibility that with a term of office longer than one-year, independent directors should be less influenced by executive directors and could feel more free to act in an honest and disinterested manner. Conversely, in my opinion, it is not possible to totally agree with the second assumption, according to which staggered boards should be seen as somewhat beneficial for the company being able to promote board stability. What I contest is not the assumption per se and the validity of its solution, which could also be considered useful, but the concept of stability of the board of directors is itself against the idea of a takeover bid and of a change of control of a company. In fact, the board stability is a valuable idea when there is harmony within the board of directors, so that it should be convenient to maintain the most experienced directors from whom the newly appointed directors could learn and benefit. However, this is not the case of a hostile takeover bid, in which it would be a hostile change of control. Indeed, in case of a hostile change of control, new

[61] L. A. BEBCHUK, J. C. COATES IV, and G. SUBRAMANIAN, *The Powerful Antitakeover Force of Staggered Boards, Theory, Evidence, and Policy*, in *Stanford Law Review*, 2002, 54, pp. 887-951.

and old directors are not likely to create a harmonious team and the newly directors are less likely to benefit from the presence of experienced directors. Thus, permitting this coexistence could be detrimental for the work and the business of the board of directors and then negative for the company's business.

(ii) Bargaining power hypothesis.

The "bargaining power hypothesis" concerns the possibility for directors and managers to use defensive measures in order to enhance their bargaining powers and so obtain a higher shares price[62]. The validity of this outcome is based on two main reasons. First, it is a general belief that target shareholders usually face a collective action problem in case of a tender offer. In fact, they usually lack coordination, and without it, they are often stimulated to accept the offer, even if it is for a lower price than the real value. In fact, the more dispersed the ownership, the higher the pressure for shareholders to tender their shares to the bidder. Moreover, managers' bargaining power could benefit the company since they often have better ability and capabilities to handle a takeover competition than shareholders alone. Finally, the most important reason relies on the assumption that directors and managers have more information on the company's business and value. This is the reason why they often ask shareholders to reject the offer assessing it as under the shares value. In fact, being the managers in charge of the conduct of the company's business, they have some important information that shareholders do not have. Moreover, managers often have some inside information that could be difficult to disclose to shareholders, since a disclosure could destroy the value of those information and then destroy value for the company. Thus, (i) due to this always present discrepancy of information between target shareholders and management team; (ii) because of the ability of the board of directors to promote a coordination between the interests of dispersed shareholders; and (iii) because of the ability of managers to conduct a takeover bid process, the possibility for managers to adopt some antitakeover provisions could lead to an increase of the offered price, in order to align it to the shares

[62] D. A. OESTERLE, *The negotiation model of tender offer defenses and the Delaware Supreme Court*, in *Cornell Law Review*, 1986, 72, pp. 117-157.

value and to let shareholders to gain a premium over the market price. In fact, the board of directors, in light of the above mentioned explanations, could benefit shareholders by employing successful selling strategies, by timing the sale of the company and imposing the manner of the sale.

It is a general belief that, talking about this potential efficient hypothesis, it should be made a division between market in which there is a developed takeovers activity and market with little development of such activity. In fact, it should be noted that, in industries with an active takeovers market, any target company could receive offers from multiple bidders, and it is thought that the competition between bidders is itself able to increase the offers price, and then that target shareholders do not need the intervention of the board of directors. Conversely, in industries with a lower number of takeover bids, target companies usually receive only one bid, and in this case, the intervention of the board of directors is more likely to be needed. Thus, the higher the number of offers that a target company is likely to receive, the lower the need of managers' intervention. Furthermore, the less developed the market of takeovers activity, the more the need to permit managers to bargain with the bidder. However, some event studies have shown that antitakeover provisions are provided for in the bylaws of companies operating in industry with active takeovers market. These evidences showed that antitakeover provisions are used in case they are less efficient and less needed. In fact, they are more common in companies target of multiple bidders than company subject to the pressure of a single bidder. This outcome is extremely important, since it explains us that the board of directors is more likely to use defensive measure in order to entrench its position, and not in order to benefit shareholders from its bargaining ability and then try to get a better offer for shareholders. Thus, these empirical data reject the possibility to explain the use of antitakeover provisions with the assumption that managers' intervention could benefit shareholders because of their better bargaining ability, so they reject the validity of the "bargaining power hypothesis" and confirm the previously explained "management entrenchment hypothesis".

(iii) Rational myopia hypothesis.

It is important to explain another possible beneficial effect of the use of takeover defensive measures, namely the "rational myopia hypothesis", according to which takeover defenses are likely to allow the board of directors to make long-term investments. In fact, one of the most common attack brought against the passivity rule is the one according to which prohibiting directors and managers to defend the company against a hostile tender offer, usually induces the management team to make too many short-term investments. Indeed, taking into account the assumption that the capital market reflects only the value of the information available for the public, the board of directors could be stimulated to not make some long-term investments and to rather take care of the activity that could raise the current shares' market value. According to the "rational myopia hypothesis", the threat of a hostile takeover bid could incentive the board of directors of target companies to run the company's business improperly[63]. Therefore, the problem is related with the fact that the board of directors have often to hide information concerning long-term investments, otherwise the plan of the company could be emulated and then the company would lose its investments. The need to maintain some long-term investments' information hide, and at the same time to maintain the market value of the shares as high as possible, could induce directors to have a myopic behavior. The situation would change if some takeover defensive measures were permitted. In fact, if managers had the ability to engage in some frustrating operations, they would be more focused on long-term investments that they evaluate beneficial for the company and its shareholders. Thus, this outcome could theoretically represent another possible explanation of the positive effects of the freedom of directors and managers to defeat a hostile takeover bid. However, in order to assess whether or not the "rational myopia hypothesis" could be valid, we need to try to confirm it through some empirical evidence. Then, our event studies start from the assumption that, in case of short-term projects, the expenditure for research and development (R&D) is quite low, whereas

[63] S. HANNES, *The Market for Takeover Defenses*, in *Northwestern University Law Review*, 2007, 101, 1, pp. 125-190.

companies that prefer to make more long-term investments usually bear higher R&D expenditures. Thus, if the "rational myopia hypothesis" is right, companies that permit their management team to use several defensive tactics should bear higher R&D expenditures[64]. In fact, if the theory is valid, the more the long-term investments and the higher the expenditure for R&D, the more the defensive measures adopted by companies. Conversely, the less the long-term investments and the lower the expenditure for R&D, the less the use of defensive measures. If the theory is valid, empirical data should meet these two assumptions. However, empirical data do not confirm the "rational myopia hypothesis". Indeed, it has been shown as companies operating in industries with high expenditures for R&D are less likely to adopt takeover defensive measures, whereas companies in market with lower expenditures for R&D are more likely to permit directors and managers to use antitakeover tactics. Thus, as well as in the case concerning the "bargaining power hypothesis", our empirical data totally reject the validity of the "rational myopia hypothesis". In fact, our study showed as antitakeover tactics, unlike what the theory would suggest, are most common where they are less efficient and less needed. Indeed, takeover defenses are more present where the business of the company is more transparent and then when the market value is more likely to reflect the shares value, so when target management has less need to protect the company from a bidder that could benefit from a discrepancy between the market value and the real value of the shares due to some hidden information in case of long-term investments. Thus, this empirical study enhances the "managerial entrenchment hypothesis", stating that takeover defensive measures are more likely to be adopted by directors and managers in order to entrench their positions and to save their jobs than to benefit companies and shareholders by bidders that could benefit from a lower market price of shares, due to some hidden information.

[64] R. DAINES and M. KLAUSNER, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, in *Journal of Law, Economics and Organizations*, 2001, 17, 1, pp. 83-120.

(iv) Lower board of directors' compensation.

Finally, the last point we need to analyze concerns the hypothesis according to which in case of the prohibition of the use of antitakeover measures, the managers' compensation should be higher than that of companies that allow them to use takeover defensive measures. This theory relies on the assumption that the possibility to use defensive measures is part of the managers' compensation, or in other words, that the impossibility for managers to use defensive measures in case of a hostile takeover bid, and so the higher risk that the management team have to bear in running the company, is compensated by higher compensations. Unfortunately, neither this time empirical data confirm the theory of who advocates the permission for the board of directors to defeat a hostile tender offer. In fact, some empirical data have shown that usually the opposite is true, and then that usually managers with high compensations are also allowed to use several defensive measures. These empirical data represents only another evidence that defensive measure are used by the board of directors and by managers in order to protect their high benefits, rather than really coordinate the dispersed shareholders' interests and get a higher price offer.

Conclusions.

In light of the numerous theories and hypothesis analyzed, it is possible to state that allowing directors and managers to decide when and how to defeat a hostile takeover bid would be detrimental from an economic point of view. Indeed, the costs that the company and its shareholders bear would be higher than the possible benefits that are rarely achieved.

In fact, on the one side, leaving target shareholders the ability to decide on the merits of the bid, and then to decide the way to face it, represents a beneficial solution for shareholders themselves, so raising their returns both in the short and in the long-term. On the other side, it has been shown that the behavior of directors and managers, even if taken in good faith and then with the aim to benefit the corporation and its shareholders, is able to reach this goal only in rare cases. Furthermore, as we have seen, directors and managers in most cases, due to the widely explained conflict of interests that they face during a hostile tender offer, use the powers and the possibility they were provided with pursuing personal interests, so prohibiting target shareholders from the possibility to obtain the eventual benefits, which as we have seen would be lower than the costs.

Thus, it is possible to affirm that the passivity rule is to be preferred, and that the idea of the European Commission to introduce a Directive in order to limit the intervention of the board of directors and managers against hostile takeover bids was, at least from an ideal point of view, a fair and valuable aim.

PARAGRAPH III – HAS EUROPEAN DIRECTIVE ON TAKEOVER BIDS ACHIEVED ITS PURPOSES?

In the past chapter, we have analyzed the economic implications of both a regime based on the passivity rule and a regime based on the possibility for directors and managers to act against a hostile takeover bid. Using some event studies and the empirical data that they have carried out, we have stated the superiority of the passivity rule. In fact, even if the managers' intervention could sometimes benefit the company and its shareholders, having they bargaining ability and then permitting to sale the company for a higher price, in most cases this intervention is likely to be detrimental for the company, raising the possibility to remain independent and lowing the shareholders' return in both the short and long run. Thus, we have stated that the European Directive on Takeover Bids (25/2004/EC) is to be faced with enthusiasm.

Now, here is the moment to assess whether or not the Takeover Bids Directive have achieved its purposes, and thus if the above mentioned positive effects of the passivity rule have been reached. In fact, this assessment is somewhat very important, since the Directive decided to provide for the optionality of the board neutrality rule, the breakthrough rule and the reciprocity rule. Indeed, being these provisions only optional rather than mandatory, and being any Member State firstly, and any national company secondly, free to implement these rules or not, it is not clear whether the Directive has achieved its purposes or not, and then it is not sure whether the economic implications linked to the passivity rule have been occurred within European Union or they have not.

Therefore, in order to assess whether the European Directive (25/2004/EC) has reached its purposes or not, it is necessary to briefly analyze how many Member States decided to introduce its provisions, or where the Member State decided to not opt-in them, how many national companies decided to introduce the provisions in their bylaws. In making this analysis, I will use the Application Report of 2012, a study carried out in order to assess the implications of the Directive until that moment. This study has been led by Marccus Partners, who is the law firm for the Mazars Group, and by the Centre for European Policy Studies (CEPS).

With regard to the transposition of the optional provisions of the Directive (25/2004/EC), the report has shown that Article 9 of the Directive, which provided for the board neutrality rule, has been introduced by the majority of Member States. In fact, 15 Member States have decided to transpose it. Instead, with respect to Article 11 of the Directive, which provided for the breakthrough rule, only 3 Member States have imposed it as a mandatory provision. Finally, with reference to Article 12 of the Directive, which provided for the reciprocity rule, it has been showed that 12 Member states have decided to implement it.

Thus, in light of these data, it is possible to judge the board neutrality rule as successful, since it has been implemented by most Member States. Conversely, the outcome concerning the transposition of the breakthrough rule could be considered as a total failure, because only three Member States implemented it, and therefore only about 1% of European listed companies are subject to this provision. Finally, the outcome of the implementation of the reciprocity rule could also be judged as satisfactory, and this could be faced with happiness since, as we have seen in the past paragraphs, the reciprocity rule seems to be the only provision able to create a level playing field within European Union. However, we need to remind that, in case Member States do not transpose these rules, they must allow national companies to introduce them in their bylaws. Therefore, in order to have a wider look at the degree of transposition of the provisions, a check of national companies is needed in order to verify whether they have introduced them in their bylaws. This activity is particularly important to be carried out about the implementation of the breakthrough rule. Unfortunately, the Application Report have stated that this appears not to have been the case. In fact, just a few private companies have voluntary decided to implement the Directive's provisions in their bylaws, and this is quite understandable and expectable.

Therefore, in light of these percentages concerning the implementation of the Directive's provisions, it is possible to say that if post-bid defenses are now forbidden in most Member States, pre-bid defensive measures are still usable within European Union. And pre-bid defensive measures represents the most common and the strongest acts that directors and managers use in facing a hostile takeover bid. In fact, as we have seen in the previous paragraph, poison pills and staggered boards, if used together, are able to totally prevent the success of a hostile takeover bid, whose detrimental effects on the shareholders' welfare have already been explained too.

Thus, the Directive on Takeover Bids (25/2004/EC) is considered to have brought a marginal impact on the market for corporate control, both in terms of contestability and openness. In fact, because of the fragmented transposition of its provisions across Member States, and since most defensive measures used before the adoption of the European Directive are still permitted, the latter is considered to have not led major changes in the legal framework of Member States. Moreover, no perceive of any increase or decrease in the use of defensive measures across Member States since the adoption of the European Directive have been noticed.

Moreover, this belief is shared from stakeholders across European Union, whose category comprehends supervisors, stock exchanges, issuers, employee representatives, other stakeholder associations and investors and intermediaries, who believe that the Directive did not have a significant effect on the takeover bids process.

Then, in order to evaluate the implications of the Directive (25/2004/EC), it should be interesting to have a look on the numbers of successful takeover bids after the adoption of the Directive. Thus, the Application Report have stated that the number of successful tender offers has sharply decreased since 2007, so this could lead us to think that the Directive have achieved an outcome opposite to its purpose. However, it is important to say that a complete and fair evaluation of this kind is not possible in this very moment. In fact, the low number of successful tender offer after the adoption of the European Directive on Takeover Bids could be explained as due to the economic situation of depression that most Member States are facing following the financial crisis of 2008.

Thus, in order to better evaluate the economic implications of the European Directive (25/2004/EC), at least with reference to the number of successful takeover bids, we should wait the end of economic regression. In fact, this is also the reason why the Application Report, notwithstanding the evident lack in the implementation of the Directive's provisions and in the harmonization within Member States, decided to not give a final assessment on the efficiency of the Directive. Indeed, the Application Report decided, at least for the moment, to maintain the board neutrality rule, the breakthrough rule, and the reciprocity rule, as optional provisions.

Now, in light of these explanations, it should be clear that, even if the passivity rule seems to be better than a regime in which directors and managers are free to defeat a bid and entrench their positions, and then that the European Commission was right in adopting the European Directive on Takeover Bids (25/2004/EC), the road to provide European Union with a more open and contestable market for corporate control seems to be still long.

CHAPTER IV – POSSIBLE FUTURE DEVELOPMENTS

In the previous chapters, we have seen in detail the reasons at the basis of passivity rule and the European Directive (25/2004/EC), and how major Member States have implemented it. Then, we have analyzed the economic implications of a regime based on passivity rule and the impossibility for the management team to act against a takeover bid, comparing them with the economic implications of an opposite regime in which the board of directors is allowed to use some defensive measures and entrench its position. Finally, and in light of some analyses, we have stated that in most cases, passivity rule is to be preferred to the opposite liberal regime.

In this final chapter, and after having provided for several empirical analyses, I intend to express my opinion on the European Directive in particular (25/2004/EC), and on passivity rule in general. The structure of this chapter will be mainly based on the exposition of what, in my opinion, the limits and weaknesses of the European Directive and the passivity rule are. Finally, I will try to propose some solutions to the issues that I will underline, in order to promote a more efficient takeover bids regulation, such as well as in order to express my personal belief on the passivity rule.

I have identified a great deal of weaknesses of the European Directive (25/2004/EC), which could be assessed to be mainly present in Article 12 of the Directive, which have introduced the reciprocity rule and that states the optional nature of the board neutrality rule and the breakthrough rule. However, other issues are also present in other points of the Directive, such as in Article 11 of the Directive and its breakthrough rule, and in the general text of the Directive, which requires the board of directors to perform some activities, such as the creation of a report and the search of alternative bids.

Finally, I will propose a regime in which independent directors play a more important role, and having a look at the possibility for the management team to adopt some unregulated defensive measures, I will finally try to assess whether or not the Directive and the passivity rule have achieved their purposes.

PARAGRAPH I – OPTIONALITY SYSTEM: IS IT USEFUL?

First, I would like to try to make an assessment on the optionality system provided for by the Directive (25/2004/EC). In fact, as we have seen in the past chapters, the European Directive provided for an optional system, leaving Member States first and national companies then, free to decide whether and how to implement the board neutrality rule, the breakthrough rule, and the reciprocity rule.

It should be immediately said that, the optionality nature of the three main pillars of the Directive (25/2004/EC) has been the aspect most debated and criticized by some academics, according to whom, due to this feature, the Takeover Bids Directive is not able to beneficially effect the market for corporate control. Though it should firstly be noted that the optionality was an obligated aspect and, secondly, that European Directive shall not be considered useless, notwithstanding its lacks.

In fact, it should be noted that making the passivity rule's provisions optional was needed, representing an obligated aspect without which probably we would not have had any Directive on takeover bids (25/2004/EC). Indeed, the Directive had a journey that lasted almost 20 years of negotiations and drafts rejected, due to the resistances by some Member States. In fact, some Member States, due to their fear to make national companies vulnerable, and then to allow foreign investors, mainly US investors, to easily obtain the control of their companies, have always refused a Directive stating the impossibility for the target board of directors to defend the company against a hostile tender offer. Therefore, even if it is true that a Directive on takeover bids should ideally be formed of mandatory provisions, it is also true that the European Commission, in order to minimally achieve its purposes and to provide virtuous Member States and companies with the possibility to follow the Directive's provisions, had to come to terms with Member States. Moreover, the aim of the European Commission was to gradually intervene in this delicate matter, with the hope to remove the optionality feature of the Directive's provisions, after Member States having bridged their fear and becoming aware of the beneficial effects of the passivity rule in the years to come.

Furthermore, in addition to the fact that the European Commission has been forced to provide for optional provisions, the optionality system shall not be considered useless. In fact, notwithstanding the Directive (25/2004/EC) stated an optionality system, it is very important to take into account that the default regime states the effectivity of the passivity rule, which any Member State is entitled to misapply. Thus, in my opinion, a default system under which the passivity rule applies is beneficial for two reasons.

First, a default regime stating the application of the passivity rule requires Member States against the passivity rule to express its view and its position on the takeover bids regulation, being they obliged to expressly intervene in case they decide to misapply the European Directive's provisions (25/2004/EC). The need to intervene represents itself a positive effect, since requiring Member States to intervene, it prohibits them from justifying the possibility not to implement the passivity rule with the difficulty to reach a political agreement between the different political parties. This beneficial effect would not have occurred if the European Directive had provided for an optionality system where the default regime stated the misapplication of the passivity rule, as well as these effects were not occurred in the years before the adoption of the European Directive.

Second, and this is maybe the most important positive effect of the optionality system, the necessity for Member States first and national companies then, to intervene and take an explicit position on whether or not to implement the passivity rule's provisions, represents a decision able to increase or decrease the shares value on the market. In fact, in the past chapter, I have explained as the decision concerning the implementation of the Directive could be considered as a price-sensitive decision, and that the introduction of defensive measures by companies in their bylaws usually lead to a decrease in the shares price, due to the fact that the company becomes less attractive for bidders. Therefore, the default system based on the application of the Directive's provisions (25/2004/EC), and the fact that their intervention is price-sensitive, could represent an important influence for Member States and companies not to intervene, so subjecting themselves to the board neutrality rule, the breakthrough rule and the reciprocity rule. In fact, the opposite decision to intervene in order to allow the target management team to take defensive actions against hostile tender offers could result to be very detrimental for the company, leading to a sharp decrease of the company's value on the market.

Therefore, despite the fact that the best takeover bids regulation should be based on provisions that any company has to follow with no possibility of misapplication, it should now be easy to understand that the belief concerning the uselessness of the Directive (25/2004/EC) due to its optional system, is wrong. Indeed, the fact that the default regulation prescribes the application of the passivity rule, could stimulate Member States and national companies to implement the Directive's provisions. This influence could be explained by the fact that the necessity for Member States and national companies to intervene in order to misapply the passivity rule could be detrimental for the company and its shareholders, due to the possible decrease of the shares price. Conversely, it has been shown that an efficient corporate governance structure, in this case deciding to implement the passivity rule, is usually able to benefit the company, producing an increase on the value of the shares on the market. Thus, the fact that the decision on whether or not to adopt the passivity rule's provisions represents a price sensitive activity, could stimulate national companies to subject themselves to the European Directive, notwithstanding the latter have provided for a huge optional system.

Conversely, it is clear that the optional system does not represents the ideal takeover bids regulation. In fact, taking into account the optionality feature of the Directive's provisions, we should ask ourselves whether or not the Directive have reached its purposes, and then whether or not an optional system is really better than a system under which national companies have the possibility to autonomously decide how to face hostile tender offers. In order to make this analysis, we should take into account the huge freedom for Member States and companies in implementing the Directive (25/2004/EC). In fact, European

Directive requires Member States to make three choices: (i) whether or not to introduce the board neutrality rule, (ii) whether or not to introduce the breakthrough rule, (iii) whether or not to introduce the reciprocity rule, and whether with reference to both the Article 9 and Article 11 of the Directive of only for one of them. In addition to these three decisions, it should be reminded that in case of opt-out by Member States, national companies are allowed to voluntarily introduce the above mentioned three provisions. With reference to this situation, I have a twofold belief, since in my opinion it is formed by both weaknesses and strengths.

I argue that the Directive (25/2004/EC), requiring Member States and national companies to introduce some rules implementing the Directive's provisions, is able to show them a road to follow, with a set of rules that Member States and companies decide to implement or not. Conversely, before and without the European Directive, should some Member States or companies intend to autonomously regulate the issue of the defensive measures permitted against hostile tender offers, without the guidelines provided for by the Directive, they would provide for heterogeneous regulations, and this would surely not lead to a harmonization of the permitted defensive measures across Member States. Thus, it shall be remarked that the optionality system of Directive provided Member States with a uniform system they are free to implement or not.

However, the previously seen wide optionality system, with the possibility for Member States and companies to make three choices, shows some weaknesses. In fact, it should be taken into account that in certain Member States, such as Italy, the possibility for national companies to introduce or not the Directive's provisions is still wider, since Italian companies have the ability to totally or partly implement the Directive (25/2004/EC). Indeed, for example, with reference to the board neutrality rule, Italian companies could decide to prohibit some post-bid defensive measures and to allow others; furthermore, this possibility is also related to the breakthrough rule, since national companies are for example free to allow the restrictions on the transfer of shares and prohibit some shareholders' agreement concerning voting rights.

In light of these statements, I argue that the optionality provided for by the Directive is too wide, being able to create a little harmonization within European Union. A solution could be to maintain the optionality system of the Directive, but requiring Member States and companies to make a convinced choice for or against the Directive (25/2004/EC). In other words, Member States and private companies should be allowed to decide whether or not to jointly introduce the board neutrality rule, the breakthrough rule and the reciprocity rule, with no possibility to make partial implementations. Thus, Member States and private companies being against the passivity rule and being afraid to become the target of not valuable bidders, could decide to totally misapply the Directive's provisions, so permitting the board of directors to adopt pre and post-bid defensive measures, without receiving the prior shareholders' meeting authorization. Conversely, Member States and private companies being favorable to the passivity rule and a more open market for corporate control, could decide to entirely accept and implement the board neutrality rule, the breakthrough rule, and the reciprocity rule, so prohibiting their board of directors to engage in pre and post-bid frustrating operations without the previous shareholders' meeting consent.

In my opinion, if regulated in such manner, the European Directive (25/2004/EC) could bring three kinds of consequences. First, being the Directive still formed of optional provisions, this amendment should not stop the adoption of the European Directive by European Parliament. Second, this amendment could negatively affect the Member States' implementation, since it could induce some Member States to desist from adopting the Directive, at least for those intending to partially introduce the Directive, such as Member States that are likely to adopt the board neutrality rule and the reciprocity rule, misapplying the breakthrough rule. Finally, and this is the strength of this proposal, the above mentioned solution could at least permit to have harmonized takeover bids regulations across Member States, and so a functioning of the market for corporate control more clear within European Union, which is instead now confusing due to the too wide opportunity to decide what provisions to apply.

PARAGRAPH II – RECIPROCITY RULE: SOME WEAKNESSES

Article 12 of the Directive (25/2004/EC) established the reciprocity rule, under which companies being subject to the board neutrality rule and to the breakthrough rule, could derogate to them, in case they become the target of a company that is not subject to the same or corresponding rules. This provision has been introduced in the text of the Directive at the end of the negotiations upon Italian proposal, and it has facilitated the adoption of the Directive. It should be said that the reciprocity rule has been faced with favor by Member States and by academics, since in a system largely based on the optionality, it represented the only one provision theoretically able to create a level playing field within European Union. In fact, thanks to the reciprocity rule, despite the different decisions taken by Member States and national companies concerning the adoption of the passivity rule, at least in their mutual relations, any company is subject to the same provisions, benefiting of the same powers and bearing the same constraints.

From this point of view, the possibility to create a level playing field and then the validity of the reciprocity rule is undeniable. However, it is still possible to identify some weaknesses in this important provision.

The first weakness concerning the reciprocity rule is that it has been introduced in a context in which it is less necessary and less useful. In fact, in my opinion, it seems that the European Commission, notwithstanding it has provided for the board neutrality rule and the breakthrough rule as optional provisions, felt to have intervened in a too drastic manner against the Member States and companies' freedom, and that it has decided to compensate them with the reciprocity rule. My opinion relies on the history concerning the troubled adoption of the European Directive (25/2004/EC). In fact, taking into account the negotiations period that have lasted almost 20 years, Member States were afraid of the fact that foreign companies, mainly US companies, which were not subject to a passivity regulation during tender offers, could have taken advantages of the European Directive and then easily taken European companies over. Thus, Member States were afraid of these possible negative consequences, rather than against the passivity rule itself and its contents. Therefore, the reciprocity rule should have been introduced with the only purpose to delete the fear of speculative tender offers received by American companies. Thus, in my opinion, the reciprocity rule should have been introduced only if the board neutrality rule and the breakthrough rule were mandatory and not optional, so creating a more rational and useful regulation. In fact, in my opinion, this proposal could be beneficial for several reasons. First, I argue that the possibility to provide for the board neutrality rule, the breakthrough rule, and the reciprocity rule as mandatory provisions could have not represented an obstacle on the approval of the Directive by Member States. Indeed, in light of the previous assumption, Member States and private companies would have equally felt protected from the receipt of tender offers by US companies, since they could have applied the reciprocity rule and could have defended themselves. Moreover, a regulation in which the three main provisions were mandatory would have created more harmonization and clearness within European Union.

In my opinion, this solution was probably not possible because the idea to introduce the reciprocity rule came to mind in a very advanced stage of the negotiations for the adoption of the Directive (25/2004/EC). In fact, Italy proposed the introduction of the reciprocity rule in a moment in which Member States had already reached a compromise, which stated the optionality nature of the board neutrality rule and the breakthrough rule. Thus, after almost 20 years of negotiations, the European Commission have preferred not to recommence the negotiations in order to propose a Directive under which the three main provisions were mandatory. However, if it is true that this renegotiation would have produced additional delays, it is also true that one or two years later, Member States would have equally accepted a Directive formed of mandatory provisions, and the European Commission would have created a more rational and harmonized takeover bids regulation.

However, the weaknesses concerning the reciprocity rule are not over. In fact, in my opinion, another relevant issue is represented by the necessity to verify whether or not the bidder is subject to the same or corresponding rules than the target company. I argue that this activity, which represent a necessary stage in order to allow the target company to derogate to the board neutrality rule and the breakthrough rule, is very complicate. First, in order to comprehend the size of this issue, we need to make a distinction between the case in which the target company receive a tender offer by a company established in a Member State, and the case in which the target company is subject to a tender offer launched by an extra-EU bidder.

With reference to the first situation, and in light of the huge optionality that Member States and companies are granted in the implementation of the Directive (25/2004/EC), the comparison between what provisions the bidder and the target companies are subject to is a very difficult activity, which is for example in Italy performed by Consob. Furthermore, and here is my major criticism on this topic, in my opinion, a comparison between the provisions that bidder and target companies have to fulfil, is not sufficient to create a rational regime and taking into account the purpose of the reciprocity rule to promote transactions on equal terms. In fact, it could happens that, despite the possibility for companies to adopt some defensive measures being they not subject to one of both the passivity rule's provisions, some companies decided to not take advantages of that possibility, because of a voluntary choice, or due to the fact that those permitted defensive measures are not common in those Member States. Thus, in order to really promote transactions on equal terms, I propose that the comparison should not only verify what defensive measures the bidder is entitled to adopt, but it should analyze whether or not the bidder have actually take advantage of the defensive measures that the target company is instead prohibited to adopt. This proposal would surely increase the difficult of the above mentioned comparison concerning the existence of the requisites of the reciprocity rule, but I argue that it could create a reciprocity rule more rational and more able to achieve its purpose to allow companies that are subject to different provisions to benefit of the same powers in their mutual relations.

With reference to the second case, *i.e.* the case in which a European company receives a tender offer by an extra-EU company, the difficulty to compare the provisions that both the companies have to fulfil is still higher. In fact, if in the previous cases it was sufficient to verify whether both the companies have implemented the board neutrality rule and the breakthrough rule, the comparison become more difficult in case of extra-EU bidders, since they are not subject to the European Directive (25/2004/EC). Indeed, in this case, the subject entitled to perform this comparison, such as Consob in Italy, have no uniform provisions to take into account, and should perform a wider analysis of the permitted defensive measures in the bidder's country. However, notwithstanding this difficult activity, the possibility to take advantage of the reciprocity rule against extra-EU bidders is fundamental, being this provision able to protect European companies from the speculative behavior of US companies.

Another aspect of the reciprocity rule, whose functioning I consider complicate, is the one concerning the application of the reciprocity rule in case of receipt of multiple tender offers, in which only one of the bidders is not subject to same or corresponding rules that the target company has to fulfil. In fact, academics have interpreted this situation conferring the target company the possibility to take advantage of the reciprocity rule only *vis-à-vis* the bidder that is not subject to the same or corresponding provisions. However, on the one hand, this solution could be considered as able to confer rationality to the system and to be conform to the text and purpose of the reciprocity rule to promote transactions on equal terms. On the other hand, it could increase the difficulty of the application of the reciprocity rule. In fact, in my opinion, it could be extremely complicate to permit the target company to adopt some defensive measures only against one of the multiple bidders. As a practical matter, I argue that it could be difficult, to allow the target company to make distinction between the bidders, for example in case the defensive measure adopted by the target company was the buy-back of its own shares. Thus, in this case, in my opinion, it could be somewhat very intricate to permit the target company to buy-back its own shares affecting only the success of the bidder that is not subject to the same or corresponding rules. In fact, a buy-back of shares, decreasing the number of shares that bidders could buy, is able to contrast all the bidders, with no difference based on the reciprocity rule. The issue that I am talking about is based on the fact that it is not easy to differently treat two bids pending in the same moment.

The last and the most important weakness concerning the reciprocity rule is strictly related to its functioning, which unfortunately allows and promotes some abuses. In order to comprehend what abuses the reciprocity rule could promote, we have to take into account the case in which a Member State decides not to implement the passivity rule's provisions. In fact, national companies have the opportunity to implement the Directive (25/2004/EC) and voluntarily subject themselves to the passivity rule. Unfortunately, the Directive, as it has been set by the European Commission, allows private companies to subject themselves to the passivity rule because of their policies of external development, rather than due to their belief for the passivity rule and their favor for a more open and contestable market for corporate control. In light of the strong incentive provided for by the reciprocity rule, I argue that private companies could decide to introduce the board neutrality rule and the breakthrough rule in the moment in which they intend to launch a tender offer, and to misapply the Directive's provisions when they have no intention to externally develop their companies.

However, a speculative possibility of this kind is not promoted only from the reciprocity rule, but also from the optionality of the board neutrality rule and the breakthrough rule. In fact, the huge freedom that European Commission has provided for, allows national companies voluntarily introducing the passivity provisions to completely overturn their belief at any time, being they entitled to misapply the Directive's provisions in any moment. It should be easy to understand the problematic functioning of the reciprocity rule with reference to this aspect, which I consider inefficient from a twofold standpoint.

First, companies could be not subject to the passivity rule and then allowed to adopt some defensive measures, until the day before the decision to launch a tender offer. Thus, companies could have the opportunity to subject themselves to the passivity rule's provisions in the moment of the launch of a tender offer, so prohibiting the target company to take advantage of the reciprocity rule and then prohibiting the target company from defending itself. Finally, at the end of the acquisition, the bidder could opt-out again the provisions and be protected in case of the receipt of tender offers. It should be easy to assess this behavior as unfair for the target company. In fact, bidder could manipulate the Directive and the reciprocity rule, abusing of the powers that they have been granted with by Article 12 of the Directive (25/2004/EC), and then empting the reciprocity rule of its purpose to promote transactions on equal terms between companies subject to different takeover bids regulations. Thus, the reciprocity rule that it has been thought as an instrument in the hands of target companies that are subject to passivity rule, allowing them to act against bidders that are not subject to the Directive's provisions, due to the above explained abuses, it could become an instrument in the hands of bidders that could take advantage of it and prohibit target companies from defending themselves.

Second, if the purpose of the reciprocity rule was to create a level playing field and to create harmonization within European Union, the possibility of abuse of it could difficulty lead to the achievement of these purposes. In fact, those abuses would be able to create a distorted level playing field and a distorted harmonization, since the latter would be present only in the moment in which some companies decide to launch a tender offer.

Thus, in light of the previous explanations, the Directive (25/2004/EC) gives the possibility to abuse of the reciprocity rule, and then some amendments are needed. In order to limit the possibility to manipulate the text of the passivity rule subjecting itself to the passivity rule only in case a company is likely to launch a tender offer, I propose to make the reciprocity rule applicable only in case the bidder is subject to the same or corresponding rules for 6 or 12 months. In this manner, should a company receive a tender offer by a bidder that is subject to the same or corresponding rules for less than 6 or 12 months, the target company would have the possibility to take advantage of the reciprocity rule and then to defend itself. At the same time, and this is the most positive consequence of this proposal, when a company intends to externally expand its business, and if it wants to benefit of the reciprocity rule, it should subject itself to the passivity rule's provisions at least 6 or 12 months before launching the tender offer. This necessary subjection represents the most important influence of the reciprocity rule, as I am proposing to set it. In fact, the period of 6 or 12 months before the launch of a tender offer, in which the future bidder has to be subject to the passivity rule, is fundamental in order to limit speculative behavior, since in that period the future bidder could be subject to a tender offer, with no possibility to adopt defensive measures. In my opinion, this proposal to amend Article 12 of the Directive (25/2004/EC), could be functional to the establishment of provision able to create the fairness feature and the positive consequences for which the reciprocity rule it was originally thought. In fact, I argue that this proposal may create a real level playing field and a real harmonization, so promoting real transactions on equal terms between companies subject to different provisions.

Thus, in my opinion, the initial idea of this provision was very valuable, but it presents many weaknesses that make its functioning very complicate and that allow private companies to manipulate the text of Article 12 and to abuse of their powers. In fact, in order to summarize, the weaknesses of the reciprocity rule have to be identified as: (i) its minimum usefulness in case of optional provisions; (ii) the difficulty to compare the provisions that the target and the bidder companies are subject to, mainly in case of extra-EU bidders; (iii) the difficulty to oppose the reciprocity rule only against the bidder that is not subject to same or corresponding rule without affecting the other bidders' success; (iv) the possibility to subject itself to the passivity rule only in the moment when a company decide to launch a tender offer.

In response to these several issues concerning the reciprocity rule, I have proposed some amendments in order to permit Article 12 of the European Directive (25/2004/EC) to achieve its purpose to subject companies with different takeover bids regulations to the same provisions in their mutual relations, and in order to create a level playing field within European Union.

PARAGRAPH III – THE BREAKTHROUGH RULE AND THE ISSUE CONCERNING THE MONETARY COMPENSATION

In my opinion, it is possible to identify a weakness of the Directive (25/2004/EC) also with reference to the breakthrough rule, under which the restrictions on the transfer of shares and on the voting rights, provided for in the bylaws on by shareholders' agreement, will not apply *vis-à-vis* the bidder during the period of acceptance of the bid. Moreover, Article 11 of the Directive, in addition to this neutralization provision that could be faced with favor, states that shareholders whose particular rights have been broken during the tender offer, should receive a monetary compensation by the bidder. Here is the point where I have noted a weakness, since in my opinion the monetary compensation lacks from two points of view.

First, European Directive (25/2004/EC), in requiring the payment of this monetary compensation, have not provided Member States and companies with any guideline concerning who is in charge of the calculation of the amount of the monetary compensation, as well as no guidelines have been provided for concerning how this amount should be calculated. From this point of view, the European Commission has justified the lack of any guideline with the necessity to leave Member States and national companies free to set up the compensation system most conform to their legal system. However, notwithstanding the possible acceptance of this justification, I argue that the lack of any guideline and the uncertain system that it creates could embarrass Member States and national companies in the concrete calculation. In fact, without the possibility to follow any principle or minimum suggestion, this system risks to encourage litigations, or at least the recourse to a judge that could state the compensation on an equitable basis, with the obvious implication to increase the costs and the duration of hostile tender offers, which could be then discouraged.

Second, I argue that the monetary compensation does not represent always a reasonable and fair arrangement, and in some cases, bidders should not bear the expenditure that it brings. In order to understand why and in which cases the compensation could be unfair, it is now necessary to make a distinction between Member States that have implemented the Directive (25/2004/EC), imposing the breakthrough rule as mandatory, and Member States that instead have not adopted the Directive, leaving national companies free to introduce its provisions in their bylaws. In fact, in the first case, companies are subject to the breakthrough rule not because of a voluntary decision, but because the Member State where they are incorporated have introduced it as mandatory. In the second case, companies are instead subject to Article 11 of the Directive because of a voluntary decision to implement it.

Now, it should be noted that, Article 11 of the European Directive did not take into account the above mentioned distinction between Member State implementation and companies voluntary adoption, stating that a monetary compensation should be paid, without any further specification. Thus, I argue that it should be introduced an amendment to Article 11 of the Directive, in order to take into account the distinction between mandatory or voluntary implementation of the breakthrough rule. At the same time, if a Directive's amendment was difficult to be realized, Member States and companies should decide to stress the above mentioned distinction in implementing the breakthrough rule. In fact, I propose to compensate only those shareholders whose rights have been broken because of a decision taken by the Member State of their company's incorporation. Conversely, I argue that in cases in which the company has voluntarily decided to subject itself to the breakthrough rule, its shareholders should not receive any monetary compensation. In other words, in my opinion, the monetary compensation should rely on the fact that the company and its shareholders have not had the possibility to decide whether or not to subject themselves to the breakthrough rule. Conversely, in case a company have voluntarily decided to implement Article 11 of the Directive (25/2004/EC), being it aware of the consequences of this choice, its shareholders should not be entitled to receive any monetary compensation, whose expenditure the bidder should not bear.

In my opinion, this proposal could result to be fair and valuable. In fact, on the one hand, it would compensate those shareholders who have not the possibility to decide, and on the other hand, it would relieve the bidder from the responsibility to compensate its target, in case the latter has voluntarily conferred to the bidder the advantages related to the breakthrough rule.

PARAGRAPH IV – THE BOARD OF DIRECTORS AND THE ROLE OF INDEPENDENT DIRECTORS

In this paragraph, I intend to identify some further weaknesses of the Takeover Bids Directive (25/2004/EC), and I would like to provide for some proposals to solve these issues, which I propose to bridge by granting the board of directors and independent directors with more powers in facing hostile tender offers.

First, I would like to express the risks concerning what European Directive (25/2004/EC), which requires the target board of directors to not take any defensive action without the prior shareholders meeting's authorization, however permit and impose the board of directors to positively do, when a hostile tender offer has been received. I am referring to the obligation for the board of directors to provide shareholders with a report concerning its opinion on the merits of the tender offer, such as the possibility for the board of directors to seek alternative bids. In this paragraph, I will explain the dangers of these two activities with the aim to propose some corrections to remove them.

SUB-PARAGRAPH I – INDEPENDENT DIRECTORS: THEIR FIGURE AND THEIR ROLE

With reference to the first activity, *i.e.* the obligation for the board of directors to create a report for shareholders with its opinion on the terms and conditions of the tender offer, in my opinion, this debatable activity, if performed by directors, could bring the risk that it is not truthful and that it negatively influences shareholders' decisions. My opinion relies on the assumption that, being directors and managers in conflict of interests in facing a hostile tender offer, as we have widely seen in the previous chapters, the board of directors could easily be stimulated to address the shareholders' behavior, providing the latter with a report totally disparaging the bidder and the received tender offer. Moreover, it should be taken into account that a disparaging report is at the basis of the request to the shareholders' meeting to allow the board of directors to adopt some defensive measures in order to defeat the tender offer. In my opinion, the risk for shareholders to receive a report that not reflects a real assessment of the tender offer is very high. In fact, being directors and managers aware that in case the tender offer succeeds they are likely to lose their office, the board of directors is stimulated to use the powers that the Directive (25/2004/EC) have granted them, and the creation of the report represent one of these powers. It should now be underlined that, under Article 2392 of Italian Civil Code, directors owed fiduciary duties to the company, since they are required to diligently fulfill the duties imposed by the law or by the company's bylaws. Thus, under Article 2395 of Italian Civil Code, in case of breach of directors' fiduciary duties, shareholders are entitled to claim a monetary compensation. However, I argue that the protection offered by such a rule is not enough and not in line with the European Directive on Takeover Bids' purposes. In fact, using the protection provided them by Article 2395 of Italian Civil Code, shareholders would obtain an ex-post protection, *i.e.* a protection that could apply only after that the hostile bid has been frustrated. Therefore, in my opinion, even if Article 2395 of Italian Civil Code is able to ex-post compensate shareholders, it would not prohibit the board of directors to defeat hostile tender offers, and then it is not able to permit the European Directive to achieve its purpose to create a more open market for corporate control.

With reference to the second activity, *i.e.* the possibility for the board of directors to seek alternative bids, with the common search of a white knight, I argue that this opportunity bring some risks for the company and its shareholders. In fact, on the one hand, the aim of this activity is to create a competition that is often able to increase the price offered. On the other hand, if it is true that the board of directors is not allowed to perform some defensive measures, such as poison pills or staggered boards, it is also true that directors could have some instruments and some manner likely to disadvantage certain bidders. Indeed, directors could be more cooperative with friendly bidders, who could compensate directors through private benefits or through the promise to maintain their office or to get another one, in case their bid succeeds. In order to be clearer and to concretely demonstrate how the board of directors could act abusing of its power, we should imagine the possibility for directors and managers to provide the friendly bidder with a higher number of information concerning the company. For example, the board of directors could perform a vendor due diligence and provide with it only the friendly bidder, as well as it could provide it with some information concerning the long-run investments carried out by the company. In these cases, the hostile bidder would be disadvantaged, since it could not benefit from the above mentioned cooperation of the target board of directors and from sensitive information. Indeed, the fact to receive some privileged information represents itself an advantage for the friendly bidder, who could have a clearer and more detailed view of the company's situation and its value, with the possibility to take advantage of these information and succeeds at the expense of its competitors. This behavior and the different treatment between friendly and hostile bidders, such as the discrepancy of information that bidders obtain, could bring some detrimental effects to the competition, which would be distorted, so impeding all the bidders to participate with the same possibilities. I argue that this distorted and unfair situation could negatively affect the shares price, which could result to be lower than the highest possible, and so it could be detrimental for the company and its shareholders, who would not benefit from all the premiums that the search of alternative bids would be able to produce.

With reference to both the above mentioned issues, *i.e.* the one concerning the abuse of the board of directors in creating the report on the merits of the bid for shareholders, and the other one concerning the possibility for the board of directors to abuse of its power to seek alternative bids, I argue that an amendment of the European Directive (Directive 25/2004/EC) is needed. Such an amendment could also be provided for by Member States or companies in implementing the Directive's provisions. In fact, under an amended Article 9 of the Directive, or by Member States implementation, for example by an amended Article 103 of the Italian TUF, it could be possible to make in charge of the above mentioned activities (i) independent directors or (ii) the statutory audit.

(i) Independent directors proposal.

A proposal could be to make in charge of these two delicate activities not the whole board of directors but only independent directors, who could have a disinterested behavior. However, if my proposal stopped here, it would not really solve the problems, since in my opinion, this solution should be accompanied by a total reform of the nature and of the role of independent directors, whose independence is currently not very guaranteed. In order to be aware of the figure of independent directors, and in order to assess whether they lack their independence or not, we would have to take into account the Italian rules concerning them. For an analysis of their figure, with have to jointly consider the rules concerning independent directors, *i.e.* Article 2386 of Italian Civil Code, Article 147-ter of Italian TUF, and Article 3 of the "Codice di Autodisciplina delle società quotate". In light of these rules, which concern their appointment, the requisites that they have to meet, their number, and their role, I argue that a huge legislative amendment of independent directors is needed. Thus, I intend to explain how I propose to develop the figure of independent directors, in order to guarantee their independence and make them useful, with the awareness that such a proposal requires an intervention of the Italian Legislator in order to amend the text of the above mentioned rules concerning independent directors.

First, in order to allow independent directors to act in a more organized and uniform manner, so that they could be more important and they could have the possibility to affect the decision on these extraordinary operations, I argue that it would be necessary to organize independent directors in an intra-board structure.

Second, in order to achieve the purpose to guarantee their independence, I argue that requiring them to meet some requisites of professionalism, honorability, and unfamiliarity with the company is not sufficient. In fact, the lack of the current figure is based on the evidence that, despite the fact that they are in possession of the necessary independency requisites, independent directors lack their fundamental aspect, since they are appointed by the shareholder' meeting, who appoint all the board of directors. Therefore, in order to make sure that they are independent, our proposal would start from changing the way of their appointment, since it could be difficult to require someone to be independent by who have appointed him. In this field, I propose to set up a system under which independent directors are appointed by a public body. For example, in Italy the public body charged with this responsibility could be the Consob, which could appoint independent directors among those entered in a register for that reason created. Thus, when a company establishes in Italy, the Consob would have to appoint independent directors among those entered in the register, with the possibility and the necessity to appoint those with the knowledge related to the new-co's business.

However, it should be noted that the above mentioned proposal could only be able to guarantee the independence of independent directors in the moment of the appointment, with no possibility to make sure that they maintain this feature for the duration of their office. In fact, here is the second issue concerning independent directors, due to the fact that even in cases in which they are independent in the moment of their appointment, independent directors usually lose this fundamental requisite during the performance of their office. This assumption could be linked to several reasons, from the simple fact that directors and independent directors are members of the same board and have to be in touch in running the company, to the fact that the controlling shareholder could easily influence them and acquire their cooperation with the promise of a future appointment as directors. In my opinion, this second issue represents the most important obstacle on the possibility to set up an efficient figure of independent directors. Thus, in order to guarantee a real independency, both in the moment of appointment and during the entire office, I propose to establish the impossibility for those entered in the public register of independent directors to be appointed as directors. In this manner, I argue that the most important instrument that the controlling shareholder could use in order to obtain the independent directors' acquiescence would be neutralized. In my opinion, independent directors, if appointed as I have just proposed, would have the ability to act in a more efficient manner, both in creating the report for shareholders and in seeking alternative bids to create a competition. Indeed, even if I am aware of the fact that this proposal could result to be too expensive and too intrusive of the company and of the board of directors' performance, I argue that my solution could allow target shareholders to receive a sincere report. In fact, in this manner the report could really be based on an honest and expert opinion on the merits of the bid, which could represent an important help for shareholders in order to allow them to take informed decisions on the assessment of the tender offer.

At the same time, I establish that my proposal, by charging independent directors of the search of alternative bids, could allow them to promote a fair and efficient competition. In fact, independent directors would not be stimulated to be more cooperative with some bidders than with others. This situation could easily create a competition in which target companies and shareholders benefit the highest shares price.

(ii) Statutory audit proposal.

However, being aware of the difficulty to create the above mentioned system, which requires a huge Italian Legislator's intervention, I intend to propose an easier solution. In fact, in addition to the first one, I propose a second solution in order to provide shareholders with a real report on the merits of the bid, and in order to create a fair competition. My second proposal is to confer these two activities, *i.e.* the creation of the report and the search of alternative bids, to the statutory audit. It should be now said that, like the board of directors, the member of the statutory audit are appointed by the shareholders' meeting, and such an appointment could influence their behavior in performing the above mentioned activities. However, on the one hand, the shareholders' meeting appoint both the board of directors and the statutory audit, on the other hand, the statutory audit, unlike the board of directors, is not in a conflict of interest during a hostile tender offers. In fact, due to the fact that the statutory audit is not threatened by the fact to be replaced in case of success of the bid, it is less likely to have a self-interested behavior and defeat the bid through a disparaging report and by creating an unfair competition. This solution, compared with the previous one, would be cheaper, less intrusive of the company and the board of directors' performance, and more doable. However, unlike the first proposal, this second solution would confer the above mentioned activities to subjects less informed of all the company's information and future projects than independent directors, due to the fact that unlike the latter they are not member of the board of directors, which will continue to be the body charged of running the company.

SUB-PARAGRAPH II – DIRECTORS' COMPENSATION

In this paragraph I intend to explain what in my opinion the weaknesses of the passivity rule in general are, *i.e.* I will explain from what points of view, an opposite regime based on the possibility for the board of directors to freely defeat a tender offer could result to be efficient, at least from a theoretically point of view. Then, I will explain how I propose to make these benefits possible also in reality. In my opinion, there are two main weaknesses concerning the passivity rule, *i.e.* the short-termism issue and the self-interested behavior of shareholders.

(i) The short-termism issue.

Prohibiting the board of directors to act against a hostile tender offer, passivity rule could make directors too much accountable to shareholders, with the result to stimulate them to try to maintain the shares price high, so influencing directors and managers to focus their business on short-term investments, without taking into account the effects on the long run. In fact, in this manner, directors and shareholders could be stimulated to take care only about shareholders, *i.e.* to run the company with the aim to meet the aim of the company's category whose interests are most based on short-termism. This belief could be explained by the fact that shareholders are only focused on the return of their economic investments, being they interested only to the received dividends. In fact, their interest is so focused to the economic return that in case of not excellent company's performance, they usually prefer to sell their shares and invest in other companies, rather than take care of the company's business. Furthermore, the issue concerning the short-termism of shareholders is becoming higher, due to the always more preeminent presence of institutional investors, such private equity funds and hedge fund. In fact, these institutional investors are still more short-termism than single shareholders, due to the fact that in their activity based on the management of the portfolio of their clients, a one-day investment could usually result to be long-termism. In light of this, I argue that a more freedom for the board of directors to act against hostile tender offers could encourage it to pay more attention to the long-term investments carried out by the company. In fact, the possibility for the board of directors to defeat hostile tender offers could induce it to be less focused on the short-term investments with a more attention to the business of the company in the long run. Thus, on the one hand, the fact that long-term investments are usually not reflected in the shares value could attract hostile bids; on the other hand, the fact that the board of directors is entitled to act against tender offers could allow it to be less afraid of the current shares value, and then more likely to make long-term investments.

(ii) Self-interested behavior of shareholders.

Second, the other weakness concerning the passivity rule concerns the fact that leaving shareholders free to decide on how to face a hostile tender offer, could allow shareholders to act in a self-interested manner, taking into account only the offered price, without any consideration of interests of other company's constituencies, such as employees and creditors. This belief is enhanced from the above mentioned assumption, in which I have stated that shareholders are only interested in the return of their economic investments. However, a valuable offer price, even if it is over the market price, does not make sure that the tender offer is valuable and profitable for all the company's constituencies. In fact, the business plan and the business policies of the bidder could be less efficient and this could be detrimental for creditors. At the same time, the bidder, as usual happens, could decide to amend the structure of the company and its employment situation, with many negative effects for the employees constituency. However, shareholders are not interested in all these considerations. Thus, the issue concerning the fact that the passivity rule leave non-shareholders stockholders without any defense in case of hostile tender offers represents another situation under which a regime based on the possibility for the board of directors to defeat hostile tender offers could be more efficient than the system provided for by the passivity rule. In fact, the board of directors, if granted with the possibility to adopt some defensive measures could take into account the interests of all the company's constituencies, being able to take the best decision for the whole company.

However, notwithstanding the above mentioned possible positive effects of the board of directors' intervention, as we have seen in the past chapters, these possible effects are often difficult to be achieved in the truth, always due to the conflict of interests of directors in facing hostile tender offers. Thus, in order to make possible the above mentioned positive effects, my proposal is to try to align as much as possible the interest of directors to shareholders ones. Therefore, I propose to increase the percentage of the directors' compensation based on stock options. In fact, a directors' compensation based on stock options could be able to decrease their conflict of interests, since directors would have part of their interests in common with shareholders. However, this instrument could represent a double-edged sword. In fact, on the one hand, a compensation based on stock options could be able to align the interests of shareholders and directors, giving the latter the possibility to better represent the interests of shareholders, and on the other hand, a too high percentage of stock options could make directors too similar to shareholders. Thus, directors could take the weaknesses and the short-termism issues of shareholders. My proposal relies on the assumption under which the conflict of interests of directors in facing hostile tender offer is proportional to the benefits that directors are likely to lose in case of successful tender offer. In other words, the lower the benefits that directors receive should the tender offer succeeds, the higher the conflict of interests between them and shareholders. From this point of view, if the compensation of directors was formed by stock options, they could receive the premium often paid in case of transfer of control, so that they would be less influenced to contrast the bid, since they would bear less costs than the case in which they are provided with no stock options. Thus, thanks to the reduced conflict of interests, the board of directors could be able to handle all the stages of a tender offer, being they less stimulated to adopt defensive measures, with the possibility to honestly decide on the merits of the bid and to provide the company and its shareholders with the highest benefits.

In light of these explanations, I argue that a compensation formed by stock options that take into account the issue concerning the fact the a too high percentage of this kind of remuneration could result to be detrimental, could reduce the board of directors' conflict of interests, so allowing them to face in a honest manner hostile tender offers. Thus, this solution could be beneficial from a twofold standpoint. In fact, on the one side, the board of directors would be able to run the company taking care of long-term investments, and on the other side, the board of director could take into account the effects of hostile tender offers for all the company's constituencies, such as employees and creditors. In fact, this positive implication would not be possible if directors were prohibited to act without the prior shareholders meeting's authorization.

Therefore, I argue that if the above mentioned proposal was performed, a system in which the board of directors has the possibility to adopt some defensive measures and to engage in some frustrating operations against hostile tender offers could be beneficial for the whole company, and that it could be preferred to the passivity rule from several points of view.

PARAGRAPH V – INTERNSHIP EXPERIENCE: EMBEDDED / UNREGULATED DEFENSIVE MEASURES

The final point I would like to analyze in this study on the passivity rule, its efficiency, and its necessary presence, concerns the possibility to bypass the Directive's provisions by using some embedded and unregulated defensive measures. The idea of this theme came to my mind during an internship experience that I have performed at a law firm in London at the beginning of 2015[65]. The change of control provision, whose check I was in charge during the

[65] I have performed an internship experience at the London office of the Italian law firm Gianni, Origoni, Grippo, Cappelli & Partners. This internship takes four weeks, since February 9, 2015 to March 6, 2015. During this experience, among other things, I was in charge of the performance of the legal due diligence concerning the acquisition of Ansaldo Sts (company established in Italy) by Hitachi Rail Europe (subsidiary of a company established in Japan). During this due diligence activity, I dealt with the check of the absence of change of control provisions in the contracts entered into by Ansaldo Sts and its counterparts. The closing of this acquisition has been published

internship, are clauses inserted in contracts entered into by companies, under which a party has the ability to immediately terminate the contract, in case of a change of control of its counterpart. Now, with reference to the market for corporate control, it should be easy to understand that the presence of this kind of clauses in the contracts entered into by a company represents a strong defensive measure for its board of directors, as well as a very strong deterrent for the launch of a tender offer against that company. In fact, the insertion of change of control clauses in contracts entered into by the target company brings issues from several points of view.

First, in case of a successful tender offer, and in case the change of control clauses were triggered by the counterpart, the bidder would have acquired a company whose value is strongly reduced compared to the price paid to tendering shareholders. Conversely, if during the performance of the legal due diligence the bidder acknowledges the presence of change of control clauses in the agreements entered into by its target company, it has two possible roads to follow. First, the bidder could decide to withdraw from negotiations with the target company, considering the operation too risky due to the presence of these clauses and the possibility for counterparts to trigger them. Second, it could decide to renegotiate downward the price offered, taking into account the presence of change of control provisions and the possible reduction of the company's value. It should be noted as all these possible situations are detrimental for bidders and for tender offers. In fact, in the first case, the bidder obtain a company whose value is strongly reduced. In the second case, the bidder withdraw from the negotiations and the operations does not happen. In the third case, the fact that the bidder decide to renegotiate the price offered, proposing a lower one, brings the consequence that, being the offered price lower than the market value, target shareholders would not be stimulated to tender their shares, and the tender offer would not succeed.

The target board of directors could decide to adopt another usual and detrimental behavior, inserting change of control clauses in the loan agreements in which it

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on legal community.it on February 24, 2015, and here is the link of the deal I have worked on: http://www.legalcommunity.it/grimaldi-e-gop-nel-passaggio-di-ansaldo-hitachi .

has entered into. Under these clauses, the lender has the possibility to entirely and immediately require the return of the lent amount, should the borrower be subject to a successful tender offer and a change of its control. As well as the above mentioned change of control provisions, it should be easy to note the deterrent effects for tender offers and for bidders, who should correctly verify the presence of these clauses before the launch of the tender offer. In fact, the eventual presence of change of control clauses in the loan agreements entered into by the target company would require the successful bidder to bear very high expenditures, due to the fact that almost all the companies, in order to benefit from the financial leverage, are likely to recourse to borrowed capital.

Now, it should be worth to analyze the nature and the aim of change of control provisions. Thus, it is possible to say that change of control clauses are usually inserted in agreements in which the identity of the counterpart is a fundamental aspect, *i.e.* in cases in which the identity of the counterpart represents a guarantee of the proper performance of the contractual obligations. Thus, it is possible to state that the role of the change of control clauses is to guarantee third parties that come in touch with the company, such as its counterparts in contracts entered into by the company in the first case, or the lender in the second case. However, notwithstanding this valuable aim, the fact that these clauses strongly affect tender offers is not debatable. In fact, the board of directors may insert these clauses in all the contracts entered into by the company, or at least in the most profitable agreements, using change of control clauses as defensive measures and entrenching its position. Moreover, and this is the most important aspect to underline, it would not be possible to prohibit these eventual abuses, since an eventual prohibition could bring too many obstacles on the ability of the board of directors to run the company.

Now, in order to analyze whether the passivity rule represents an efficient way to regulate takeovers, I argue it may be useful to compare the negative consequences of the use of the defensive measures that the passivity rule prohibits, and the detrimental implications of change of control clauses, which could be used as a response to the passivity rule.

With reference to the eventual detrimental effects of the use of the defensive measures that the passivity rule prohibits, we need to remind the consequences of the most used anti-takeovers devices, such as poison pills and staggered boards. As we have seen in the past chapters, poison pills are generally used in order to dilute the ownership that a bidder obtains after the success of a tender offer. Thus, poison pills require a bidder to first gain the control of the board of directors by the win of a proxy fight, and then to remove the pills and launch the tender offer. Obviously, these forced stages bring high costs and delays that the bidder has to bear. Conversely, staggered boards, allowing the bidder to annually remove only a minority of the members of the board, usually only one-third, force the bidder to win two proxy fights in order to gain the control of the board of directors and benefit from its controlling ownership. Therefore, as well as poison pills, staggered boards bring high costs and delays, but they do not totally avoid the bidder from acquiring the target company. As we have seen in the past chapters, the above mentioned costs and delays caused by poison pills and staggered boards are still higher in case these two devices are used together.

Conversely, the above mentioned change of control clauses, mainly the clauses under which a party is entitled to immediately terminate the contract in case its counterpart is subject to a successful tender offer and a change of its control, could result to be more detrimental than poison pills and staggered boards. In fact, unlike poison pills and staggered boards that are usually able to bring delays and high costs for the bidder, but that do not avoid the bidder from succeeding and taking the company over, the presence of change of control clauses and their use by the counterpart could confer to the bidder a company with a reduced value. Furthermore, the situation would be still more desperate in cases in which the target board of directors have inserted change of control clauses in the majority of the most profitable agreements entered into by the target company, whose value would be close to zero in case of successful tender offer.

Thus, in light of these explanations, I argue that we should take into account one important outcome. In fact, it should be considered that, if on the one hand, passivity rule prohibits the adoption of some defensive measures that could be detrimental for the company and its shareholders, on the other hand, the adoption of the passivity rule stimulates the board of directors to use the above mentioned change of control clauses. However, I need to specify that I do not intend to affirm that the adoption of the passivity rule could lead to a generalized adoption of change of control clauses. Instead, I mean that the board of directors that used to adopt defensive measures such as poison pills and staggered boards, due to the prohibitions provided for by the passivity rule, will be likely to devise new methods to contrast hostile tender offers and entrench its position. Finally, I argue that change of control clauses could represent for the board of directors a valid instrument for their entrenching purpose.

PARAGRAPH VI – CONCLUSIONS

In light of this, I mean to provide for a summary of what I have stated on passivity rule. I argue that, it should be noted that the passivity rule, whose ideals and purposes may be shareable, presents several weaknesses, at least with reference to the text provided for by the European Directive (25/2004/EC). In fact, we have first had a look at the optionality system's weakness. In addition to these issues, we have realized the fact that the passivity rule induces the board of directors to have short-run interests and lead them to be too accountable to shareholders, so ignoring the effects of tender offers on other company's constituencies, such as creditors and employees. After that, we have analyzed the impact of the insertion of change of control clauses in the agreements entered into by the target company. Thus, we have realized that the introduction of the passivity rule's provisions could represent a double-edged sword. In fact, the target board of directors is induced to find new ways and new instruments to defend its position, and as we have seen with the change of control clauses, the directors' inventiveness may produce instruments that could result to be even more disadvantageous than the classic defensive measures forbidden by the passivity rule.

Finally, I conclude this chapter stating that, even if I agree with passivity rule and its purposes to create a more open market for corporate control, as well as to create a level playing field for takeover bids within EU, I argue that the Directive (25/2004/EC) is far from limiting the possibility for directors to entrench their positions. In fact, to conclude, I argue that directors and managers are able to bypass the passivity rule's prohibitions and to defend themselves from hostile tender offers devising new defending instruments, and that the adoption of the above mentioned change of control clauses represent only one of the instruments in their possession.

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