

JAN SCHANS CHRISTENSEN

CONTESTED TAKEOVERS

IN DANISH LAW

A Comparative
Analysis based on
a Law and
Economics Approach

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Preface

Limited liability companies have gained popularity and importance as a vehicle for the conduct of business operations in most modern societies. Long ago it was realized that there are definite advantages connected to the corporate structure, which allows a large number of participants to pool some of their funds and vest the right to manage the business in a management team. In addition to limiting the liability of the participants (shareholders), the corporate model facilitates the buying and selling of their interests in the business and permits them to join forces with people who are, supposedly, better managers than they are themselves.

However, despite its apparent success, the corporation conceptually raises a number of crucial questions: who controls, or ought to control, the business; management, the shareholders, or perhaps some third party? And, related thereto: in whose interest is the business managed and what are the limits of managerial discretion? What duties does management owe to the shareholders? What if there is a conflict between the interests of management and those of the shareholders, whose interests should prevail?

Danish corporate law creates a framework which regulates the activities of companies, but only provides limited guidance with respect to the above queries. Yet, I believe these are key questions if one's goal is to determine the laws of corporate governance which, in turn, are critical for the future success of the corporation as a business vehicle. This is where the subject matter of this book comes into the picture. An analysis and evaluation of contested takeovers inevitably begins – and ends – with a discussion of who should govern the company and, in particular, who should have the final say as to whether or not control must change.

My general interest in these issues was sparked during my studies at Columbia University School of Law, New York, in 1987-88, in particular by the classes in Corporate Finance given by professor Louis Lowenstein, director of Columbia's Center for Law and Economic Studies.

I began writing this book in August 1988 and the manuscript was submitted as a dissertation to the University of Copenhagen Faculty of Law in November 1990. Right from the outset, when he heard of my interest in this field, my friend and colleague Eskil Trolle encouraged me to write and, throughout the term of this project, he maintained an enthusiasm and interest in my work which gave me much inspiration and kept my spirits high. Also, Eskil read earlier versions of the manuscript and took

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the time to discuss many of the issues. All this has been of immense help to me.

Another person who has been of vital importance for the coming into being of this book is professor, dr. jur. Bernhard Gomard, the University of Copenhagen Faculty of Law. Professor Gomard gave me the idea of turning my interest in writing on contested takeovers into a dissertation. Moreover, I would like to express my gratitude to professor Gomard for showing his interest in the project and thus stimulating the writing process as well as for discussing with me a number of the issues found in the book.

I am deeply indebted to my friend, associate professor, dr. jur. Mads Bryde Andersen, the University of Copenhagen Faculty of Law, who has rendered great support during the project. Mads not only provided me with his valuable comments on the manuscript but also took the time to discuss several of the viewpoints expressed therein. For this, and for Mads' encouraging comments and inspiration, I am very grateful.

Hands-on experience, I believe, is a useful tool for enhancing the understanding of a concept like contested takeovers. During my employment (1988-89) as an associate with the law firm Debevoise & Plimpton, New York, I had the opportunity to work on contested corporate acquisitions. I would like to extend my thanks to my colleagues at Debevoise & Plimpton, in particular Meredith Brown, head of the firm's mergers & acquisitions practice, who possesses a scholarly interest in the law of a kind rarely found among practising attorneys, and with whom I had many fruitful discussions.

The value of secretarial assistance is frequently underestimated. I take this opportunity to thank my secretary, Inger Turner, who did the word-processing with ever-lasting diligence and patience and, chiefly due to a fine sense of humor, survived the many changes, reorganizations, etc. of the manuscript.

Several persons other than those listed above have contributed to this book in different ways, including my colleagues in Bech-Bruun & Trolle, not least Niels Mørch, employees in the Commerce and Companies Agency who made my empirical studies possible, Poul Erik Skaanning-Jørgensen, the Copenhagen Stock Exchange, and my friends Christian Bovet, Geneva, and Antoine d'Ornano, Paris.

I would like to thank the Institute of Legal Science at the University of Copenhagen for providing me with the opportunity to use the Institute's library facilities.

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The Danish Social Science Research Council (Statens samfundsvidenskabelige Forskningsråd) and G.E.C. Gads Fond have contributed to the publishing of this book by means of grants for which I would like to express my gratitude.

Finally, but certainly not the least, I wish to mention the great help which Birgitte gave me. In addition to assisting me with proofreading, checking references and preparing the index, Birgitte's moral support and patience made it possible for me to meet my self-imposed deadlines, although her task has not been an easy one.

The manuscript was submitted to the University of Copenhagen Faculty of Law on November 28, 1990, but has been updated to reflect the law in all essential respects as per April 15, 1991.

Jan Schans Christensen
Copenhagen, May 1991

Commonly used abbreviations

ALI:	American Law Institute.
A/S:	Abbreviation of “aktieselskab”, i.e. Danish public companies.
CEO:	Chief executive officer.
The City Code:	(British) The City Code of Take-overs and Mergers.
COB:	(French) The Commission des Opérations de Bourse.
Disclosure Directive:	Council Directive 88/627 EEC of December 12, 1988, on the information to be published when a major holding in a listed company is acquired or disposed of.
Draft Fifth Directive:	Amended proposal for the Fifth Company Law Directive on the structure and organization of public companies (O.J. No. C 240/2 of 9.9.1983) as amended again in December 1990, cf. COM (90) 629 Final – SYN 3, Brussels, December 13, 1990.
Draft Takeover Directive:	Draft 13th Council Directive on Company Law concerning takeover and other general bids, COM (90) 416 Final-SYN 186, Brussels, September 19, 1990.
EC:	European Community.
E. Cir.	(following names of parties to Danish court decisions): Danish High Court for the Eastern Circuit.
ESOP:	Employee Stock Ownership Plan.
The General Rules:	(French) The so-called “Règlement Général du Conseil des Bourses de Valeurs”, issued by the Stock Exchange Council.
The German Guidelines:	The guidelines on voluntary public purchase offers and offers for exchange.
GWB:	The German Cartel Act.
IRC:	(U.S.) Internal Revenue Code.

Commonly used abbreviations

M&C Ct.	(following names of parties to Danish court decisions): Danish Maritime & Commercial Court, Copenhagen.
The Merger Rules:	(Dutch) The so-called “Fusiegedrag Regels” issued by the Social Economic Council.
The Merger Commission:	(Dutch) The so-called “Commissie voor Fusieaangelegenheden”.
NASDAQ:	National Association of Securities Dealers Automated Quotation System.
NYSE:	New York Stock Exchange.
plc:	(British) public limited company.
ROC:	Return on capital.
SAR:	(British) The Rules Governing Substantial Acquisitions of Shares.
SEC:	The U.S. Federal Securities and Exchange Commission.
Sup. Ct.	(following names of parties to Danish court decisions): Danish Supreme Court.
The Swedish Recommendation:	Recommendation regarding Public Offers for Shares (1988).
The Swiss Take-Over Code:	Schweizerischer Übername-Kodeks, adopted by the Swiss Stock Exchanges.
The Take-Over Panel:	(British) The Panel of Take-overs and Mergers.
U:	Ugeskrift for Retsvæsen (Danish Weekly Law Reporter).
W. Cir.	(following names of parties to Danish court decisions): Danish High Court for the Western Circuit.
Williams Act:	(U.S.) The provisions added to the U.S. Securities Exchange Act in 1968 and i.a. dealing with tender offers.
Yellow Book:	(British) Admission of Securities to Listing, issued by the International Stock Exchange, London.

Introduction

1. Background and purpose

“Hostile takeovers”, “tender offers” or “bids”, “poison pills”, “lock-ups” and “green-mail” are among the terms which have been known for several years in the United States and Great Britain where the so-called “hostile” or contested takeovers have become a common vehicle for corporate acquisitions.

While “friendly” or negotiated acquisitions are transfers of corporate control, based on an agreement or consensus between the management of the acquiror¹ and the management of the company to be acquired, the “target-company”, such agreement or consensus does not exist in connection with contested takeovers. It is a typical feature of such a takeover that the acquiror, knowing or expecting that the management of the target-company will resist the takeover attempt, makes an offer for purchase of the shares of the target-company directly to some or all of the shareholders of that company. The management of the target-company, on its side, does not sympathize with the acquiror and will thus do what is in its power to oppose the attempt to take over the company.

The term “hostile takeovers” is somewhat misleading. Except for the lack of cooperation between the acquiror and target-management, this type of corporate acquisition conceptually carries with it no “hostile” elements. Therefore, “contested takeovers”, rather than “hostile takeovers”, will be the designation used throughout this book.

Contested takeovers have been known in the United States for years, but since the early 1980'es the level of merger and acquisition activity in the United States has increased significantly and contested takeovers have now been sweeping the North American continent for several years. In 1988, the United States experienced mergers and acquisitions for a total amount of more than 200 billion dollars.²

Since the mid-eighties, several contested takeovers and takeover attempts have been made in the Western European countries. Probably the most

¹ While the word “acquiror” is neutral, the term “raider” sometimes triggers a less pleasant association and, consequently, is used to describe an acquiror with whom one does not sympathize for one reason or another.

² See Financial Times, January 11, 1989, p. 20.

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well-known example was the attempt in 1988 of Carlo de Benedetti, an Italian industrialist and financier, to gain control of Société Générale de Belgique, Belgium's largest conglomerate, representing approximately one third of the total Belgian economy. Another example is the battle for control in 1987 between the two large Dutch publishing companies, Kluwer and Elsevier.³ From being an exclusively Anglo-American phenomenon the contested takeover technique is becoming an acquisition device known in a number of European countries.

Even Denmark has experienced a few contested takeover attempts lately. In the spring of 1988, Klaus Riskær Pedersen attempted to gain control of Fisker & Nielsen A/S through his acquisition vehicle, Accumulator Invest A/S. The attempt failed, partly due to Fisker & Nielsen's defensive purchase of its own shares. In the spring of 1989, the management of SEAS, a Danish semi-public utility, made the company buy back its own shares at a premium price in order to eliminate a foreign shareholder who had launched a plan to gain control of the company.

The purpose of this book is two-fold: to introduce to Danish legal research the law and economics approach, and to apply this methodology together with the traditional legal method in order to analyze and evaluate the law pertaining to contested acquisitions in Denmark. The analysis includes a discussion of the impact of contested takeover activity as well as the use of defensive means and an appraisal of the existing Danish legal framework for corporate acquisitions and transfer of corporate control.

The fact that very little Danish case law exists regarding the subject matter and that no Danish legal scholars have addressed the issues relating thereto with any great degree of detail has made it relevant and important to approach the matter from a comparative angle.

2. Plan of book

Chapter I of the book serves to introduce and explain the basic concept of how economic theories can be applied to legal analysis.

After being "equipped" with these methodological tools we turn, in chapter II, to a description of the historical background and structure of contested transactions.

Chapter III attempts to determine the public interest in the stockmarket and thus the interest in how it ought to be regulated.

³ This dispute has been described and commented by Willem Beusekamp & John Schoonbrood in *De Overval van Elsevier op Kluwer*.

I then narrow down the analysis to focus on the economic impact of contested takeovers, cf. chapter IV.

To provide a basis for the further studies, chapter V contains an analysis of whether Danish society would benefit from contested takeover activity.

Next, we turn to a description and evaluation of the sources of takeover regulation in Denmark, cf. chapter VI.

Chapter VII focuses on the acquisition of shares and the regulation thereof.

The particular issue of minority shareholder protection in the takeover context is dealt with in chapter VIII.

No analysis of takeovers can be conducted without involving financial and tax aspects. This is done in chapter IX.

The focus of chapter X is on the standards for managerial behavior once somebody threatens to take over a company or in the event that a company is susceptible to takeovers.

Chapter XI elaborates further on defenses against takeovers and includes an outline of a number of possible defenses as well as an evaluation of these.

In addition to defenses on part of the company being taken over, trade regulation aspects may have an impact on this kind of activity. These issues are dealt with in chapter XII.

Finally, chapter XIII focuses in more detail on the Danish market for contested takeovers. After considering the factors that are important to takeover activity, this chapter includes a discussion of some broader implications which seem relevant.

3. Limitations of scope

The present book is confined to companies with shares listed on one or more stock exchanges. Moreover, only contested takeovers will be covered. Attempts to acquire a company through a public offer addressed directly to a company's shareholders but with the consent of the target-company's management, falls outside the scope of this book.

Two additional caveats should be kept in mind:

Because of the overall purpose, no attempt has been made to exhaustively describe takeover techniques and defensive devices. Accordingly, a number of variations of the techniques described have not been included.

In addition, it should be noted that the emphasis has been put on the corporate law aspects of contested takeovers. Other legal aspects of such acquisitions, including aspects falling within the provinces of tax law and

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trade regulation, have only been dealt with to the extent necessary in order for the reader to understand the scenario of which contested takeovers are part.

I Methodology

1. Introduction – choice of methodology

Legal problems or issues may be approached from various angles. Not one true or exclusive method can be alleged to exist.

While any method of jurisprudence must meet certain generally acknowledged standards with respect to the collection and processing of source materials, the stating of assumptions or premises, and the drawing of conclusions, no compulsory method must be applied to legal scholarship. Frequently, a choice of methodology is motivated by a desire to draw attention to or focus on certain aspects of the law that the scholar considers relevant and material. For example, a scholar who wishes to analyze the criminal system may tend to focus on the ability of statutory criminal laws to deter criminal behavior. The purpose of such an approach could be to determine the nature and extent of the sanctions provided for in the statutes and the amount of crime. However, criminal statutes may also be analyzed from other angles, e.g. to determine whether the regulation provided in the statutes represents a sensible solution from an economic viewpoint.

If the purpose is normative, i.e. to evaluate whether the law is satisfactory as it is or whether it should be changed, some methodologies are better fit to serve this goal than others. More precisely, some scientific approaches are founded on premises or assumptions with respect to the subject area of law that reflect the values which are pursued by the community more adequately than others. Some methods thus seem more relevant than others.

2. Economics of law

2.1. Background. The proposition that legal issues or problems may be analyzed by using the tools of micro-economic theory has been labelled “law and economics”.

Although legal matters have been approached from an economic angle since the 18th century (e.g. Beccaria-Bonesera (1764), Bentham (1789), and Marx (1867)), the application of economics to law in most of this century was confined to anti-trust and governmental regulation of the

I. Methodology

economy.¹ In the early 1960's some articles were published in the United States that later turned out to be the cornerstone of a new and articulated scholarly discipline, the "merger" of law and economics into an interdisciplinary subject. Among the most prominent pioneers in this field are Guido Calabresi and Ronald H. Coase². Also, when mentioning the most remarkable individuals who have promoted the economic approach to law to what it is today, the name of Richard A. Posner inevitably comes to mind. Together with judges Robert Bork and Frank Easterbrook, Posner is also an example of the many federal judges who use a law and economics approach on the bench.

Two journals should be mentioned as fora that have facilitated the spread of this discipline, the *Journal of Law and Economics* and the *Journal of Legal Studies*.

While law and economics has developed in the last 30 years to become a subject part of the curriculum of numerous American law schools – and has led to the establishment of several centres for the studies of law and economics at the universities – it has gained only limited attention among legal scholars outside North America, with the exception of Great Britain.³ Since its origin, the law and economics approach has been applied by American scholars to a number of legal areas, including property, contracts, torts, family law, criminal law and constitutional law.⁴

2.2. Basic concepts. Economics is the "science of rational choice in a world – our world – in which resources are limited in relation to human wants"⁵, the study of "how scarce resources are allocated among competing ends".⁶

An important underpinning to the economic approach is the assumed behavior of the individual who is expected to be rational and attempting to

¹ See Paul Burrows & Cento G. Veljanovski, *The Economic Approach to Law* p. 2.

² See G. Calabresi, *Some Thoughts on Risk Distribution and the Law of Tort*, 70 *Yale Law Journal* 499 (1961) and R.H. Coase, *The Problem of Social Cost*, 3 *Journal of Law & Economics* 1 (1960).

³ See Burrows & Veljanovski, *The Economic Approach to Law* p. 1.

⁴ See Richard Posner, *Economic Analysis of Law* and Werner Z. Hirsch, *Law and Economics, An Introductory Analysis*. In Danish legal theory Bo von Eyben has included the law and economics aspect in his book *Kompensation for Personsskade – Reformerende af Ulykkeskompensationen*, Vol. I, p. 499 ff.

⁵ See Posner, *Economic Analysis of Law* p. 3.

⁶ See Robert Cooter & Thomas Ulen, *Law and Economics* p. 15.

maximize his (clearly specified) ends and satisfactions.⁷ The notion of the self-interested individual does not necessarily mean that each individual is supposed to be an egoist⁸; other people's joy may be part of one's satisfaction.⁹ Maximizing behavior (utility (=happiness)-maximization) is achieved by pursuit of consistent ends by efficient means (this is the rational element).¹⁰ However, the theory does not claim that all individuals are rational, rather it states that groups of individuals behave as if their members are rational.¹¹

The notion that by rational behavior Man maximizes his self-interest creates the foundation of one of the key assumptions in connection with micro-economics; that the individual will respond if his surroundings change in a fashion that he could increase his satisfactions by changing his behavior.¹² Economists have developed three assumptions on this basis, all of which are important for the understanding of the micro-economic approach:

The first is the inverse relation between price charged and quantity demanded, or the theory of consumer choice and demand. We assume that a consumer knows what he likes and what he does not like and, moreover, is able to rank his preferences. Such preferences are an entirely personal matter and need not be shared by others. Say, the consumer likes and buys apples on a regular basis. Then the price of apples increases by 5 percent. For many consumers this probably would not affect their decision to buy apples, while for others the price increase would motivate them to look for alternatives to apples, for example, pears. The point is that the consumer's preference faces obstacles to its satisfaction: he has a limited income and must, therefore, make a choice. This will probably lead him to pick the highest ranking alternative feasible for him. Picture a scenario where a study is made of the behavior of all consumers and it will appear that the aggregate demand for a good or service almost always falls when the price

⁷ See Posner, *Economic Analysis of Law* p. 3 f., Hirsch, *Law and Economics, An Introductory Analysis* p. 5, and Burrows & Veljanovski, *The Economic Approach to Law* p. 3 ff.

⁸ As suggested by Burrows & Veljanovski in *The Economic Approach to Law* p. 3.

⁹ See Posner, *Economic Analysis of Law* p. 4 and Hirsch, *Law and Economics, An Introductory Analysis* p. 10, note 21.

¹⁰ See Cooter & Ulen, *Law and Economics* p. 11.

¹¹ See Burrows & Veljanovski, *The Economic Approach to Law* p. 3-4.

¹² See Posner, *Economic Analysis of Law* p. 4.

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increases and, conversely, rises when the price drops. This is known as the Law of Demand.¹³

Secondly, there is the notion of opportunity cost. While consumers pursue utility-maximization suppliers are assumed to try to maximize profits. Suppliers will have to make choices based on costs: each supplier disposes of limited resources and he will have to decide for which purpose to allocate such resources. The economic benefit forgone by employing a resource in a way that denies its best alternative use is known as the opportunity cost. As the same resources cannot be used twice, the cost is crucial to the choice between various competing uses.¹⁴ Laws will ordinarily affect the behavior of human beings and thus also the choices made when resources are used. In other words, any law is likely to have economic impacts, and this is so even though not all laws govern activities in markets since the resources available are not unlimited.¹⁵

The third assumption is that resources have a tendency to gravitate towards their highest value if the market permits them to do so. The rationale behind this is that if suppliers and other traders have access to a market where they can voluntarily trade their goods and services, resources will be allocated to those uses where the value to the consumers, as measured by the consumers' willingness to pay, is highest.¹⁶ The market place will allow buyers who e.g. can exploit products better than their present owners to acquire such products and improve their use. Resources that are being used so that their value is highest are being employed efficiently.¹⁷

In the following, the term "efficiency" refers to the relationship between the aggregate benefits of a situation and the aggregate costs of the situation. A transaction or allocation is only efficient if the aggregate benefits connected thereto equal or exceed the aggregate costs.

This definition is based on A. Mitchell Polinsky, *An Introduction to Law and Economics* p. 7. As stated by Polinsky, this is a somewhat intuitive and simplis-

¹³ This mechanism is explained by mathematical means by Cooter & Ulen, *Law and Economics* p. 22 ff. See also Posner, *Economic Analysis of Law* p. 3 ff., where further details in connection with this assumption may be found.

¹⁴ See Burrows & Veljanovski, *The Economic Approach to Law* p. 4-5. See also Cooter & Ulen, *Law and Economics* p. 35.

¹⁵ For a further discussion of the economic implications of laws, see Burrows & Veljanovski, *The Economic Approach to Law* p. 4-5.

¹⁶ Hirsch, *Law and Economics, An Introductory Analysis* p. 4 ff. and Posner, *Economic Analysis of Law* p. 9-10.

¹⁷ Hirsch, *Law and Economics, An Introductory Analysis* p. 4 ff. and Posner, *Economic Analysis of Law* p. 9-10.

tic definition of efficiency. Economists employ various notions of efficiency. One of the best known definitions is the so-called “Pareto criterion” (named after an Italian economist, Vilfredo Pareto). Pareto efficiency or optimality exists if resources are allocated in such a fashion that no changes in the allocation can be made to the benefit of some without having a detrimental effect on others, see Polinsky, *An Introduction to Law and Economics* p. 7 and Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 Hofstra Law Review 509 at 512 f. (1980). An allocation of resources is not efficient according to the Pareto efficiency concept if the welfare of someone can be improved without impairing the welfare of anyone else. A transaction is Pareto superior if it improves the welfare of at least one individual and harms no one. Inherent in this criterion is that superiority is unanimity of all affected individuals, see Posner, *Economic Analysis of Law* p. 12 f. Another concept of efficiency is the so-called “Kaldor-Hicks” model. According to this, an allocation of resources (b) is efficient to another (a) if those whose welfare increases in the move from (a) to (b) can fully compensate those who lose welfare (but the winners need not always compensate the losers), see Posner, *Economic Analysis of Law* p. 12 ff. Posner here (p. 12-13) gives an example of Kaldor-Hicks efficiency: A sells a woodcarving to B. If A values the woodcarving at \$ 5 and B at \$ 12, so that at a sales price of \$ 10 the transaction creates a total benefit of \$ 7, then it is an efficient transaction (A considers himself \$ 5 better off and B considers himself \$ 2 better off), provided that any harm done to third parties (adjusted for any benefits they may reap) does not exceed \$ 7. As explained further by Posner, the transaction would not be Pareto superior, unless A and B actually compensated the third parties for any harm suffered by them. Both the Pareto and the Kaldor-Hicks concepts are relational notions of allocation of resources, however, due to the very rigorous assumptions in connection with the Pareto concept, most economists refer to the Kaldor-Hicks notion rather than the Pareto concept when using the term “efficiency”. The efficiency definition used in this book is based on the Kaldor-Hicks approach. For a further discussion of the various criteria and the interrelationship between these, see Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 Hofstra Law Review 509 at 512 ff. (1980). and Posner, *Economic Analysis of Law* p. 11 ff.

We have seen earlier how consumers are assumed to maximize utility while suppliers are assumed to pursue profit maximization. One may query how these assumptions interact. For each price thinkable of a product or service there is a corresponding quantity that consumers will demand. Likewise, for each price there is a quantity that suppliers will supply. If supply exceeds demand, the excess supply will cause the price to drop. Once the price falls, the consumers’ demand will increase while suppliers supply less, causing the gap between supply and demand to diminish. When demand equals supply, nothing in the market will cause the

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price to change, apart from changes from outside (e.g. change in consumer preferences). This point of balance is known as “equilibrium”.¹⁸

The purpose of this chapter is not to introduce and discuss all of the fundamental concepts of micro-economics. Rather, we merely aim at getting acquainted with some basic notions that we need in order to understand this method.

One more term thus needs to be explained before proceeding, the notion of transaction costs. Transaction costs are obstacles to reaching solutions that would otherwise be “perfect”, based on the market mechanisms. They include the costs of communication, negotiation, and monitoring.¹⁹ Suppose we had the option to choose among various alternative legal rules that may be applied to regulate a problem, an economist would point out that the existence of positive transaction costs (as opposed to no or “zero” transaction costs) should affect our choice. While zero transaction costs would mean that efficiency would not be affected irrespective of our choice of legal rule, the existence of positive transaction costs means that not every legal rule will ensure efficiency, and in such case we should prefer the legal rule that minimizes transaction costs.²⁰

Polinsky uses an example that may illustrate the impact of transaction costs.²¹ Suppose the smoke from a factory causes damage to the laundry hung outdoors by five nearby residents. If no action is taken, each resident would suffer \$ 75 in damages, a total of \$ 375. Suppose further that the smoke damage can be eliminated by either of two ways: a smokescreen can be installed on the factory’s chimney at a cost of \$ 150, or each resident can be provided with an electric dryer, at a cost of \$ 50 per resident. The efficient solution would be to install the smokescreen because it eliminates total damages of \$ 375 at an expense of only \$ 150. This option is cheaper than buying 5 dryers for a total of \$ 250. If the residents (or any other citizen for that matter) have a right to clean air, the factory, as explained by Polinsky, has 3 choices. It may choose to pollute and pay \$ 375 in damages. Alternatively, the factory may install a smokescreen at a cost of \$ 150, or buy 5 dryers for the residents at an aggregate cost of \$ 250. In this

¹⁸ See Cooter & Ulen, *Law and Economics* p. 36 f.

¹⁹ See Burrows & Veljanovski, *The Economic Approach to Law* p. 130-131 and Cooter & Ulen, *Law and Economics* p. 100 ff. The idea and impact of transaction costs have been analyzed by, among others, Ronald H. Coase in his path-breaking article, *The Problem of Social Cost*, 3 *Journal of Law & Economics* 1 at 15 ff. (1960).

²⁰ See Polinsky, *An Introduction to Law and Economics* p. 11 ff. where Polinsky extracts parts of the principle expressed in the “Coase theorem”, the transaction cost analysis and thesis of Ronald H. Coase.

²¹ See Polinsky, *An Introduction to Law and Economics* p. 11 ff.

scenario the smokescreen would clearly be the cheapest and most efficient solution. If, on the other hand, the factory has a right to pollute, the residents have 3 choices. They could either suffer damages of a total of \$ 375, purchase 5 dryers for \$ 250 or buy a smokescreen for the factory for \$ 150. The cheapest solution for the residents would also be to buy the smokescreen. It follows from this that the efficient outcome would be achieved irrespective of whether the factory has a right to pollute or the residents have a right to clean air. Stated differently, the choice implied in the legal rule (i.e. the right to pollute or the right to clean air) does not affect efficiency provided that there are zero transaction costs. This is the basic principle of the so-called "Coase-theorem".²² If, in the example, it is assumed that the costs for each resident to go together with the others is \$ 60, this will not affect the choice of remedy if the residents have a right to clean air. The factory will still prefer the smokescreen solution. If, on the other hand, the factory has a right to pollute, it will be more attractive for each of the residents to buy a dryer than get together to buy a smokescreen. In other words, the choice that is cheapest for the residents is not the most efficient one. From an economic viewpoint the right to clean air thus leads to a more efficient outcome than the right to pollute. The choice of legal rule thus affects efficiency in the scenario where there are positive transaction costs. From an economic point of view, the legal rule that minimizes transaction costs is the most attractive.

2.3. The economic approach as a tool for analyzing legal issues and problems.

2.3.1. Economic and legal analyses. One major difference in the traditional way in which lawyers approach a problem compared to the way economists do so is the degree of abstractness or generality. The legal (or judicial) method is basically a tool to discover, interpret and construe the various sources of law. It is a means by which to employ these sources for the purpose of determining the result of the application of relevant legal rules to a particular problem or set of problems. The fact pattern, sometimes a fictitious one, of each matter is the basis for the lawyer's analysis.

The economist, on his part, approaches the law in a much more abstract fashion by using models. He focuses on the various human goals, not from the viewpoint of each individual but rather on the basis of ends and desires of groups of individuals. In short, the economist focuses on general planning.

Critics may challenge the economist's method and argue that the real world is not standardized and that it is, therefore, misleading to base one's analysis on models that presuppose uniform patterns of behavior.

²² See Ronald H. Coase, *The Problem of Social Cost*, 3 Journal of Law & Economics 1 (1960).

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Economists would probably respond that this criticism is not at point since the economic approach does not claim to describe how each individual actually behaves. Rather, it provides general answers and guidance with respect to the interaction of needs and demands on the one hand and law on the other. Economics may be a useful means by which to quantify the impact of law. While giving answers of a general nature, economics does not seek to provide a comprehensive analysis of the law: the focus is merely on particular problems, e.g. of tort or criminal law, and the economic approach does not suggest that results found in one area should also apply to other areas of law. Perhaps the best illustration of the justification of using models is found in the conclusion in an article by Guido Calabresi and A. Douglas Melamed²³:

“Framework or model building has two short-comings. The first is that models can be mistaken for the total view of phenomena, like legal relationships, which are too complex to be painted in any one picture. The second is that models generate boxes into which one then feels compelled to force situations which do not truly fit. There are, however, compensating advantages. Legal scholars, precisely because they have tended to eschew model building, have often proceeded in an ad hoc way, looking at cases and seeing what categories emerged. But this approach also affords only one view ... It may neglect some relationships among the problems involved in the cases which model building can perceive, precisely because it does generate boxes, or categories.”

Also, as stated by Posner, as a response to criticism of economic reasoning applied to law²⁴:

“Newton’s law of falling bodies, for example, is unrealistic in its basic assumption that bodies fall in a vacuum, but it is still a useful theory because it predicts with reasonable accuracy the behavior of a wide variety of falling bodies in the real world. Similarly, an economic theory of law will not capture the full complexity, richness, and confusion of the phenomena – criminal or judicial or material or whatever – that it seeks to illuminate. But its lack of realism, far from invalidating the theory, is the essential precondition of theory. A theory that sought faithfully to reproduce the complexity of the empirical world in its assumptions would not be a theory – an explanation – but a description.”

²³ See G. Calabresi & A.D. Melamed, *Property Rules, Liability Rules, and Inalienability: One View of The Cathedral*, 85 Harvard Law Review 1089 at 1127-1128 (1972).

²⁴ See Posner, *Economic Analysis of Law* p. 16.

2.3.2. Further particular aspects of economic analysis. Apart from the idea itself of using models, one may query whether the assumptions used by economists are realistic.

Micro-economic theory assumes that individuals or groups of individuals act rationally, i.e. pursue consistent ends by efficient means. Since economics deals with analyzing human behavior, the question is if this assumption is a useful one. In the legal world, individuals are assumed to be reasonable or, at least, the reasonableness-standard is used as a standard for human behavior in many jurisdictions. In Denmark, for example, the general liability standard, the “culpa-rule”, is based on what a prudent and reasonable man (a so-called “bonus pater”) would do in the circumstances. Individuals who adhere to this standard escape liability unless the act or omission in question is governed by a particular rule of law that imposes liability on a different basis.²⁵

How does this rational man-concept fit into the legal standard of a reasonable man? A man may very well be rational without being reasonable, and vice versa. Some have argued that the hypothesis of the economic approach is that each individual may not be rational, although many probably are, at least to a certain extent, but the legal system is rational and, consequently, may be subject to economic analysis.²⁶ This does not give a very convincing answer to the question. Suppose the legal system is rational and human beings are not. Since the economic approach is based on human behavior, it is hard to see how one can support the use of economic analysis by arguing that the law is rational, unless human beings are also rational. A more convincing argument would be that most people, when they interact, e.g. by buying from or selling to each other, do show, in various degrees, rational behavior and that the rational man is, therefore, if applied generally, a suitable concept although not identical with the concept of a reasonable man.

Many commentators emphasize that economy, evaluated on the basis of “explanatory power” has enjoyed success. They point out the high level of statistical analysis and ability to quantify the effects of the law.²⁷ Posner, in particular, refers to examples that demonstrate how economics correctly

²⁵ The culpa-rule is discussed by Anders Vinding Kruse, *Erstatningsretten* p. 29 ff., Henry Ussing, *Erstatningsret* p. 8 ff., and Stig Jørgensen, *Erstatningsret* p. 62 ff.

²⁶ See Cooter & Ulen, *Law and Economics* p. 12.

²⁷ See Burrows & Veljanovski, *The Economic Approach to Law* p. 16 and Posner, *Economic Analysis of Law* p. 16-17.

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predicted the way people reacted in response to changes in their environment.²⁸

Some have challenged the alleged explanatory power of economic analysis, making the point that the notion of utility maximization by consumers is tautological. As stated by Arthur Leff²⁹, the “considerable power in predicting how people in fact behave” is not at all surprising if it is assumed that “human desire itself becomes normative (in the sense that it cannot be criticized)” and, simultaneously, is “made definitionally identical with certain human acts”, since “then those human acts are also beyond criticism in normative or efficiency terms; everyone is doing as best he can exactly what he set out to do, which, by definition, is “good” for him”.³⁰ Although Leff has a point in that the notion of utility maximization, when used generally, is hard to “second guess”, it is probably a fact that the concepts of economic analysis, applied to specific problems, do give us a tool to better understand and predict the impact of changes in people’s environment.

The tool that economics thus presents to us may be applied to law in two different fashions. First, it may be used as an empirical science using the economic analysis for the purpose of explaining the legal rules and the effects they have. This is known as the positive or descriptive approach. Second, economics may be used in a normative way to assist in the formulation of legal rules. This approach, also known as “welfare” economics, is concerned with maximizing efficiency, as an objective function, in connection with the future allocation of resources.³¹

2.3.3. Efficiency and equity. Perhaps the most fundamental and controversial aspect of micro-economics applied to law is its sole focus on efficiency in connection with allocation of resources. An economic analysis can tell how available means are employed most efficiently, but it does not give any advice with respect to the question if, seen from the viewpoint of society as a whole, the most efficient solution is also the one that should be chosen. The concentration on efficiency has given rise to the question if there is an inherent conflict between efficiency and equity or what other

²⁸ Posner, *Economic Analysis of Law* p. 16-17.

²⁹ See Leff, *Economic Analysis of Law: Some Realism about Nominalism*, 60 Virginia Law Review 451 at 458 (1974).

³⁰ See also Hirsch, *Law and Economics, An Introductory Analysis* p. 5 and Burrows & Veljanovski, *The Economic Approach to Law* p. 15.

³¹ Hirsch, *Law and Economics, An Introductory Analysis* p. 3-4, and Burrows & Veljanovski, *The Economic Approach to Law* p. 5 ff.

interrelation there is, or should be, between the two concepts. Many authors have touched upon these issues, but few have discussed them in depth.³² In order to have a meaningful discussion of this, we need to take a closer look at the notion of equity or justice.

2.3.4. The notion of justice or equity. When economists discuss the results of their analysis, they do not always include issues of justice or equity, and when they do, they typically use the term in a different sense than lawyers ordinarily do. When using the word “equity”, many economists refer to the distribution of income among individuals while they do not include the process of distribution.³³ Posner attempts to build a bridge between equity (justice) and efficiency, arguing that efficiency is one out of various notions of justice. One of Posner’s points is that it is “immoral” to waste resources in a world where resources are scarce.³⁴ Some have challenged this reasoning, which would suggest that efficiency should be a goal of social policy and judicial behavior and lead to changes in, among other things, the legal structure.³⁵

However, the fundamental problem is that terms such as “justice”, “equity”, and “fairness” are used in a variety of senses. This point may be illustrated by some of the modern general concepts of justice that have been developed.

In his well-known and comparatively recent (1971) work, *A Theory of Justice*, John Rawls states (p. 11):

“My aim is to present a conception of justice which generalizes and carries to a higher level of abstraction the familiar theory of the social contract as found, say, in Locke, Rousseau, and Kant. In order to do this we

³² See e.g. Hirsch, *Law and Economics, An Introductory Analysis* p. 6, Posner, *Economic Analysis of Law* p. 25-26, Polinsky, *An Introduction to Law and Economics* p. 7 ff., and Burrows & Veljanovski, *The Economic Approach to Law* p. 16-17. Of these authors only Posner discusses these issues in detail. In his book, *The Economics of Justice*, Posner further develops his view on efficiency and equity.

³³ See Polinsky, *An Introduction to Law and Economics* p. 7 and Posner, *Economic Analysis of Law* p. 25.

³⁴ See Posner, *Economic Analysis of Law* p. 25 and p. 238 ff.

³⁵ See for an example of such criticism e.g. Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 Hofstra Law Review 509 at 526 ff. (1980). Here Coleman challenges the notion that efficiency should be pursued as a fundamental goal such as it was suggested in an earlier article by Posner, *Utilitarianism, Economics, and Legal Theory*, 8 Journal of Legal Studies 103 (1979).

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are not to think of the original contract as one to enter a particular society or to set up a particular form of government. Rather, the guiding idea is that the principles of justice for the basic structure of society are the object of the original agreement. They are the principles that free and rational persons concerned to further their own interests would accept in an initial position of equality as defining the fundamental terms of their association. These principles are to regulate all further agreements; they specify the kinds of social cooperation that can be entered into and the forms of government that can be established. This way of regarding the principles of justice I shall call justice as fairness”.

On the basis of this point of departure and developing this idea further, Rawls proposes two principles of justice (p. 60 ff.):

“First: each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others.

Second: social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone’s advantage, and (b) attached to positions and offices open to all.”

Whether one agrees to the notion of a “social contract” or the importance of an “initial position” is not the point at focus here. Rather, our prime concern is to find out if Rawls’ concept is a useful tool by which to analyze the law. And the answer is that it is not. Rawls’ two principles of justice are obviously of importance and interest to anybody (including lawyers, philosophers, and politicians) who is concerned with how society should be shaped. Rawls thus expresses his views on what he considers just and fair, and one may find that his suggestions intuitively seem “right”. But the problem is that he does not give us any guidance in connection with our attempt to determine the substance of the justice concept in a given situation.

A similar observation may be made in connection with other approaches to justice. Robert Nozick views the concept of justice from a different point of view than Rawls. According to Nozick, a distribution of economic benefits (wealth or income) in a society is just if it arises from another (just) distribution by legitimate means.³⁶ Nozick’s theory is heavily based on an analysis of the historical changes in the way of distributing economic benefits. His formal approach is further expressed in some principles developed for the purpose of determining the justice of a person’s holdings. Nozick explains that “An injustice can be worked by moving from one distribution to another structurally identical one, for the second,

³⁶ See Robert Nozick, *Anarchy, State, and Utopia* p. 150 ff.

in profile, the same, may violate people's entitlements or deserts; it may not fit the actual history."³⁷

While Nozick's theory of justice is procedural, Hal Varian focuses on wealth-fairness among individuals.³⁸ Varian views each individual in society as having a "bundle" of consumption (i.e. the goods or services consumed by each individual). He labels a given distribution of such "bundles" as equitable if no individual, if asked, would prefer the bundle of somebody else. Fairness exists if everyone is "envy-free" in this sense. Providing each person with identical bundles may not coincide with the preferences of the individuals and, consequently, they may in that case elect to trade their bundles. But the moment all individuals find their bundles at least as attractive as the bundles of others so that they have no wish to trade what they have, the situation, according to Varian, is "fair" to the individuals.

In his book, *Foundations of Economic Justice*, Morris Silver discusses various economic rules of justice, see p. 133 ff.

The troubling aspects of these – as well as other – theories of economic justice is that they tend to express notions of moral and ethics rather than creating a tool that can help legal scholars analyze the law. To be sure, this does not mean that, for example, Varian's notion of equitable distribution is not relevant or interesting. It surely is. But it is a concept that is difficult to apply by lawyers as a legal notion.

Since the exact meaning of economic justice is so very hard to determine, one could query if lawyers should limit themselves to consider legal ideas of justice.

But even legal scholars who develop notions of justice do not always give us much guidance in our analysis. Natural law, for example, presupposes that justice or equity is a notion of imperative nature, born and developed in our minds. It assumes that justice is possessed by human beings, a priori, and in this respect reminds us of Posner when he uses terms such as "proper" and "immoral" in connection with justice. Surely, each of us has some intuitive idea of what is right and what is wrong, but these values, which we have been given by our parents, family, teachers and others, who have influenced the shaping of our ways of thinking, are not

³⁷ See Nozick, *Anarchy, State, and Utopia* p. 155.

³⁸ See Hal R. Varian, *Equity, Envy and Efficiency*, 9 *Journal of Economic Theory* 63 (1974).

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common values. Individuals have different ideas of what is “good” and what is “bad”.

To have a meaningful discussion of justice for the purpose of legal analysis, it is necessary to consider how a concept like this can serve the purpose of legal analysis. On the one hand we know that concerns about what the world should look like and how people should be treated play a very important role for any scholarship dealing with human behavior. On the other hand, theories that chiefly express moral, ethical, and political preferences are too abstract to give any helpful guidance for our purposes.

Consequently, we may want to use the term “justice” or “equity” in a more specific manner.

For our purposes we need a definition of justice that is suited in connection with our attempt to evaluate the outcome of the micro-economic approach of a given set of rules. Since the economic approach is so closely tied to the way in which resources are allocated in the most efficient fashion, the prime concern in connection with this is probably if an efficient allocation also constitutes a treatment of the various groups of individuals that is considered acceptable from society’s viewpoint. It is, therefore, relevant for us to examine and phrase the notion of justice as a demand for equality, which is one of the basic concepts in most modern political and philosophical theories.

Viewing justice from this angle, the Scandinavian realist approach to justice seems particularly helpful. One of the most prominent contributors to this school of thought is Alf Ross.³⁹

As succinctly explained by Ross, “justice” is a word that may be used in two different senses, a formal sense and a substantive sense. If used in an absolute sense, justice would mean that everyone, irrespective of differences in circumstances, should be treated in the same manner.⁴⁰ This is clearly not what is ordinarily meant by the word. People in different circumstances may be treated differently according to most commentators. As stated by Ross⁴¹, justice should be understood in a relative manner, meaning that like must be treated alike. In other words, differentiation in the treatment must be based on general criteria, i.e. general rules that apply to individuals who belong to the same category. If the rules are applied

³⁹ See Alf Ross, *On Law and Justice* p. 268 ff.

⁴⁰ See Ross, *On Law and Justice* p. 269.

⁴¹ Ross, *On Law and Justice* p. 270.

correctly, rather than arbitrarily, people are being treated equally according to this line of thought.⁴²

But in order to be a workable tool for legal analysis, it is not sufficient to rest here. We must go beyond the formal sense of justice and equality, which, following this path of thinking, have the same meaning.

In order to have a substantive equal treatment, it is thus necessary to define the criteria that determine the categories of individuals who must receive equal treatment. This may be done by considering, for example, their moral merits, performance, needs, abilities or rank.⁴³ Only by adding to the notion of formal justice or equal treatment a framework of reference does it become meaningful for an individual to claim that he does not receive equal treatment.

The relevant criteria for assessing if equal treatment is granted in a given situation are found in the law as “valid” (“gældende ret”), i.e. not only in statutes and regulations, but also in court decisions and the reactions of legal scholars to such decisions.⁴⁴ In other words, these sources of law are the key to evaluating the merits of a claim for “equal treatment” or “justice” in a given situation.

However, we might want to consider as lawyers (and citizens) if the law, as it is, represents a satisfactory or desirable regulation of the human behavior of our society or if the criteria used as basis for our equality-standards ought to be reconsidered. To be sure, such an analysis will include elements of what one considers to be a reasonable and adequate way of organizing the affairs of society and treating individuals. Nevertheless, the definition of justice or equality used here still serves our purpose by making it clear when we are concerned with issues of law and when we focus on questions of morals and ethics.

The basic idea in the notion of equality as expressed by Alf Ross is also found in some of the significant works on Danish administrative law. Poul Andersen in his *Dansk Forvaltningsret* in his discussion of the exercise of discretion by public authorities seems to use, as his point of departure, the term equality in the same sense as it is used by Ross, see p. 426 ff. See also Bent Christensen, *Forvaltningsret, Hjemmelsspørgsmål* p. 107 ff.

⁴² Ross, *On Law and Justice* p. 272-273.

⁴³ Ross, *On Law and Justice* p. 270-273.

⁴⁴ For a discussion of the concept of “valid” law, see Ross, *On Law and Justice* p. 29 ff.

I. Methodology

Assuming that we use the concept of justice described here, there are no grounds for stating that an inherent conflict exists between efficiency and equity.

It is certain, however, that the choices made by law do not always coincide with a sole pursuit of efficiency.

3. Making the choice of method

The point I want to make here is that law and economics is a relevant and useful method. This is in particular true in an area where the law is still not fully developed, and the borderline between the law as it is and as it ought to be is not distinct.

Micro-economics should not, and does not attempt to, dictate how the law should be shaped. But it gives us a useful tool for analyzing the choices we have made in our pursuit of justice. Put differently, economics applied to law enables us to evaluate trade-offs and thus the “costs” of justice. Since resources are not unlimited, and any employment of resources therefore expresses a priority, it is fair to assume that society as a whole is concerned not only with justice, but also with the economic impact of justice. For the same reasons it is of interest to consider, based on an economic approach, if changes in the law are desirable.

When reaching this point in the analysis and discussion, our inquiry should be extended to include the role played by equity in each particular matter and an evaluation of whether the existing criteria determining who must be treated equally coincide with what we deem should be the relevant criteria.

For the sake of completeness, it ought to be borne in mind that the law and economics approach to law will not be the only one employed in this book. The economic approach supplements the traditional legal method and does not replace it. However, since the traditional legal method hardly needs to be introduced, the focus so far has been on explaining why the economic approach may be a useful supplement to it.

Both positive and normative approaches will be used in the following. The positive approach will primarily be founded on economic studies by economists. The normative analysis, on the other hand, will be based on a verbal and “non-technical” use of the concepts briefly outlined above.

Those who desire to obtain insight in the mathematical analyses underlying micro-economics may be referred to the economic literature, e.g., Paul A. Samuelson, *Foundations of Economic Analysis*, Harvard Economic Studies, Vol. 80.

I. Methodology

See also Hal R. Varian, *Microeconomic Analysis*, and Edwin Mansfield, *Microeconomics: Theory, Applications*.

One additional comment needs to be made before proceeding. While most economists agree to the fundamental concepts of the economic approach to law, different schools of thought have developed that subscribe to theories not shared by others and that reach different conclusions with respect to the same legal issues. We will revert to this later.

II Historical background and structure of contested takeovers.

1. Historical background

Although the most significant contested takeover activity in the last 10 – 15 years has taken place in the United States, the origin of this phenomenon is Great Britain.¹ While contested acquisitions have been known even further back, Great Britain experienced a boom of this type of transactions in the late 1950's.

Until the mid-sixties it was almost unheard of that a U.S. company would acquire a company listed on a stock exchange by purchasing the shares in that company directly from the company's shareholders and without negotiating with the company's management. The ordinary procedure in the United States until the early 1960's would be to have the managements of the acquiring company and the target-company negotiate the terms for the acquisition subject to the subsequent approval by the two companies' shareholders.

In the 1960's the *modus operandi* for U.S. corporate acquisitions began to change, and acquisitions were increasingly effected by public purchase offers made by the acquiror directly to the shareholders of the target-company.

The reasons for this change were probably to be found in the general improvement of the U.S. economy and the increasing willingness on the part of U.S. banks to participate in the structuring and financing of such transactions.

Also, the valuation of the shares on the stock markets began to take place on a different basis. For a long time it had been assumed that the collective valuation of a company's shares made by numerous independent investors and reflected in the price quoted for such shares on a stock exchange, would be equal to the value of the company. During the 1960's it was acknowledged by more and more investors that there may very well

¹ It should be noted, however, that a number of contested takeovers took place in the United States in the 19th century, as early as in 1825, see Walter Werner, *Corporation Law in Search of its Future*, 81 Columbia Law Review 1611 at 1635 (1981). See also Louis Lowenstein, *What's Wrong with Wall Street* p. 119 ff.

II. Historical background and structure of contested takeovers

be a difference between the aggregate value of a company's shares as quoted on a stock exchange and the value or potential value of the company to a single owner.²

Until the mid-eighties, corporate acquisitions were ordinarily funded through the acquiror's own assets and, in addition, commercial banks would grant loans to finance the transactions. This picture changed, however, in 1984, when a new financial concept, the so-called "junk bond"-financed takeover appeared. Junk bonds or "high-yield bond" are bonds issued with a marginal security only and paying a high interest rate. Due to the high risk attached to junk bonds, they cannot be classified in any of the standard classifications issued by Standard & Poors and Moody's.³ Junk bond financing is undoubtedly one of the factors that have contributed most to the increase of takeover activity in the U.S., see below.

In late 1989 an event took place that was to signal a significant change in the use of junk bond financing. The junk bond market had for some months showed signs of stagnation when several banks refused to participate in the financing of the acquisition of UAL Corp. (holding company of United Airlines) by a group including labor unions, management and British Airways plc. Perhaps due to a combination of the weakened junk bond market and general uncertainty over the future economy, the banks were not convinced that the transaction could be refinanced⁴ by means of junk bonds. Shortly thereafter a number of other deals suffered a similar fate.⁵ It is probably not likely that the junk bond market will disappear entirely, but these recent developments suggest that the market has shrunk and that equity financing will regain some of its lost importance. Time will show exactly to what extent.

U.S. mergers and acquisitions have increased substantially within the last 15 years. In 1975 merger and acquisition activity amounted to 12 billion dollars but increased to 44 billion dollars in 1979, 83 billion dollars in 1981, 180 billion dollars in 1985 and more than 200 billion dollars in 1988.⁶ Merger and acquisition activity amounted to 118.7 billion dollars

² For a further discussion of these issues, see Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Columbia Law Review 249 at 257 ff. (1983).

³ Junk bond financing is further discussed under 2.

⁴ See 2 for further details on this.

⁵ This development is further described in *Mergers & Acquisitions*, Vol. 24, No. 4, p. 18, and No. 6, p. 29 (1990).

⁶ See Louis Lowenstein, *What's Wrong with Wall Street* p. 128 and, as regards 1988, Financial Times, January 11, 1989 p. 20. In 1988 the largest contested

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in the first 6 months of 1989, which was slightly less than the comparable period in the preceding year.⁷ The level indicated represents “friendly” as well as contested transactions. However, there is reason to believe that contested takeovers or the threat of contested takeovers has caused a significant part of the friendly merger and acquisition activity. A substantial number of leveraged buy-outs and management buy-outs⁸ are made as a response to a contested takeover attempt, which makes it likely that the level of merger and acquisition activity is to a very large extent influenced by contested takeovers.⁹ ¹⁰ The very latest trend in the United States seems to be a substantial decline in takeover activity, probably in part due to the collapse of the junk bond market in late 1989.¹¹

Since the early eighties, a majority of the Western European countries have experienced a substantial increase in the number of corporate mergers and acquisitions. In 1988, the merger and acquisition activity in Western Europe amounted to approximately 134.2 billion dollars.¹²

takeover in history took place when Kohlberg Kravis Roberts & Co. acquired RJR Nabisco, Inc. for 24.88 billion dollars. Two other very large acquisitions took place in 1988: Philip Morris acquired Kraft for 12.90 billion dollars and British Grand Metropolitan plc acquired American Pillsbury for 5.75 billion dollars.

⁷ See Wall Street Journal, at C 11, (July 25, 1989). The number of companies that were acquired dropped by 17 percent in the above 6 months’ period, compared to the first 6 months of 1988. Foreign acquisitions of US targets amounted to 21.9 billion dollars in the first 6 months of 1989 compared to 29.8 billion dollars in the corresponding period of 1988, see study by IDD Information Services, released July 24, 1989; BNA Corporate Counsel Weekly, August 2, 1989, p. 2.

⁸ Leveraged buy-outs and management buy-outs are discussed under XI.10. and 9., respectively.

⁹ See Louis Lowenstein, *What’s Wrong with Wall Street* p. 128.

¹⁰ The historical development of takeovers in the United States is described and discussed by John Brooks in *The Takeover Game* p. 1 ff. See also Devra L. Golbe & Lawrence J. White, *Mergers and Acquisitions in the U.S. Economy: An Aggregate and Historical Overview* in *Mergers and Acquisitions* (Alan J. Auerbach, ed.) p. 25 ff.

¹¹ See *Mergers & Acquisitions*, Vol. 25, No. 2, p. 91 (1990) where it is suggested that in particular the value of transactions has sunk.

¹² See Financial Times, January 11, 1989 p. 20. The amount indicated is based on transactions having a volume of more than 100 million dollars, publicized in 1988, and in connection with which at least one of the parties is located in Europe. Of the total amount indicated in the text, 59.6 billion dollars concern transactions with participation of parties from one and the same European country,

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This figure includes “friendly” as well as “contested” transactions. Contested transactions still only constitute a lesser part of the total number of transactions. In 1988, as per December 1, 63 contested takeover bids had been made, of which 40 had been made in Great Britain, whereas 23 had been made in Continental European countries, including 11 in France.¹³ The prime reason for this development may be the expectations with respect to increased competition and, as one of the consequences hereof, a demand for larger companies that is connected to the implementation of the EC “Internal Market” in 1992.¹⁴ It seems as if many European companies and their managements have realized that corporate acquisitions is a means by which larger and more competitive companies may be created.

This development in Europe has been accompanied by the use by European companies of legal and financial concepts and methods that have been developed in the United States. For example, as we shall see later, a number of the offensive and defensive techniques known from the United States have spread to Europe. Also, it seems as if banks and financial advisors as well as companies in some countries are in the process of revising their views on the use of financing through borrowed funds. Although nothing suggests that leveraged financing will gain the popularity seen in the United States, it is likely that debt-financing will increase and, to a certain extent, replace equity financing, at least in some European countries.¹⁵ This changed attitude to leveraged financing has led to an incipient

while transactions in which parties from more European countries were involved amount to 13.2 billion dollars. Transatlantic mergers and acquisitions, i.e. transactions involving parties from Europe as well as the United States, amount to 52.5 billion dollars, while transactions between companies in Europe and Asia amount to 8.8 billion dollars.

¹³ See Matthew Crabbe, *Fending Off Unwelcome Attention*, Euromoney, p. 83 ff. (February 1989). The increased level of contested takeover activity on the Continent is illustrated by the fact that only four contested takeovers were consummated in 1987, of which three were made in France and one in Holland.

¹⁴ See Eric G. Friberg, 1992: *Moves Europeans Are Making*, Harvard Business Review, p. 85 ff. (May-June 1989).

¹⁵ For a discussion of the changed views on leveraged financing, see *Mergers & Acquisitions*, Vol. 24, No. 5, p. 25-33 (1990). See also Richard Evans and Peter Lee, *Why Junk is About to Leverage Europe*, Euromoney, p. 52 ff. (December 1988). In this article the authors discuss, inter alia, Bank of England's apparently changed views with respect to debt-financing. In 1988, the British company Beazer acquired American Koppers for 1.8 billion dollars, of which approxi-

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market for junk bonds that has developed quite substantially lately but which continues to play a minor role only in connection with the financing of acquisitions in Europe. However, it is likely that the junk bond market in Europe will be affected by the decline of the United States' junk bond market and that the so-called "private placements", i.e. loans issued by banks or institutional investors, will remain the prime source of leverage financing, to the extent that such financing will be used in the future.¹⁶

Simultaneously with the spread of American acquisition techniques and defensive means to Europe, a number of American investment banks have established offices within Europe and have so far been very successful in assisting and advising European companies in connection with contested acquisitions.¹⁷

The one single contested takeover attempt that has probably drawn the most attention and triggered most discussion is the attempt mentioned earlier by Carlo de Benedetti to acquire control of Société Générale de Belgique, which by most Belgians is considered to be the "crown jewels" of Belgium.

While many Belgians seemed to acknowledge that Société Générale might benefit from Mr. de Benedetti's leadership, strong national interests were attached to keeping the company on Belgian hands.¹⁸

mately 1.7 billion dollars was financed through loans from banks. For a discussion of this and of the scepticism that has been expressed regarding increased leverage, see Corporate Finance, p. 35 ff., and, in particular, p. 42-43 (December 1988).

¹⁶ For a discussion of the use of junk bonds in Europe, see Alistair Macdonald, *Gearing*, Corporate Finance, p. 19 ff. (September 1988). See also by the same author, *Laws of Leverage*, Corporate Finance p. 26 ff. (October 1988) and Richard Evans and Peter Lee, *Why Junk is About to Leverage Europe*, Euromoney, p. 52 ff. (December 1988).

¹⁷ In the first six months of 1988, the American investment banks, Goldman Sachs and Shearson Lehman Hutton International were involved in five out of the ten largest takeovers of companies listed in Great Britain, cf. Claire Makin, *The Americanization of British M&A*, Institutional Investor, p. 41 ff. (October 1988).

¹⁸ The attempt by Mr. de Benedetti failed, at least so far, because Société Générale made an alliance with and issued shares to a "friendly" third party. The matter is an illustrative example of how a contested acquisition is not only a question of economic interests but also may carry with it a number of political issues, in this case the relationship between the Flemish-speaking and French-speaking peoples in Belgium. The Société Générale-matter is discussed by Valérie Hirsch, *Le Raid sur la Société Générale de Belgique: Une Leçon de Choses pour l'Europe*, Re-

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Other incidents have shown that national interests do play a significant role in the European debate. It has thus been criticized that, inter alia, Swiss and German companies appear on the European corporate arena as contested acquirors, while it is extremely difficult, if not impossible, to acquire Swiss or German companies by means of a contested takeover.¹⁹ This debate clearly shows that even though an increased number of mergers and acquisitions have been experienced in Europe in recent years, considerable differences exist as regards the legal and business “climate” for takeovers in the European countries.

Although it is only recently that the term “contested takeover” or “fjendtlig overtagelse” has been used as a label on certain corporate acquisitions in Denmark, the factors that constitute a contested takeover are not, as such, new in Denmark. There have been incidents several years ago where a shareholder attempted to acquire control of a company and where it has been a part of the acquiror’s plan to remove the incumbent management.

Examples include Arne Groes’ attempt to gain control of Sadolin & Holmblad in 1983 and KFK’s attempt to acquire Peder P. Hedegaard in 1987.

The development in the other European countries suggests that the number of corporate takeovers will increase in the years to come and that future takeovers will to a large extent be influenced by new ways of thinking in terms of financing of the transactions as well as with respect to the legal structuring of acquisitions. It has yet to be seen if Denmark will be among

vue du Marché Commun, No. 314, p. 61 ff. (February 1988), and by Simon Brady, *The Unguillotined Aristocrat*, Euromoney, p. 120 f. (February 1989).

- ¹⁹ See the discussion in the New York Times, August 26, 1988, p. D 3. The two Swiss companies, Nestlé and Jacob Suchard, in the spring of 1988, made competing “hostile” takeover bids in order to acquire control of British Rowntree plc. The outcome of the competition was that Nestlé acquired Rowntree. At the same time, many Swiss companies have denied registration of shares bought by foreign companies, thereby preventing such foreign shareholders from exercising their voting rights. See also Peter G. Rogge, *Foreign Takeovers of Swiss Companies*, p. 6 f., Swiss Bank Corporation/Prospects 5/1988, and Nedim Peter Vogt and Hanspeter Wüstiner, *Share Transfer Restrictions under Swiss Law and Hostile Takeovers of Swiss Companies*, International Business Lawyer, p. 355 ff. (September 1988). One of the most recent examples of German companies’ “hostile” takeover activity was Siemens’ attempt jointly with GEC to acquire British Plessey.

II. Historical background and structure of contested takeovers

the countries that adopt the American concepts used by now in many other European countries.

According to a report on merger and acquisition activity in Denmark in 1989 prepared by the Danish Competition Council ("Konkurrencerådet") and published in 1990, 391 companies were acquired in 1989. This figure comprises acquisitions irrespective of whether they are "friendly" or contested. Only very few of these acquisitions could be referred to as "contested", however. The companies acquired represent an aggregate turnover of approximately DKK 28 million and a total number of employees of some 29,000. Acquisitions by foreign acquirors account for 21 percent of the total number of acquisitions and 19 percent of the aggregate turnover of acquired companies. This group of acquisitions represents 21 percent of the total number of employees of acquired companies.

2. Structure of contested takeovers

So far, contested acquisitions or acquisition attempts have only been seen on few occasions in Denmark, and, consequently, no particular pattern reflecting methods and techniques has yet developed.

However, it is likely that in Denmark, as is the case in other countries, contested takeovers will be initiated by one or more single purchases in the stock market followed by a public offer to the shareholders of the target-company. It might be expected that the takeover will be effected by means of an acquisition vehicle, i.e. a company established and funded for the sole purpose of buying the shares of the target-company. After having gained control, the acquiror may sometimes want to cash out minority shareholders, perhaps in connection with a merger between the acquiror, or his acquisition vehicle, and the target-company.

By contrast, a substantial contested takeover activity has led to a number of models being developed in the United States. Since the American regulation of takeovers plays an important role in connection with our discussions later of the issues raised by contested takeovers, I will outline briefly the typical structure of a U.S. contested acquisition.

Ordinarily, a U.S. contested takeover is initiated by the acquiror making stock purchases in the market followed by a tender offer, i.e. a public offer addressed to the shareholders of the target-company, inviting such share-

II. Historical background and structure of contested takeovers

holders to tender their shares.²⁰ By far the majority of all tender offers are based on a 100 percent cash payment to the tendering shareholders.

However, there is nothing to prevent an acquiror from making a tender offer based on payment in kind, e.g. by the acquiror issuing stock or bonds to the shareholders of the target-company in exchange for target-shares.

As will be seen later, the price offered in a tender offer will always include a premium in excess of the market price to induce the target-shareholders to tender their shares.²¹

In a junk bond financed acquisition the acquiror will, after having acquired all the target-company's shares or, at least, a sufficient number of shares to gain control of the company, often use his influence to merge the target-company and the acquiror.²² Typically, the acquiror establishes a new company to be used as a vehicle for his acquisition of the target-company, and, if this is the case, a merger is effected between such new company and the target-company. Simultaneously with the merger, or shortly thereafter, a substantial part of the assets belonging to the target-company, or divisions of the company, will be sold. The proceeds from the sale will enable the surviving company to pay the extra costs, including interest, connected with the servicing of the junk bonds. The fact that the target-company's own assets create the basis for the financing of the takeover entails that junk bond financing is a means by which even very large companies can be taken over by considerably smaller acquirors.

At least until late 1989 or early 1990, the financial structure of a contested acquisition would ordinarily include approximately 10 percent equity capital; 40-50 percent of the financing would consist of ordinary,

²⁰ For a more precise definition of tender offers, see VII.2.3.1. Occasionally the tender offer is preceded by a letter to the target-company containing a proposal by an acquiror to acquire the shares of the target-company in a privately negotiated acquisition. This kind of approach, known as a "bear hug", was e.g. used by Ivanhoe Partners in connection with its attempt to take over Newmont Mining Corporation, see *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2 d 1334 (Del. 1987).

²¹ The reason why it makes sense for an acquiror from a business point of view to offer the selling shareholders a premium price is discussed under IV.3.2.

²² Several of the American state legislatures have enacted legislation which restricts an acquiror's ability to merge with a target-company, see VIII.3.4. for a more detailed discussion hereof.

II. Historical background and structure of contested takeovers

long-term debt, while the remaining 40-50 percent would be financed through the issuance and subsequent sale of junk bonds.²³

The use of junk bonds spread rapidly since 1984 and turned many companies with a conservative capital structure (i.e. with a considerable equity financing and a limited leverage) into highly leveraged companies.²⁴ Companies “pay” for junk bond financing not only by exposing themselves to a higher debt and, consequently, a risk of not being able to service the increased debt, but also by paying a higher interest rate on junk bonds than on other bonds of comparable maturity.

In recent years, the average default rate for junk bonds has been 1.6 percent, while the average default rate for corporate bonds as such is 0.08 percent, according to Altman & Nammacher, *The Default Rate Experience on High-Yield Corporate Debt* (study made for Morgan Stanley, March 1985). Typically, the interest payable on junk bonds is 3 to 5 percentage points higher than the yields on bonds of comparable maturity, issued by the Government of the United States, see Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in *Knights, Raiders, and Targets* p. 314 ff. at 337 ff.

Junk bond financing has been made possible because, inter alia, a large number of institutional investors for several years proved to be more than willing to buy junk bonds.²⁵ Apart from the institutional investors' creation of a market for junk bonds, two other factors should be noted when considering the reasons for the success of junk bond financing. First, the right for companies to deduct interest payments in connection with computation of their taxable income has, no doubt, been of tremendous im-

²³ As a part of the recapitalization following a takeover, the securities used include, in addition to common stock and bonds, preferred stock with only limited or contingent voting rights as well as various hybrids between equity and debt securities.

²⁴ See IV.3.2. A number of the most recent takeovers are discussed in *Institutional Investor*, p. 77 ff. (January 1989). See also *BusinessWeek*, p. 138 ff. (November 7, 1988). On November 30, 1988, RJR Nabisco, Inc. was acquired by Kohlberg Kravis Roberts & Co., for a price of 24.88 billion dollars of which 20 billion dollars is estimated to be debt-financed, see *The New York Times*, December 1, 1988, p. A 1 and D 8.

²⁵ Not only American but also European, Japanese, and Arabic investors have shown interest in investing in junk bonds. It is estimated that approximately 5 percent of the junk bonds issued by American companies are bought by non-American investors, see *Institutional Investor*, p. 43 ff. at 47 (January 1989).

II. Historical background and structure of contested takeovers

portance.²⁶ Second, the role of the American investment banks in the development of junk bond financing should not be understated.

Investment banks are firms that act as underwriters or agents in connection with issues of securities to the public. An underwriter assumes the risk of buying a new issue of securities from the issuing company and reselling the securities to the public. Such resale may take place directly or through dealers. The term “underwriting”, in its strict sense, is limited to transactions where the investment bank purchases the issue from the issuer on a firm commitment basis, i.e. with the bank carrying the entire risk connected to the resale of the issue. Such transactions are sometimes referred to as “bought deals”. The daily use of the term “underwriting” includes references to arrangements where the risk is shared between the investment bank and the issuer, such as “best effort” and “standby” commitments. In order to pool the risk and facilitate distribution of the securities, investment banks often form a group of underwriters which then appoints a managing underwriter. The underwriter’s profit lies in the difference between the price he pays to the issuer and the public offering price, known as the “underwriting spread”.²⁷

Investment banks often assume a major part of the risk connected to takeover transactions by accepting assignments as underwriters on a “bought deal”-basis. Also, the investment banks frequently facilitate junk bond financing by granting so-called “bridge loans” to the acquiror. A bridge loan is a temporary credit facility which enables the acquiror to make a cash tender offer without having to await the structuring of the permanent financing.²⁸ The bridge loan will only remain outstanding until the investment bank has succeeded in completing the public distribution of the junk bonds. Until that moment the investment bank is exposed to a considerable risk, for which reason bridge loans carry a high interest rate.²⁹ The bridge loan will be repaid through the proceeds from the distri-

²⁶ See the general provision on deductibility of interest payments in Section 163 (a) of the Internal Revenue Code.

²⁷ See Barron’s Dictionary of Finance and Investment Terms.

²⁸ Under American law, an acquiror is not obligated to ensure that he can obtain a satisfactory financing of the acquisition prior to making a tender offer, see the discussion about possible conditions for tender offers under VII.2.3.3.

²⁹ Typically it is agreed that the investment bank refinances the acquisition made by funds provided through a bridge loan right after the acquisition. If the bridge loan remains outstanding for a longer period, e.g. 90 days, the rate of interest will normally be further increased.

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bution of junk bonds and, frequently, from the sale of assets belonging to the target-company.

III The public interest in an organized stock market and its regulation

The organized stock market is public in the sense that it is open to anybody who wishes to participate by investing and trading. Moreover, any company that meets the listing requirements can have its shares offered at the stock market.

The stock market is also public in another sense, namely that its performance has an impact on the economy of society.

The two aspects of the stock market are, although conceptually different, interrelated.

From the viewpoint of investors, the goal of a stock market should be to provide a system whereby shares could be purchased and sold in the smoothest possible fashion and at the lowest possible cost. A stock market with many listed shares and large trading volumes would give investors a variety of investment alternatives and opportunities as well as a place where the shares could be resold easily. Moreover, investors would put an emphasis on having a market that gives them a certain protection against abusive acts (such as fraudulent transactions). Protection should be provided by a clear and, if possible, simple regulatory framework that ensures a high degree of predictability in terms of what treatment the investor can expect when operating in the market while still allowing the market to operate efficiently. In other words, investors would put an emphasis on having an efficient market as well as a "level playing field".

When referring to the interests of "investors", it is attempted to describe what interests this group of persons should be expected to have. It is not suggested that any investor would support the idea of having a level playing field. Some investors may prefer to have a maximum degree of freedom when operating in the market, thereby being able to reap quick benefits at the expense of others. However, it is likely that investors, seen as a group, would have an interest in both efficiency and a degree of protection.

From the viewpoint of companies the prime objective of having a public offering of shares at a stock exchange (sometimes referred to in this context as the "primary market" for the shares) is to obtain sufficient capital at the lowest possible price. Once the shares have been listed it is typically in the interest of the company that trading of its shares in the ("secondary") market take place at reasonably high prices so that future, additional offer-

III. The public interest in an organized stock market and its regulation

ings can be effected at a high market price and thus at a low cost of financing.

Since the cost of a company's financing via the stock exchange is dependent on investor interest – the greater the interest, the lower the cost – companies would prefer a stock market that can attract investors. This, in effect, means that companies and investors have common interests as to the functioning of the stock market, cf. above.

The public interest in the stock market, understood as society's interest, is closely tied to the economic impact of the market.

A well-functioning stock market will create a system whereby buyers and sellers of shares, and thereby buyers and sellers of companies, can freely trade their interests. This creates the possibility for having resources allocated to those uses where the value is maximized, see I, 2.2. Both original issues of stock and subsequent disposals of shares are obviously facilitated by the existence of an active market where such securities can be traded easily.

If the stock market is capable of attracting capital in large amounts, a basis is created for economic growth of companies as well as increased competitiveness of business undertakings that have the stock market as a source of finance. The more attractive investors consider the stock market, the more money will flow into the market, and the more inexpensive will financing become for the listed companies.

Society has an interest in companies growing and being competitive. This is a prerequisite for the companies' ability to survive and prosper and thereby to remain or bring themselves in a position where they can contribute to society by means of creating and maintaining jobs and by paying taxes and duties to state and local authorities. Also, competitiveness is a prerequisite for companies being able to provide products or services at reasonable prices to consumers in Denmark and export such products or services for the benefit of the country's trade balance.

In addition to facilitating the trading of shares among investors in the market, society has an interest in preventing manipulations in the market causing unreasonable fluctuations of stock prices and losses incurred by some investors due to excessive speculation or abuses by others.

There are various reasons why society should want to avoid such implications. First, excessive speculation or abuse may simply cause so much harm that it affects substantial parts of the business community and thereby also indirectly causes losses to the general economy of society. Second, a substantial risk of being exposed to manipulations or abuses may deter investors from entering into the stock market and thereby affect

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the price of capital in the market. Third, there are ethical reasons why society is concerned with investor behavior. If no protection exists, the economically strongest and most sophisticated players in the market are likely to gain undue advantages at the expense of weaker players. Politically, such a state of affairs would hardly be accepted in a country like Denmark.

After having considered the various public interests in the stock market it seems reasonable to conclude that society should pursue a regulation which strikes a balance between creating a framework that ensures that activities in the stock market can take place smoothly and at low costs, on the one hand, and provide a satisfactory level of protection of investors, on the other.

It is not an easy task to determine what this conclusion means in terms of regulation of contested takeover activity. But one thing is certain: we need to know more about the economic impact of such activity. Without further knowledge we do not even know whether contested takeovers should be outlawed as being an evil per se or if the focus ought to be on regulating them.

The various public aspects of stock markets are discussed in R.W. Jennings & H. Marsh, Jr., *Securities Regulation, Cases and Materials* p. 1 ff. where, among other things, excerpts are included from a very illustrative report from the American SEC (Report of Special Study of Securities Markets, Pt. 1, p. 9-19 (1963)).

IV Economic impact of contested takeovers

1. Introduction

When approaching a concept of transfer of corporate control, in casu contested acquisitions, the question comes to mind why these kinds of transactions occur at all and what impact they have on the companies and shareholders involved as well as on society at large. Who benefits from such activity? Does it create values for society or is it simply a means by which to redistribute wealth from one group of shareholders to another?

Since no empirical evidence exists regarding contested takeovers in Denmark, and because there has been little debate about these issues in Denmark it may be helpful to examine the experience and discussions that have been recorded in the United States.

The experience and debate known from the United States has also played a key role in other European countries where discussions of the impact and desirability of contested takeovers have been initiated. See, for example, the discussion among German scholars, illustrated by the following articles from the German company law review, *Die Aktiengesellschaft*: Friederich Trockels, “*Business Judgement Rule*” und “*Corporate Takeovers*”, 4/1990, p. 139 ff., Michael Adams, *Was spricht gegen eine unbehinderte Übertragbarkeit der in Unternehmen gebundenen Ressourcen durch ihre Eigentümer?*, 6/1990, p. 243 ff., and Hans-Joachim Mertens, *Förderung von, Schutz vor, Zwang zu Übernahmeangeboten?*, 6/1990, p. 252 ff. For an example from the Dutch debate, see G. Rietkerk, *Bestuursonvriendelijke Overneming: Countervailing power, de naamloze vennootschap* 66/2, March/April 1988, p. 45 ff. As regards the discussion in Switzerland, see e.g. Julian I. Mahari, *Rückkehr zur Aktionärherrschaft als unternehmerische Chance und rechtspolitischer Impuls: Vorstösse zur Beendigung der Machtdelegation an das Management anhand der Entwicklung der Takeovers in den USA*, *La Société Anonyme Suisse* No. 60/1988, p. 14 ff.

2. Empirical evidence from contested takeovers in the United States

2.1. Introduction. Over the past twenty years there has been extensive research into the economic impact of corporate acquisitions, including contested takeovers. While the amount of research is impressive and establishes a useful basis for discussion within some areas, other aspects of

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takeovers have given rise to more controversy and are, therefore, more difficult to tackle.

In the following we will focus on the various aspects of contested takeovers, looking at the effects that takeovers have on the different entities or groups of persons.

2.2. The impact on target-shareholders. The empirical studies regarding the effect on the value of the shares of the target-company upon the occurrence of a takeover attempt create a consistent picture. Almost all studies show that the response to the announcement of a takeover attempt is a substantial increase in the price of the target-shares. This is most likely connected to the fact that acquirors virtually always offer large premiums over the pre-announcement market price.

In a study of 56 “hostile” tender offers in the years 1975-83, Edward S. Herman and Louis Lowenstein have found that winning bidders paid an average premium over the pre-announcement market price of about 80 percent.¹

In a study of 33 companies that faced “hostile” takeover threats in the period 1969-1983 Larry Dann and Harry DeAngelo found that the “hostile” bidder’s initial bid entailed a cash premium of 56.51 percent above the market price which prevailed 41 days before the takeover attempt was initiated.²

Michael Bradley has found that, in a sample of 161 tender offers over the period 1962-1978, the premiums averaged 47 percent above the market price at the time of the announcements of the offer.³

Richard Roll has compiled a number of studies that show the impact of a takeover bid on target-shares.⁴ Roll, inter alia, refers to a study by Michael Jensen and Richard Ruback where the results of about 20 papers

¹ See Herman & Lowenstein, *The Efficiency Effects of Hostile Takeovers*, in *Knights, Raiders, and Targets* p. 211 ff. at 218 ff.

² See Larry Y. Dann & Harry DeAngelo, *Corporate Financial Policy and Corporate Control, A Study of Defensive Adjustments in Asset and Ownership Structure*, 20 *Journal of Financial Economics* 87 (1988).

³ See Michael Bradley, *The Economic Consequences of Mergers and Tender Offers*, in *The Revolution of Finance* (Joel M. Stern & Donald H. Chew, Jr., ed.) p. 368 ff. at 373.

⁴ See Richard Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth*, in *Knights, Raiders, and Targets* p. 241 ff.

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were examined and it was shown that the price of target-shares increased by 30 percent in average in the period around the takeover event.⁵

In another paper by Dennis and McConnell, referred to by Roll, it was found that the average target-company's shares increased by 8.7 percent on the day a bid was announced and the previous trading day.⁶

There is, in other words, basis for concluding that empirical evidence shows that shareholders of acquired companies enjoy significant economic benefits when they tender their shares and that the stock market generally responds positively when receiving information about the occurrence of a takeover bid.⁷

The conclusion that takeover bids provide wealth gains for target-shareholders is further underscored by the study by Dann and DeAngelo referred to above. The data of their study show that if we compare the value of target-shares at a point in time 40 days before initiation of the takeover attempt with the value at the outcome, we will see an average increase in value of 42.97 percent in events where the acquiror prevailed. In events where the first (potential) acquiror pulled out in favor of an offer by a third party, the Dann-DeAngelo study shows an average wealth gain for target-shareholders of 57.58 percent. In other words, the study suggests that not only successful takeover attempts, but also attempts which turn out not to succeed but which motivate others to make bids, benefit target-shareholders.

Since target-shareholders thus enjoy benefits from takeover-activity, it is natural to look at the economic effects of a defeat of a contested takeover attempt.

Three studies, by Asquith, by Bradley, Desai & Kim, and by Jarrell, have focused on the price of the target-shares in the event where a tender offer is defeated.⁸ These studies show, consistent with what we saw above,

⁵ See Michael Jensen & Richard Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 *Journal of Financial Economics* 5 (1983).

⁶ See Debra K. Dennis & John J. McConnell, *Corporate Mergers and Security Returns*, 16 *Journal of Financial Economics* 143 (1986).

⁷ See also Ellen B. Magenheimer & Dennis C. Mueller, *Are Acquiring-Firm Shareholders Better Off after an Acquisition?*, in *Knights, Raiders, and Targets* p. 171 ff.

⁸ See Paul Asquith, *Merger Bids, Uncertainty, and Stockholder Returns*, 11 *Journal of Financial Economics* 51 (1983), Michael Bradley, Anand Desai, & E. Han Kim, *The Rationale Behind Interfirm Tender Offers: Information or Synergy?* 11 *Journal of Financial Economics* 183 (1983), and Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?* (Study referred to in an

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that the price of a target-company's stock rises significantly (approximately 15 percent, 35.5 percent, and 30 percent, respectively) compared to the rest of the market once a bid is announced. If a bid is defeated and no competing bids are made, almost the entire gain for the target-shareholders is lost.

According to the three studies, defeat of a bid almost led the price of target-shares to drop back to the pre-bid level. However, even in these events a small appreciation of the value of target-shares relative to pre-bid value could be found (Asquith: 1 percent (computed 60 trading days after the initial bid), Bradley et. al.: 3.43 percent (one year after initial bid), and Jarrell: 9 percent (100 trading days after initial bid)).

All three studies clearly suggest that shareholders lose money when a bid is defeated.⁹

Related to the issues dealt with here is the question of the economic impact of takeover defenses. Takeover defenses provide a varied picture and can hardly be treated as a whole. We will, therefore, discuss the economic aspects of takeover defenses in chapter XI. where the various responses to takeovers are discussed in detail.

2.3. The impact on the acquiror and its shareholders. When reviewing the empirical studies regarding the impact of contested takeovers on the acquiror and its shareholders, one gets a somewhat kaleidoscopic impression.

Some studies, for example a study by Bradley¹⁰, a study by Asquith¹¹, and a study by Dennis & McConnell¹² indicate that the value of shares of companies that make bids for the shares of other companies tends to increase, although frequently not very much.

article by Frank H. Easterbrook & Gregg A. Jarrell, *Do Targets Gain from Defeating Tender Offers?*, 59 New York University Law Review 277 at 283 (1984).

⁹ The three studies are examined by Frank H. Easterbrook and Gregg A. Jarrell, see Easterbrook & Jarrell, *Do Targets Gain from Defeating Tender Offers?*, 59 New York University Law Review 277 at 283 ff. (1984).

¹⁰ See Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 Journal of Business 345 (1980).

¹¹ See P. Asquith, *Merger Bids, Uncertainty, and Stockholder Returns*, 11 Journal of Financial Economics 51 (1983).

¹² See Dennis & McConnell, *Corporate Mergers and Security Returns*, 16 Journal of Financial Economics 143 (1986).

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Other studies, for example a study by Dodd¹³, a study by Firth¹⁴, and a study by Eger¹⁵, suggest that acquiror-shares tend to experience a decline in their value.

The above studies, which only represent some of the many studies that have been made in this area, do not give us any conclusive answer to our query. One of the main problems is that different methodologies have been used for the studies.

In some studies (for example the Asquith-study mentioned above), the performance of the acquiror-shares before and after the acquisition is measured against the performance of shares of companies with similar betas.¹⁶ Other studies (for example, the Firth-study mentioned above) measure pre- and post-performance of the acquiror against the market portfolio in 48 preceding months. Many variations have occurred. Some studies thus compare the acquiror's performance to the performance of its relative industry rather than the market portfolio. Likewise, the timeframe within which performance is measured varies among the studies. The problems discussed here and the results of a number of other studies are discussed by Ellen B. Magenheimer & Dennis C. Mueller, *Are Acquiring-Firm Shareholders Better Off after an Acquisition?* in *Knights, Raiders, and Targets* p. 171 ff. See also Richard Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth*, in *Knights, Raiders, and Targets* p. 241 ff., who points out (p. 242) that irrespective of whether the effects on acquirors are positive or negative on an average, they are generally small in percentage terms and are less statistically significant.

A study by Herman and Lowenstein¹⁷ includes an examination of the earnings on the total capital of acquirors who made tender offers in the years 1975-83. Interestingly, this study suggests that bidders that were involved in acquisitions in the period 1975-1978 were, generally, performing better after an acquisition than bidders that made acquisitions or bids during the early 1980'es. Bidders in 1975-1978 earned a weighted average

¹³ See Peter Dodd, *Merger Proposals, Management Discretion and Stockholder Wealth*, 8 *Journal of Financial Economics* 105 (1980).

¹⁴ See Michael Firth, *Takeovers, Shareholder Returns and the Theory of the Firm*, 94 *Quarterly Journal of Economics* 235 (1980). Firth's study is based on empirical evidence from Great Britain.

¹⁵ See C.E. Eger, *An Empirical Test of the Redistribution Effect in Pure Exchange Mergers*, 18 *Journal of Financial and Quantitative Analysis* 547 (1983).

¹⁶ Betas reflect the relative volatility of a stock. It is a covariance of a stock in relation to the rest of the stock market, see Barron's *Dictionary of Finance and Investment Terms*.

¹⁷ See Herman & Lowenstein, *The Efficiency Effects of Hostile Takeovers*, in *Knights, Raiders, and Targets* p. 211 ff.

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of 14.7 percent on their total capital (ROC) in the 5 years prior to the tender offer and 19.6 percent in the 5 years after the consummation of an acquisition. Prebid ROC for acquirors making bids in the period 1981-83 was approximately 20.7 and postbid was approximately 17.7.¹⁸ As pointed out by the authors, this perhaps suggests that the early bids were less speculative than what is the case for more recent developments.

Even though several studies suggest that acquirors benefit from contested acquisitions, other studies point in the opposite direction. The conclusion that should be made at this point is that we simply do not have sufficient evidence to evaluate, on an empirical basis, the impact on the acquiror and the shareholders of the acquiror.

2.4. Target performance after transfer of control. Above, we focused on the economic benefits that the tendering shareholders of the target-company may receive in connection with a contested takeover. Also, we had a look at the value of the acquiror after the acquisition compared to prior to the acquisition.

A third aspect, however, is the performance of the target-company after the consummation of a change of control.

Lichtenberg and Siegel have examined approximately 20,500 plants, owned by approximately 5,700 companies.¹⁹ Approximately one-fifth of the total number of plants changed owners at least once in the period 1972-1981. This enabled Lichtenberg and Siegel to compare the productivity of those companies that changed owners with those companies that remained in the same hands. The study focuses on the development as to productivity in a period beginning 7 years prior to and ending 7 years after the change of ownership. The trend, according to this study, is that productivity decreases in the years prior to the change of ownership and in a period of approximately 12 months after the change of ownership, but then increases substantially and reaches a level equivalent to the level that exists for companies that did not change hands. This suggests that companies that are acquired, generally, are not performing as well as other companies. Moreover, it seems as if the change of ownership has a beneficial effect on productivity.

¹⁸ The study only includes ROC data up to and including 1985.

¹⁹ See Frank R. Lichtenberg & Donald Siegel, *Productivity and Changes in Ownership of Manufacturing Plants*, Brookings Papers on Economic Activity No. 3/1987, p. 643 ff.

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The study by Lichtenberg and Siegel is extensive and the results it indicates persuasive.

Nevertheless, other studies have reached different conclusions. Ravenscraft and Scherer have thus made a study, based on a more limited number of samples, which suggests that acquisitions have an adverse impact on productivity, see David J. Ravenscraft & F.M. Scherer, *Mergers, Sell-offs, & Economic Efficiency* p. 75 ff.

3. The debate on the economic impact of contested takeovers in the United States

3.1. Introduction – two ways of looking at the stock market. Before we examine the various thoughts and ideas that have been expressed in favor of or against contested acquisitions, it is useful to be acquainted with two economic approaches to predicting stock prices that have had tremendous importance as bases for the theories that have developed in connection with contested takeovers.

One of the most influential schools of thought in modern finance theory is the so-called “neo-classical school”, sometimes also referred to as the “Chicago” school of economists. On the assumption that history tends to repeat itself and that past patterns of stock price development will recur in the future, a means by which to predict stock prices is to examine the history of stock prices for the purpose of evaluating which development is likely to come. By looking back one may be able to recognize situations where the price of a share behaved in a particular manner and, if a similar situation exists now, there is a likelihood that the price will develop in a somewhat similar fashion.

Neo-classical economists have developed the notion of “the efficient market hypothesis”, which presupposes that the stock market, when determining the value of a company’s shares, takes into consideration all existing, available information about the company. Any time a new piece of information about a company becomes known to the public, the investors will, according to this theory, take that new piece of information into consideration when valuing the shares. Accordingly, the stock price at any given time reflects all relevant, available data about the company.

Three variations have been developed of the efficient market hypothesis, the so-called “weak” version, the “semi-strong” version, and the “strong” version, respectively, see Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 *Journal of Finance* 383 (1970), and Graham & Dodd, *Se-*

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curity Analysis p. 23 ff. The version dealt with in the text is the semi-strong version.

Eugene Fama²⁰ has characterized an efficient market as a market where there are “large numbers of rational profit maximizers competing, with each trying to predict future market values of individual securities and where important current information is almost freely available to all participants”.

The efficient market hypothesis presupposes that the market cannot “be wrong”.

If the price of a company’s stock is extraordinarily low compared to, for instance, the company’s intrinsic value, this is not caused by a “mistake” by the market. Rather, a low stock price reflects the degree of efficiency in which a company’s assets are utilized, which, in turn, is ultimately a question of the management of the company. According to this theory, the reason for a company’s stock price to be low compared to the intrinsic value of the company is often to be found in inefficient use of the company’s assets. Such inefficiency could be caused by management not being fully qualified or motivated or by lack of implementation of changes in the company’s business necessitated by new technology or a change in the market structure. The stock market values a company’s shares on the basis of the existing information about the company, including statements from management about planned projects, new investments, etc. The moment plans leading to a more efficient use of a company’s assets are publicly known, the market will appreciate such information by increasing the price of the company’s stock.

For a further explanation of the efficient market hypothesis, see Bob L. Boldt & Hal L. Arbit, *Efficient Markets and the Professional Investor*, Financial Analysts Journal, Vol. 40, No. 4, p. 22-34 (1984) and Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Virginia Law Review 549 (1984). See also Eugene Fama, *Random Walks in Stock Market Prices*, Financial Analysts Journal, Vol. 21, No. 5, p. 55-59 (1965).

The other well-known approach to the pricing of stock is the theory of fundamental or intrinsic value analysis. According to this theory, which has been promoted by, among others, Benjamin Graham and David Dodd as well as John Keynes, investors ought to value the shares of a company on the basis of the company’s intrinsic value, expected returns, earnings power or other standard relating to the fundamentals of that particular

²⁰ See Eugene Fama, *Random Walks in Stock Market Prices*, Financial Analysts Journal, Vol. 21, No. 5, p. 55-59 (1965).

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company. The fundamentalist approach argues that investors should not, as is frequently seen, focus on comparing the shares of a company to other shares in the market.²¹

Keynes has compared the modern stock market with a newspaper beauty-contest where the winners are those whose choice “most nearly corresponds to the average preferences of the competitors as a whole; so that each competitor has to pick, not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view”.²²

Proponents of the fundamentalist approach challenge the assumption of the neo-classical school of thought that the stock market is “efficient”, claiming that it sometimes reacts irrationally and, for example, often fails to appreciate research and development, which may not have beneficial effects for the company in the short term, but will benefit the company and its shareholders in the long run. A low valuation by the stock market of a company’s shares, according to the fundamentalist approach, does not necessarily mean that the company is badly managed or that the assets of the company are insufficiently utilized. It may very well be caused by the stock market’s lack of efficiency, understood as failure to appraise the true value of certain projects and assets of companies.²³

3.2. Views in favor of contested takeovers. Proponents of contested takeovers argue that this takeover technique leads to an improved utilization of the capital invested in the stock market. Many of them assume that shares of target-companies are generally undervalued compared to the shares of other companies with similar asset-characteristics. In other words, “victims” of contested takeovers are often “limping dogs”, i.e. underperforming companies. Typically, they have stagnated and are characterized by relatively large cash-flows and large amounts of funds invested in activities or projects which do not give the shareholders as high a return on their investment as should be expected, considering the degree of risk that the shareholders are exposed to. The reason for target-companies in

²¹ See Graham & Dodd, *Security Analysis* p. 140. The views by Graham and Dodd are shared by John Keynes, see Keynes, *The General Theory of Employment, Interest, and Money* p. 147 ff.

²² See Keynes, *The General Theory of Employment, Interest, and Money* p. 156.

²³ See F.M. Scherer, *Testimony for the Sub-Committee on Telecommunication, Consumer Protection, and Finance*, House Committee on Energy and Commerce, March 12, 1985.

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general performing below average is often to be found in management lacking the necessary skills or motivation. Inefficient management leads to inefficient use of a company's assets.

The business rationale for an acquiror to make a contested takeover is that he expects the return on his investment in the target-company to exceed the price, including the premium, he has to pay for its shares. Since acquirors will always have to pay a premium price in order to induce the target-company's shareholders to sell their shares, contested takeovers only make sense from a business point of view if the acquiror is able to improve the performance of the target-company. In order to increase the value of the stock of this company, a more efficient use of the capital invested is required. This often leads to replacement of the board of directors as well as executive officers.²⁴

In addition to increasing profitability, contested acquisitions may also lead to advantages connected to economies of scale, including an improved basis for developing and using advanced technology.²⁵

Others have emphasized, in support of contested takeovers, that the threat of a takeover has a disciplining effect on corporate managements. Management knows that the risk that the company will be taken over increases, the lower the market price of the company's shares. Management also knows that an improved stock price presupposes a more efficient use of the company's assets, which means that management is motivated to perform at its best.

An empirical study by Mark L. Mitchell and Kenneth Lehn supports this argument, see Mitchell & Lehn, *Do Bad Bidders become Good Targets?* in 98 Journal of Political Economy 372 (1990).

Moreover, management is motivated by the forces of the "market for corporate control".²⁶ Management competes with other management teams for the right to manage corporations. The market, i.e. the potential future employers, evaluate the performance by management and this evaluation

²⁴ See Thomas J. McCord, *Limiting Defensive Tactics in Tender Offers: A Model for the Protection of Shareholder Decision Making*, 21 Harvard Journal on Legislation 489 at 493 ff. (1984) and Easterbrook & Fischel, *The Proper Role of Target's Management in Responding to a Tender Offer*, 94 Harvard Law Review 1161 at 1168 ff. (1981).

²⁵ See *Economic Report of the President* p. 198-199 (February 1985).

²⁶ This theory was introduced into the literature by Henry G. Manne in the article *Mergers and the Market for Corporate Control*, 73 Journal of Political Economy 110 (1965).

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is crucial for the career prospects of management, thereby having a disciplinary influence on its performance.²⁷

The consummation of a contested takeover (the way it was done until recently) as well as a defensive management buy-out or leveraged buy-out²⁸ lead to an increased debt and a reduced equity element in the capital structure of the target-company. For many years debt increasingly replaced equity financing. In 1987, debt amounted to approximately 85 percent of the capital structure of American companies while the figure for 1975 as well as 1980 was approximately 60 percent.²⁹ In 1988, interest payments on debt were estimated to amount to an average of 24 percent of companies' cash flow. However, if the debt is compared to the market value of the shares, the debt reached a peak in 1974 with 106 percent and is estimated to amount to 75 percent in 1988.³⁰

A somewhat different picture is drawn in a study, published in a quarterly report by the Danish Central Bank ("Danmarks Nationalbank, Kvartalsoversigt"), February 1990, p. 8 ff., in an article by Tonny Lybek and Erik Haller Pedersen. Here a survey is made of the ratio of debt to aggregate book value of assets of non-financial companies. The survey indicates that as to American companies debt amounted to 51 percent in 1987, 44 percent in 1980, and 45 in 1975. The corresponding figures for Danish companies are 58 percent, 63 percent and 63 percent, respectively.

Some commentators have argued that increased debt-financing, within certain limits, benefit companies not only because debt-financing is often an inexpensive way of obtaining the necessary financing due to the right to deduct interest for tax purposes, but also because a relatively high level of

²⁷ See Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in Knights, Raiders, and Targets p. 314 ff. and Ronald J. Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers*, 33 Stanford Law Review 819 at 841 ff. (1981).

²⁸ See XI.9. and 10. for a discussion of these concepts.

²⁹ BusinessWeek November 7, 1988, p. 140.

³⁰ See BusinessWeek November 7, 1988, p. 139. See also Louis Lowenstein, *What's Wrong with Wall Street* p. 148 ff. The impact of increased debt-financing for the research and development of a company is reflected in *Survey of Industrial Research and Development*, published on February 2, 1989, by the National Science Foundation. The study, which is based on limited empirical evidence relating to the years 1986 and 1987, suggests that companies, which have been subject to a leveraged buy-out have reduced their expenses for research and development, while other companies have increased their research and development expenses in 1986 and 1987.

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debt compels management to manage the company in a rational way. The theory presupposes that management tends to aim at a growth of the company beyond the point where such growth is in the interest of the shareholders. In management's pursuit of maximum growth rather than a maximization of the value of the shareholders investment, the funds invested in the company will not be utilized in an optimal way. If a company has a substantial debt, the cash-flow is reduced whereby management will have fewer funds available for use at its discretion.³¹ By the same token, the increased risk of bankruptcy in case the company fails to service its debt will lead to increased alertness and higher performance on the part of management.³² Subscribers to this theory state that these conclusions are supported by empirical evidence showing that shareholders of companies which incur additional debt in connection with a "friendly" or contested acquisition or restructuring receive a higher return on their investment.³³

Subscribers to the view that contested takeovers are beneficial for shareholders and for society do not claim that any contested acquisition is beneficial. As in other kinds of corporate acquisitions (including "friendly" acquisitions) and investments, mistakes appear. Also, there may be takeovers which lack rationality or which are abusive. However, this is not an inherent feature of contested takeovers.³⁴ According to the theory, these few incidents do not change the general picture of contested acquisitions. In this connection it is emphasized that e.g. liquidation of a target-company and sale of its assets are not necessarily an evil, seen from society's point of view. In such a situation the target-company's assets will be transferred to competitors or new companies in the market which will be able to use the assets in a more rational fashion, which is in the interest of society and, in addition, such a change will frequently lead to the creation of new jobs instead of those that were lost when the target-company was liquidated.

³¹ See e.g. the statements made by Vice Chairman of the Board of Governors of the Federal Reserve System, Manuel H. Johnson, quoted in *Federal Banking Law Reports*, No. 1291, p. 4 (1989).

³² For these motivating aspects of debt, see Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence* in *Knights, Raiders, and Targets* p. 314 ff. at 322 ff.

³³ See the studies referred to by Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 *Virginia Law Review* 807 at 815 ff. (1987).

³⁴ See *Economic Report of The President* p. 191 (February 1985).

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In sum, according to this theory, contested takeovers will ensure that the capital invested in the stock market is allocated to the businesses where it is used most efficiently.³⁵

3.3. Views that disfavor contested takeovers. Opponents of contested takeover activity have argued that target-companies are not always under-valued or underperforming.³⁶ Some have argued that the price of a company's shares following a successful defense against a contested takeover is often higher than the price which was offered by the contested bidder and that target-shareholders thus gain when takeover bids are defeated.³⁷ However, this argument has been challenged by many.³⁸

Critics of contested takeovers also claim that such takeovers do not necessarily lead to increased efficiency. The desire on the part of many managements to "build empires", i.e. create large but not always rational conglomerates, sometimes leads to small or medium-sized rationally operated companies being taken over by less rationally managed acquirors.

Also, critics emphasize that liquidation of target-companies following a contested acquisition lead to economic losses for society, including losses as a consequence of employees being laid off, as well as costs in connection with transfer of assets from one business to another.³⁹ Aspects of contested takeovers which are being emphasized by proponents as advan-

³⁵ For a further discussion of these aspects of contested takeovers, see Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in *Knights, Raiders, and Targets* p. 314 ff.

³⁶ For a discussion of this view, see Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 *Columbia Law Review* 249 at 289 ff. (1983) and Edward S. Herman & Louis Lowenstein, *The Efficiency Effects of Hostile Takeovers*, in *Knights, Raiders, and Targets* p. 211 ff.

³⁷ See Martin Lipton, *Takeover Bids in the Target's Boardroom: An Update after One Year*, 36 *Business Lawyer* 1017 at 1025-26 (1981) and the same author in *Takeover Bids in the Target's Boardroom*, 35 *Business Lawyer* 101 at 106-09 (1979).

³⁸ See the criticism by Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 *Business Lawyer* 1733 at 1741-43 (1981). Thomas J. McCord reviews the various viewpoints in his article *Limiting Defensive Tactics in Tender Offers: A Model Act for the Protection of Shareholder Decision Making*, 21 *Harvard Journal on Legislation* 489 at 493-496 (1984).

³⁹ For a discussion of some of these negative aspects of contested takeovers, see Harold M. Williams, *Tender Offers and the Corporate Directors* (1979-80 Transfer Binder) *Federal Securities Law Reporter* (CCH) 82,445 (speech given in San Diego, January 17, 1980).

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tages connected with economies of scale are by critics considered to be steps towards a monopolization of businesses.

Moreover, critics emphasize, the profits gained in connection with contested takeover activity does not benefit long-term investors or society but rather the arbitrageurs in the market place.⁴⁰

The business of trading on the prospect of takeovers, mergers and reorganizations that have not materialized in order to obtain a profit is known as "risk arbitrage". As opposed to "classic arbitrage" where one buys in one market and sells in another, the risk arbitrageurs stay in the same market and hope to benefit from the premium prices offered by acquirors, see John Brooks, *The Takeover Game* p. 141.

Not all commentators agree to the notion that the motivating effect of contested takeovers on management is always beneficial to the company and its shareholders. Rather than motivating management to perform well, a constant takeover threat may lead to management spending much of its time planning defensive strategies and using the corporate funds to prevent the company being taken over and management being removed. Critics of contested takeovers contend that a high level of takeover activity motivates target-management to pursue short-term results in their attempt to increase the price of the company's shares. Management will feel tempted, in order to boost the share price, to increase and accelerate the dividend payments, thereby leaving fewer resources with the company for, for example, research and development, which benefits the company in the long run.⁴¹

Critics of contested takeovers have underscored the risk that the massive use of debt-financing exposes many American companies to a substantial risk of bankruptcy if or when a new economic recession occurs. Companies which are highly leveraged, frequently by means of short-term loans, lack the necessary flexibility in case a recession comes.⁴² In this connection the significant growth of the junk bond market has been emphasized. While the aggregate issue of junk bonds amounted to 2 billion dollars in

⁴⁰ See Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 Business Lawyer 101 at 104 (1979).

⁴¹ See Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 University of Pennsylvania Law Review 1 at 23-25 (1987).

⁴² See the discussion in The New York Times, October 30, 1988, Section 3, p. 1 and Louis Lowenstein, *What's Wrong with Wall Street* p. 144 ff. For a discussion of the use of junk bonds, see Lowenstein, *Three New Reasons to Fear Junk Bonds*, The New York Times, August 24, 1986, p. D2.

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1978, the figure for 1987 was 31 billion dollars. The total amount outstanding of junk bonds was 9 billion dollars by mid-1977 and approximately 180 billion dollars by the end of 1988.⁴³ Critics of this development argue that it has led to investors losing confidence in the stock market with the consequence that future investments in the market will be reduced.⁴⁴

For a long time nothing suggested that the investors had lost interest in investing in the stock market, or in junk bonds for that matter. Not even the dramatic decline in stock prices in October 1987 seemed to have discouraged the investors.⁴⁵ As regards junk bonds, it is notable that the largest debt-financed acquisitions have taken place after October 1987. However, a new market decline occurred on October 13, 1989, and was followed by a reaction by the market against the use of junk bond financing.

In late 1989 a proposed acquisition of United Airlines (through acquisition of its holding company) failed due to the banks pulling back from financing the transaction, see II.1. This event and events that followed signal that financiers are getting increasingly worried about the risks involved in leveraged acquisitions.

Another aspect of debt-financing, which has been emphasized by some commentators, is the impact which a company's junk bond issue may have on existing, outstanding debt securities.⁴⁶ If the debt securities issued by a company do not contain covenants that protect the security holders against an increase of the company's leverage, the value of the debt securities may drop significantly upon the completion of a leveraged buy-out.

In practice, most bonds contain covenants that limit the debtor company's right to issue additional debt *pari passu* with or senior to the existing bonds. However, such covenants often do not prevent or inhibit the issue of debt securities junior

⁴³ See the information provided by Assistant Comptroller General, General Accounting Office, Richard Vogel, referred to in BNA's banking report, March 6, 1989, p. 575.

⁴⁴ See Sterngold, *Deep-Pocketed Dealmakers*, The New York Times, April 14, 1987, p. D1 and Rohatyn, *Junk Bonds and Other Securities Swill*, Wall Street Journal, April 18, 1985, p. 30 and Lipton, *Takeover Abuses Mortgage the Future*, Wall Street Journal, April 5, 1985 p. 16.

⁴⁵ For an analysis of the development as regards leverage in 1987 and 1988, see Ben S. Bernanke, John Y. Campbell & Tony M. Whited, *U.S. Corporate Leverage: Developments in 1987 and 1988*, Brookings Papers on Economic Activity 1/1990, p. 255 ff.

⁴⁶ See The Economist, October 29 – November 4, 1988, p. 81 f. and The New York Times, October 26, 1988, p. D1.

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to the existing debt. In this connection it should be noted that even junior debt may influence the price of the existing bonds: issue of any additional debt will increase the risk that the debtor company cannot service the aggregate debt, which will, in turn, increase the risk of bankruptcy. The reason why the price of the existing (senior) bonds is affected by such increased risk of bankruptcy is that investors know that bankruptcy proceedings are time-consuming and costly and often entail that even the holders of senior bonds will carry a share of the aggregate economic burden in connection with the bankruptcy.

Louis Lowenstein is perhaps one of the most thoughtful critics of contested takeovers. Lowenstein admits that some contested takeovers are undoubtedly beneficial for the economy in that they remove "tired old managements" or assets to more highly valued uses, but finds it difficult to tell if contested takeovers in the present form will generally lead to improved efficiency. Lowenstein also emphasizes the abusive steps which have become a part of today's takeover process. Moreover, the scarce regulatory framework for tender offers and the fact that shareholders are passive and do not participate in corporate decisionmaking are aspects stressed by Lowenstein. This has led Lowenstein to make the following conclusion:

"Takeovers are a good idea gone bad, gone to excess. Takeovers were a small and useful activity in the mid-1970's. Then they expanded 15 times and the premiums soared and the bankers' fees and lawyers' fees expanded and it is very difficult to see that it is helping American industry."⁴⁷

3.4. Proposals for reform. The high level of contested takeover activity which was seen in the United States for a number of years has led to the surfacing of several proposals for reforms, including proposals for legislation.

Some of those commentators who consider contested takeovers as well as the takeover techniques used in the current takeover wave to be leading to an increase in everyone's welfare have contended that any step or restriction which inhibits or prevents contested takeovers will prevent a maximum utilization of the investments made in the stock market. Consequently, they argue, investors will feel less attracted to invest in the stock market if contested acquisitions are restricted. A drop in the investments made in the stock market will, since the funds become a more scarce commodity, make it more expensive for those companies that obtain their financing from the stock market. Increase in the costs of financing is likely

⁴⁷ See The New York Times, July 17, 1988, Section 3, p. 4.

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to have a negative impact on the competitiveness of American companies compared to their foreign competitors that obtain their capital from foreign capital markets. Subscribers to the above theory point out that target defenses as well as federal and state regulation of contested takeovers make such takeovers more costly and thereby lead to reduced efficiency.⁴⁸

Frank H. Easterbrook and Daniel R. Fischel⁴⁹ have made a proposal for reform pursuant to which the existing regulation of contested takeovers in the Williams Act⁵⁰ would be abandoned to ensure that a takeover can be consummated as fast as possible and without allowing target-management time to frustrate the takeover.⁵¹ Easterbrook and Fischel also find that the so-called “business judgment rule”, which is a standard according to which acts by target-management are reviewed by the courts (discussed further under X.3.1.2.), should not apply to the decision to resist a takeover offer. They argue that the courts have never applied the business judgment rule in situations where management had a conflict of interests. When facing a takeover offer, Easterbrook and Fischel argue, a management does have an interest conflicting with the interests of the shareholders, for which reason management’s decision to resist the takeover should not be shielded from review by the courts under the protection of the business judgment rule.⁵²

⁴⁸ See *Economic Report of The President* p. 202 ff. (February 1985) and Separate Statement of Frank H. Easterbrook & Gregg A. Jarrell in the *SEC Report of Recommendations of Advisory Committee on Tender Offers*, p. 71-73 and 79-84, (July 8, 1983), reprinted in Victor Brudney & Marvin A. Chirelstein, *Corporate Finance, Cases and Materials* p. 833 ff. See also the debate in *The New York Times*, February 7, 1988, Section 3, p. 2, *Curbing Raiders is Bad for Business*, about the Delaware legislation discussed under VIII.3.4.

⁴⁹ Frank H. Easterbrook, a judge, and Daniel R. Fischel, professor at the University of Chicago Law School and Graduate School of Business, are together with Gregg Jarrell, chief economist for the SEC, and Michael C. Jensen, professor at Harvard Business School, among the most prominent proponents of contested takeovers in the present form.

⁵⁰ Discussed under VII.2.

⁵¹ See Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 *Stanford Law Review* 1 (1982), and the same authors, *The Proper Role of Target’s Management in Responding to a Tender Offer*, 94 *Harvard Law Review* 1161 (1981). See also Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders’ Welfare*, 36 *Business Lawyer* 1733 (1981).

⁵² Martin Lipton, a New York practising attorney, has maintained that the decision whether to defeat a contested takeover offer should be treated as any other busi-

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The Easterbrook-Fischel-model would facilitate contested takeovers but would, at the same time, leave target-shareholders without the protection provided for in the Williams Act. If the disclosure requirements as well as the provisions creating a substantive protection of the target-shareholders were repealed, it is likely that target-shareholders would run a risk of being exposed to unfair and abusive tactics on the part of acquirors.⁵³

In 1983, Louis Lowenstein⁵⁴ proposed an amendment of the Williams Act, according to which contested tender offers would have to remain open for a minimum of 6 months.⁵⁵ A 6 months' offer period would give target-managements time to seek shareholder approval of structural changes. Also, Lowenstein argues, a 6 months' offer period would encourage a more rational and efficient auction for the company. Thirdly, an offer period as long as 6 months may inhibit but not eliminate tender offers as such.⁵⁶ Lowenstein also proposes that responses to a contested tender offer by target-management must, to the extent that they entail structural changes, be submitted for shareholder approval.⁵⁷

ness decision, see Lipton, *Takeover Bids in the Target's Boardroom*, 35 Business Lawyer 101 at 115 ff. (1979).

⁵³ For a discussion of certain of these aspects, see Thomas J. McCord, *Limiting Defensive Tactics in Tender Offers: A Model for the Protection of Shareholder Decision Making*, 21 Harvard Journal on Legislation 489 at 502-503 (1984). McCord also proposes a Model Act (p. 509 ff.) that would increase the difficulty of making charter amendments that discourage tender offers and would prohibit extraordinary transactions by a company during or immediately prior to a tender offer. McCord's Model Act also would impose limited, strict liability to corporate managers who make untrue or misleading statements in connection with a tender offer.

⁵⁴ Louis Lowenstein is a professor at Columbia University School of Law.

⁵⁵ See Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Columbia Law Review 249 at 317 ff. (1983). Subsequently, Lowenstein has suggested a minimum period of 3 months, see *What's Wrong with Wall Street* p. 222.

⁵⁶ See Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Columbia Law Review 249 at 317 ff. (1983). A number of bills have been proposed with the purpose of lengthening the offer period of tender offers, see e.g. S. 521, 100th Cong., 1st Sess. (1987) (Proposal from Senator Simon for a minimum offer period of 45 days) and S. 678, 100th Cong., 1st Sess. (1987) (Proposal from Senator Metzenbaum for a minimum offer period of 60 days).

⁵⁷ Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 Columbia Law Review 249 at 317 ff. (1983).

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Louis Lowenstein does not want to rule out contested takeovers but points out that they do, in their present form, cause some difficulties in corporate America.⁵⁸

Ronald J. Gilson⁵⁹ assumes that contested takeovers are useful and therefore should be encouraged. In his proposal for reform he has focused on the conflict between the interests of target-management and target-shareholders. Rather than proposing a detailed regulation of the takeover process, he suggests a general rule which would prevent target-management from taking any step or action that could interfere with the outcome of a contested bid or which could deprive the target-shareholders of the opportunity to tender their shares.⁶⁰ However, pursuant to Gilson's proposal a management would have the right to present its view with respect to the contested offer and would also be allowed to solicit competing offers.

Gilson's concept is inspired by the takeover regulation set forth in The City Code on Take-overs and Mergers that governs contested acquisitions in Great Britain. One of the salient features of British takeover regulation is that management of the target-company may take no frustrating action against a takeover attempt without the consent of its shareholders, cf. X.3.2.3.

Recently, Bevis Longstreth⁶¹ in his statement before the Subcommittee on Securities of the Senate Banking Committee made a recommendation which was also inspired by the British takeover regulation.⁶² Bevis Longstreth pointed out that major changes in managerial control and stock ownership are occurring that weaken managerial accountability to shareholders. The approval by Delaware as well as other states of elimination of

⁵⁸ According to Louis Lowenstein, "The issue is not whether takeovers are useful, but how useful they are...", see Lowenstein, *What's Wrong with Wall Street* p. 218.

⁵⁹ Ronald J. Gilson is a professor at Stanford University School of Law.

⁶⁰ See Ronald J. Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers*, 33 Stanford Law Review 819 at 878-79 (1981).

⁶¹ Bevis Longstreth is a former SEC commissioner and presently a partner of the law firm Debevoise & Plimpton, New York.

⁶² Statement made by Bevis Longstreth before the Subcommittee on Securities of the Senate Banking Committee, on October 3, 1989. See also Longstreth, *Takeovers, Corporate Governance, and Stock Ownership: Some Disquieting Trends*, in 16 Journal of Portfolio Management 54 (1990).

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liability for breach of a board's duty of care⁶³, the adoption of second generation anti-takeover laws, the wide approval by the courts of poison pills, the use of non- or limited voting stock, the fact that proxy contests are normally won by incumbent management⁶⁴, and the fact that market forces as a check on management have been eroded, are all factors which are emphasized by Longstreth as giving management "a tighter grip on the reins of the corporation". As regards the development with respect to stock ownership, Longstreth points out that the growth in recent years in institutional holdings and the institutional "voicelessness", the trend towards increased separation of stock ownership from control, the use of passive investment techniques, the tendency among institutional investors to allocate their assets among different markets (and, within a single market, among the different classes of investment), and the fact that institutional investors increasingly turn to non-public investments, are factors that weaken managers' accountability to shareholders.

This development in managerial accountability is considered by Longstreth to be detrimental to the American corporate system and the nation's competitiveness as well as economic well-being. Consequently, he recommends that Congress add rules to the Williams Act which provide the shareholders with the right to consider an offer for their shares without having management frustrate such right. The only exception would be acts by management that have been approved by a majority of the target-company's shareholders.

3.5. Recent developments. In July, 1983, a committee established by the SEC submitted a report on the economic effects of takeovers. The members of the committee were not in agreement, which is demonstrated by the following excerpt from the report prepared by the committee:

"A substantial majority of the Committee, however, is of the view that the economic data is problematic. They are unable to agree that substantial economic benefits or detriments of takeover activities have been conclusively established

As with other capital transactions, the Committee believes the fact that some takeovers prove beneficial while others prove disappointing is less attributable to the method of acquisition and more to the business judgment reflected in combining the specific enterprises involved

⁶³ The duty of care is further discussed under X.3.1.2.

⁶⁴ The defensive devices mentioned here are discussed in detail under XI.

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On the strength of the evidence presented, the Committee does not believe that there is sufficient basis for determining that takeovers are per se either beneficial or detrimental to the economy or the securities markets in general, or the issuers or the shareholders, specifically.”⁶⁵

The discussion about the effects of contested takeovers, and in particular about the leverage resulting from takeover activity, continued and gained new strength after the occurrence of a couple of very large debt-financed acquisitions that took place in 1988. Critics of the level of debt-financing, among other things, proposed that the right to deduct, for tax purposes, interest incurred in connection with debt-financed transactions be eliminated. Some of these proposals led to recommendations and bills from members of the Senate and the House of Representatives.⁶⁶

On December 22, 1988, the Senate Finance Committee and the House Ways and Means Committee initiated a series of hearings in order to examine whether steps ought to be taken regarding the widespread use of debt-financed acquisitions. Even though many politicians were worried by the substantial debt of many companies, some feared that the “treatment” could be even worse than the “disease” and that, for example, a limitation of the right for American companies to deduct interest for taxation purposes would have a negative impact on the ability of corporate America to compete with foreign companies that are subjected to no limitations with respect to interest deductibility.⁶⁷ Others, including the chairman of the Federal Securities and Exchange Commission, SEC, David Ruder, was of the opinion that it is extremely hard to determine if use of debt-financing in general has a negative effect on the economy of the American businesses and that it would be preferable to have the fate of

⁶⁵ See the excerpts from *SEC Report of Recommendations of Advisory Committee on Tender Offers*, p. 7-9, xix-xxv, (July 8, 1983), in Victor Brudney & Marvin A. Chirelstein, *Corporate Finance, Cases and Materials* p. 832-833.

⁶⁶ A recent example is the recommendation made on December 8, 1988, by Fortney Stark, a member of the House of Representatives, to Congress, proposing a change of the right to deduct interest in the takeover context, see BNA’s *Daily Tax Report*, December 9, 1988. See also Peter Canellos, *The Over-leveraged Acquisition*, 39 *Tax Lawyer* 91 at 115-119 (1985) proposing that junk bonds for taxation purposes be treated like equity capital and thus give rise to no right to deduction.

⁶⁷ See the statement by the chairman of the Finance Committee, Lloyd Bentsen, in *BusinessWeek*, February 6, 1989, p. 86.

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leveraged buy-outs be determined by the market forces rather than governmental regulation.⁶⁸

Ironically, the market reacted faster than Congress, and – as Ruder had envisaged – in late 1989 financiers began pulling out of the highly-leveraged transactions, giving equity financing a renaissance, cf. 3.3. and II.1.

4. Preliminary conclusions

Virtually all commentators agree that shareholders of a target-company tendering their shares obtain immediate, considerable profits as a result of a contested takeover. As stated under 2.2., this is substantiated by empirical evidence.⁶⁹

There is no conclusive empirical evidence or consensus among the commentators regarding the question of whether managements of target-companies are less efficient than average managements, and whether target-companies are in general undervalued.⁷⁰ Also, we have no conclusive empirical evidence, and disagreement exists, as to whether a successful contested takeover will lead to improved utilization of the target-company's assets and if the acquiror and the shareholders of the acquiror achieve an economic benefit equivalent to or exceeding the premium price paid to the target-company's shareholders. In short, disagreement exists as to whether the performance of target-companies improves as a result of a contested takeover and if such takeovers are in the interest of the shareholders of the acquiring company.⁷¹

⁶⁸ See Ruder's statements in The New York Times, December 23, 1988, p. D1 and the criticism hereof by Benjamin Stein in Barron's, January 23, 1989, p. 44 f.

⁶⁹ See, for example, Richard Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth*, in Knights, Raiders, and Targets p. 241 ff. See also Ellen B. Magenheim & Dennis C. Mueller, *Are Acquiring-Firm Shareholders Better Off after an Acquisition?* in Knights, Raiders, and Targets p. 171.

⁷⁰ See e.g. the report by American Enterprise Institute, *Proposals Affecting Corporate Takeovers* (99th Congress 1st session, 1985) at 29. For the view that the undervaluation rationale cannot be ruled out, see David J. Ravenscraft & F.M. Scherer, *Mergers, Sell-Offs & Economic Efficiency* p. 9-10.

⁷¹ See Michael Bradley, *Interfirm Tender Offers and The Market for Corporate Control*, 53 Journal of Business 345 (1980), Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 Journal of Financial Economics 5 (1983), Ellen B. Magenheim & Dennis C. Mueller, *Are Acquiring-Firm Shareholders Better Off after an Acquisition?* in Knights, Raiders, and Targets p. 171 ff., Richard Roll, *The Hubris Hypothesis of Corpo-*

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Despite extensive and lengthy discussions among commentators, there is no final conclusion as to whether the current contested takeover activity in the United States benefits the American society.

However, the American experience and the discussion among American scholars and commentators provide a basis for assessing contested takeovers as a concept. While commentators disagree with respect to the impact of the present takeover wave, there is a consensus among most commentators that properly regulated contested takeover activity has positive effects on managerial behavior and thereby on corporate efficiency. Most proponents as well as opponents of contested takeovers find it desirable that management of a company that does not perform satisfactorily can be removed by the shareholders, whether or not such removal is effected upon an acquisition of the company. If an acquiror did not have this right to remove management, the result would be that management were insulated from shareholder control. Shareholders and management of public companies do not always have identical interests, and contested takeovers, if allowed, may create a motivation for management to follow the interests of the shareholders rather than their own personal interests. Most commentators also agree to the notion that the decision to sell the shares of a target-company must be made by its shareholders and not by target-management. They feel that target-management must not defeat a contested takeover bid that provides benefits to the shareholders.

The disagreement primarily concerns the impact of highly leveraged contested acquisitions on the economy of the companies and the country. Also, many commentators feel that a high level of contested takeover activity may lead to management paying too much attention to short-term results and spending too much time and money on preventing or combating takeovers. Moreover, it has, perhaps not as often now as earlier, been emphasized by some scholars that certain takeover techniques are unfair to the shareholders of the target-companies.

However, the important conclusion at this point, based on the experience and the debate in the United States, is that contested takeovers contain elements of vital importance for the motivation and efficiency of corporate management. This, of course, does not mean that contested takeovers are always beneficial. But it suggests that efforts should be made, not to rule out contested takeovers as an acquisition technique, but

rate Takeovers, 59 *Journal of Business* 197 (1986) and Scherer, *Takeovers, Present and Future Dangers*, *The Brookings Review*, Vol. 4, No. 2, p. 15-20 (1986).

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rather to focus on the regulatory framework governing contested takeovers in order to eliminate or reduce the possible negative effects.

V Are contested takeovers beneficial for the Danish society?

1. Introduction

Under III we sought to determine the public interest in the stock market and the regulation thereof.

In IV we examined the empirical evidence and the viewpoints among American commentators regarding the different implications of contested takeover activity. The purpose of this was to evaluate if there are beneficial economic impacts connected to this kind of activity.

Although many elements of uncertainty exist, I found a basis for concluding that contested takeovers, viewed as a concept, contain elements of importance for keeping corporate managements alert and thereby improving efficiency.

However, we still do not have sufficient grounds to state if contested takeovers benefit the Danish society. In order to establish a firmer basis for conclusion, we will now examine further the relationship between shareholders and corporate management as well as the interests of those two groups. When we have determined this, the question we will address is what role contested takeovers should play in the corporate governance context from a shareholder viewpoint. Finally, we will turn to the question if society at large has an interest in this kind of activity.

The point of departure for our analysis will be the role played by the investors in the stock market.

2. The role and interests of shareholders

2.1. Shareholder passiveness. In the following it is assumed that shareholders of most Danish listed companies¹ are passive in the sense that they do not or only rarely participate in shareholders meetings, cast their votes, or show only limited interest in the business operations of the company. The assumption that most shareholders are passive can easily be verified by attending shareholders meetings of most listed companies.

¹ I.e. public companies, "Aktieselskaber" (A/S), see VI.1.1.

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In recent years, pension and labor market funds, including the Employees Capital Pension Fund² and the Danish Labor Market Supplementary Pension Fund³, have increasingly invested in the Danish stock market. So far it seems as if these institutional investors have been reluctant to actively participate in attempts to influence management although recent statements by representatives of some of the major institutional investors suggest that this position may be changing.⁴

2.2. Division of ownership and control. When analyzing the reasons for many shareholders being passive, it is appropriate from the outset to take a look at one of the typical features of listed companies, the division of ownership of the company, and the right to manage the company, or, put differently, the division of the economic and managerial rights, the right to receive the fruits, and the right to govern the business. This division has been acknowledged ever since Berle and Means in 1932 pointed it out and has subsequently given rise to much debate.⁵

Danish companies are managed by a board of directors ("bestyrelse") and one or more managers ("direktion"), cf. the Companies Act⁶ § 54, Subsection 1.

Following the basic principles of corporate governance in Continental European corporate law, the managerial structure of Danish companies consists of two tiers. Public companies must have a board consisting of at least 3 members that are elected by the shareholders, cf. § 49, Subsections 1 and 2, of the Act. As regards companies that have had a minimum average of 35 employees in the preceding 3 years, the employees are entitled to elect a number of members of the board corresponding to half the number of members elected by the shareholders, cf. § 49, Subsection 2, of the Companies Act. Moreover, public companies must have at least one, but may have more, managers, who are appointed by the board, cf. § 51, Subsection 1. The board of directors sets forth the policy of the company, issues general instructions to, and monitors the managers who are in

² Lønmodtagernes Dyrtdsfond, LD.

³ Arbejdsmarkedets Tillægspension, ATP.

⁴ See e.g. the statements by Steen Villemoes, The Danish Association of Engineers' Pension Fund ("Dansk Ingeniørforenings Pensionskasse") and Flemming Skov Jensen, The Employees Capital Pension Fund, in the daily newspaper, Politiken, November 26, 1989, Section 3, p. 4.

⁵ See Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property*. See also Berle, *Power without Property*, and Bernhard Gomard, *Hovedpunkter af selskabsretten* p. 21 f. For a discussion of the impact, according to Berle and Means, of the division of ownership and control, see 2.5.

⁶ "Aktieselskabsloven", see VI.1.1.

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charge of the day-to-day management of the company within the framework created by the guidelines and instructions given by the board, cf. § 54, Subsection 2, of the Act. Also, the board of directors makes decisions with respect to matters of particular importance or unusual nature, cf. § 54, Subsection 2, and Gomard, *Aktieselskaber og anpartsselskaber* p. 120 ff. Although the Companies Act provides some guidance with respect to the relationship between the roles of the board and the managers, an accurate distinction between the tasks that the two entities are concerned with cannot be drawn and varies depending on the size and nature of the company's business. For a more detailed discussion of this, see Gomard, *Aktieselskaber og anpartsselskaber* p. 120 ff., Paul Krüger Andersen, *Aktie- og Anpartsselskabsret* p. 145 ff. and Jan Kobbemagel, *Direktionen* p. 85 ff.

As already suggested, the terminology "board of directors" or "board" will be used here as a reference to the "bestyrelse" whereas the term "manager(s)" will be used when referring to the "direktion". The designation "management" will be used as a general reference to the "bestyrelse" and/or the "direktion".

The Companies Act provides that a company's shareholders may exercise their influence on the board and the managers, including express criticism, or, if necessary, remove the board and thereby also effect the removal of the managers.

Shareholder consent⁷ is necessary in connection with a number of material corporate decisions, including charter⁸ amendments and mergers as well as liquidations.⁹ Apart from these particular situations, shareholders have no right to participate in the management of the company's business, while they have a right to receive the economic benefits that the company generates, typically in the form of dividend payments.¹⁰ In addition, the shareholders may elect to dispose of their shares rather than remaining shareholders.

The Companies Act sets forth a distribution of powers between the board, the managers and the shareholders, but for obvious reasons does not

⁷ The shareholders exercise their rights at shareholders meetings, cf. § 65, Subsection 1, of the Companies Act.

⁸ The term "charter" is used here to describe what is known in Danish law as a company's "vedtægter". Rules similar to those that are found in the charter and by-laws of an American company are, as regards Danish companies, found in one document, the "vedtægter".

⁹ See e.g. §§ 78 and 79 and Chapters 15 and 14 of the Companies Act.

¹⁰ The shareholders at a shareholders meeting decide if and how much dividend the company should pay for a given fiscal year, however, the dividend may not exceed the dividend proposed or approved by the board, cf. § 112 of the Companies Act. See also Gomard, *Aktieselskaber og anpartsselskaber* p. 152.

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express any views with respect to the extent to which shareholders should actually exercise their influence to control and monitor the board and the managers.

In chapter XI. of this book, an attempt will be made to explain how contested acquisitions may be eliminated or severely restricted by various means, including the adoption of certain charter provisions.

In practice, the majority of listed companies have deviated from the point of departure envisaged by the drafting of the Companies Act by adopting “anti-takeover” charter amendments or establishing other kinds of “defensive” arrangements, cf. the study on the prevalence of takeover defenses in Denmark under XIII.5.1. A common denominator of many of these devices is that they enhance the powers of the management at the expense of the shareholders, see further XI.16.3.

For example, the use of A- and B-shares is likely to insulate management from shareholder control. It is often seen how e.g. family controlled companies that “go public” list their low-voting B-shares while keeping the high-voting A-shares in the hands of the family. The use of dual class stock is probably one of the purest examples of an effective division of ownership and control.¹¹

Similarly, charters that provide for capped and disparate voting rights entail that the board (and the managers) can almost be certain that no acquiror can threaten them.

Danish law, including the rules issued by the board of the Copenhagen Stock Exchange¹², so far has not prevented shareholders of a listed company at a shareholders’ meeting from adopting charter amendments which enhance the powers of management as outlined.

There is reason to believe that the widespread use by Danish companies of defensive charter provisions and the resulting limitations that apply to shareholders’ possibilities to influence the management of companies are some of the prime reasons for passiveness among shareholders.

Investors who know in advance that they will, in effect, have no influence on the company in which they have the opportunity to acquire shares are only inclined to make such an investment if they believe in the ability of incumbent management to manage the company. Such shareholders typically buy shares of companies they consider well-managed and do not intend to influence the management of the company.

¹¹ See VIII.2.1.3. for a description of the concept of A- and B-shares.

¹² See VI.

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For many investors active control of management is a time-consuming and costly activity. Following at short range the company's business and evaluating managerial performance requires time and expertise.

Consequently, not only the fact that the shareholders' powers have been limited by charter provisions in many companies, but also the costs of control and monitoring deter many investors from actively participating in the process of holding the board and (indirectly) the managers accountable. At least at a first glance, it seems much easier to buy shares in a company that one believes is well-managed and just sell the shares again if it turns out that those charged with managing the company do not perform as well as expected. This notion – "love them or leave them" – is known in the United States as the "Wall Street-rule". As will be seen later, an attitude among shareholders that shares should just be sold if one disagrees with the management has led to the so-called "free rider"-problem.¹³

2.3. Shareholders' interests versus the interests of the managers and the board. It is generally acknowledged that the shareholders of a company and the managers, who are in charge of the day-to-day operations of the company, do not always share the same interests.

Shareholders constitute a diverse group of investors who have the common denominator that they have invested in the stock market but who may have various motives, goals and expectations with respect to their investment. For some shareholders the purpose of investing in the stock market is a pure desire to obtain maximum profits. Within this group of shareholders, some may prefer stable and high dividend payments, while others are tempted by the probability of reaping a premium in connection with a subsequent sale of the shares.

Another category of shareholders may, in addition to looking at the returns on their investment or the probability of premiums, consider factors that do not directly relate to a maximization of the value of their investment. Some private shareholders may stress the importance of retaining family control of a company, while, for example, employees owning shares of the company that employs them may stress the importance of keeping jobs. Other shareholders are likely to attach importance to keeping local industry alive, rather than having a large out-of-town competitor acquire it for the purpose of closing it down.

No doubt, shareholders have a number of different reasons for investing in shares and for behaving the way they do in connection with decisions

¹³ See the discussion of this problem under 2.6.

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affecting their investment. The diversity of motives, goals, and expectations obviously makes it more difficult to assess the interests of the shareholders when looking at them as a group.

However, maximizing the value of the equity investment is probably a common goal for almost all shareholders. This does not imply that shareholders always focus on short-term profits or gains. Some shareholders may, for example, decide not to tender their shares to an acquiror even though this would provide them with a substantial profit. There may be many reasons for rejecting an offer, some of which have been mentioned above. Still, most shareholders would like to see the value of their shares increase as much as possible.

The managers of a company will typically seek to accommodate the interests of the shareholders in connection with their management of the company, inter alia, in order to ensure and promote their own careers with the company.

However, it is a widely held view that the managers of a company often consider it advantageous to have the business of the company grow even if such growth exceeds the point where the size of the business and the use of its capital are optimal, seen from the shareholders' viewpoint.

A growth of a company will increase the number of employees and the amounts of funds to be administered by the managers, who are likely to perceive such changes as prestigious since it is considered to be more prestigious to be the manager of a large company than the manager of a small or medium-sized one. Moreover, the size of the company will be reflected in the compensation that the managers receive. Often the compensation of the managers is tied to a growth of the company rather than an increase in the profits in excess of an ordinary return on the investment.¹⁴ Consequently, managers often have a direct economic interest in having the company grow.

Also, it could be argued that managers are more adverse to risk than shareholders. If the company goes bankrupt, the shareholders lose their investment but are not personally liable for losses incurred by creditors. As a point of departure, managers cannot be held personally liable either. Still, they run the risk that creditors commence lawsuits on grounds of mismanagement, and succeed in doing so. Managers may of course do their best to avoid being held liable but are basically stuck with this risk. They cannot, like shareholders, spread (diversify) the risk of losses. While

¹⁴ See report, prepared by Michael Møller & Niels Christian Nielsen, *Aktieoptioner som aflønningsform* p. 6 (1988).

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shareholders can buy shares of different companies in different trades or industries and thus reduce their risk by diversification, this obviously cannot be done by the managers of a company. In their desire to avoid the company's insolvency, managers may put additional emphasis on growth in the (often erroneous) belief that this gives the company as well as themselves a "buffer" against the risk of insolvency.¹⁵

For a general discussion of these sceptical views on growth, see William Baumol, *Business Behaviour, Value and Growth* and Robin Marris, *The Economic Theory of "Managerial" Capitalism*. See also, for a survey of the various views on these issues, John C. Coffee, Jr., *Shareholders versus Managers: The Strain in the Corporate Web*, in *Knights, Raiders, and Targets* p. 77 ff. at 82 ff.

For these reasons managers could be said to have an interest in expanding the company, e.g. by investments, acquisitions or diversifications, even though an analysis of the market suggests that the company ought rather to concentrate on limited, and perhaps existing, products and services and not seek new opportunities. In these situations, the managers would, in effect, invest the shareholders' money in activities that do not give the shareholders as high returns as they would be able to get if they themselves invested directly in other activities with a similar risk factor.

The above assumptions do not apply if the managers themselves have an interest in maximizing the value of the company's equity capital, which e.g. would be the case if they own shares of the company or have been granted options to buy shares at a favorable price.

But why are we concerned with these interests of managers? Decisions as to the business strategy of a company, including whether or not it should grow, and, if so, how, are matters of policy which it is left to the board – and not the managers – to decide upon. This is, at least in theory, the point of departure, cf. the comments under 2.2. above. However, various factors suggest that the "working-model" (i.e. "real life") differs from theory.

While managers hold full-time positions with the company, being a member of a board is normally a part-time assignment, and in many companies board members hold similar positions with other companies. It is, therefore, reasonable to assume that the board members, generally speaking, have less time to devote to the business of each company. Moreover, due to this time constraint and since the board has no "hands-on" control of the managers of the company, the managers to a certain degree control

¹⁵ See John C. Coffee, Jr., *Shareholders versus Managers: The Strain in the Corporate Web*, in *Knights, Raiders, and Targets* p. 77 ff. at 82 ff.

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the information which is conveyed to the board. This advantage for the managers, compared to the board, enables the managers of many companies to take the initiative even as regards policy matters.¹⁶ Frequently, plans regarding major matters, such as e.g. mergers or acquisitions are initiated by managers while the board only comes into the picture at a later point in time.

Ought we to be worried about this state of affairs where frequently much influence on corporate policy is conferred upon the managers? The two-tier management-concept is designed to create a checks-and-balances system whereby the board monitors and controls the managers. It aims at ensuring that those responsible for the day-to-day business of the company are held accountable.

Viewed in a broader context, we could say that the shareholders elect their agents, the board members, who may be monitored and removed by the shareholders and who, in turn, appoint their agents, the managers. And just as the board should be held accountable by the shareholders, the managers are supposedly controlled and may be removed by the board.¹⁷

The fact that managers consider and plan policy issues, and even take initiatives that will ultimately have to be approved by the board, may not give rise to much concern as long as the board makes its independent and informed evaluation of the managers' proposals. Provided that the board remains active and does not apply a "rubberstamp"-approach, the checks-and-balances system may still be intact. However, the aforementioned constraint of time and limitation of information suggest that it may often be difficult for boards to adequately evaluate managers' plans and proposals, and thus exercise control. Obviously, much depends on the attitude of the board members as well as the effectiveness of channels of communication and monitoring of each company.

But how important is control by the board of the managers really and what happens, or is likely to happen, if it fails? To answer these questions we must consider the impact of the board's control which, in turn, depends on the interests that the board must be expected to pursue. Put differently,

¹⁶ See also Robert Charles Clark, *Corporate Law* p. 106ff. The text does not apply to companies with a chairman of the board who works closely together with the managers in the day-to-day operation of the company.

¹⁷ The discussion in the text focuses on the control and monitoring mechanisms, while it is not suggested, of course, that the managers do not owe duties to the shareholders. They certainly do, see under X.

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does it make any difference from the shareholders' viewpoint whether or not the board monitors and controls the managers?

To some extent the points made with respect to the interests of managers also apply to the board's interests. There is thus reason to believe that board members are more risk-adverse than shareholders: they cannot spread the potential risk of being held liable. On the other hand, the careers of the members of the board are ordinarily not as closely tied to the company as is the case with the managers. Also, the compensation of the board is normally not tied to the growth of the company. The board, therefore, does not have the same interest in a growth of the company as the managers have.

Against this background we probably have sufficient grounds to conclude that the interests of managers and boards are not congruent. Managers probably are inclined to aim at growth to a higher degree than boards do. But we also should recognize that the interests of board and shareholders are not quite congruent either. We may draw two inferences from this. First, that it is an advantage for shareholders to have the board monitor and control the managers since the "gap" between the interests of boards and of shareholders is smaller than the gap between the interests of shareholders and managers. Second, that shareholders cannot expect that boards share all the shareholder interests, i.e. corporate growth is likely to play a greater role in the minds of board members than in the minds of shareholders.

If the board's monitoring and control of the managers do not comply with the shareholders' interests, or perhaps even fail entirely, the consequence, according to the above, will be that the capital that is tied in the company will not be used in an optimal way. Lack of or inefficient "internal" control may result in a drop in the stock price of the company, whereby the price of the company's shares may fall below the aggregate value of the assets of the company.

Obviously, isolation of the board from shareholder influence may have particularly far-reaching implications in the event that the board's monitoring of the managers is unsatisfactory from shareholder viewpoint, since the board's inefficiency cannot be remedied by shareholder intervention.

Against this background the question is if shareholders should abstain from depriving themselves of the right to actively intervene if the board and the managers do not perform satisfactorily, or if they should just dispose of their shares without making any attempts to influence management. This question will be discussed in the following.

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2.4. The shareholder – an owner or an investor? Charter amendments that strengthen the board at the expense of the shareholders, including use of A- and B-shares, are matters that require shareholder approval with qualified majorities at a shareholders meeting. Shareholders are free to adopt such charter provisions, and they may elect not to do so. This is entirely a voluntary matter.

Investors who acquire shares of a company that has limited the powers of the shareholders to the advantage of management and shareholders who acquire low-voting B-shares should be expected to be familiar with their weak position vis-a-vis the board.

The problem, thus, is not that shareholders are forced to “surrender” their influence to the board. Nor should they be considered to be unaware of their limited influence when acquiring shares.

Rather, the question is whether shareholders have an interest in surrendering their rights to hold the management accountable for their acts. Phrased differently, should shareholders consider themselves as owners of a company and in that capacity attempt to monitor and control the board (and indirectly the managers), or ought they to view themselves as investors for whom the sole concern is if their investment generates satisfactory returns and their shares have a fair value while they do not wish to deal with managerial issues? If the latter attitude is followed, the effect will be that shares of a company that is not managed in an optimal or satisfactory manner will be disposed of by the shareholders as soon as possible and at the best price possible.

2.5. The American discussion. Corporate accountability issues and the question whether shareholders should be viewed as owners or merely investors have been subject to much debate, particularly in the United States. The principal questions, however, are the same in Denmark and it is, therefore, appropriate to consider the theories that have been developed among American scholars.

Approximately 50 years ago, Berle and Means noted that shareholders of publicly held companies with dispersed shares will find it hard to monitor management in an efficient manner. Berle and Means thus stated:

“... the shareholder in the modern corporate situation has surrendered a set of definite rights for a set of indefinite expectations. The whole effect of the growth of powers of directors and “control” has been steadily to diminish the number of things on which a shareholder can count; the

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number of demands he can make with any assurance that they must be satisfied.”¹⁸

According to Berle and Means, the separation of ownership and control has to a very large extent made management autonomous.

The above quotation reflects a theory expressed in the United States more than 50 years ago but seems to be an adequate description of the surrender of shareholders’ rights that has taken place and still takes place not only in the United States, but also in Denmark, see XIII.5.1. on the prevalence of takeover defenses.

Berle and Means’ theory presupposes that the desire to hold management accountable is best achieved by increasing shareholder power.

Not all authors share this view. In 1959 Abram Chayes said:

“Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporation whose consent must be sought. If they are, it is only in the most limited sense. Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in the catalogue of corporate decisions with which this paper began, decisions on prices, wages, and investment. They are no more affected than nonshareholding neighbors by these decisions.”¹⁹

Rather than increasing shareholder influence, Chayes would reduce shareholder power and instead increase the powers of other constituencies, including e.g. employees and customers. Chayes envisages that such constituencies should exercise their powers through an institutional arrangement devised to represent their interests.

It seems, however, that Chayes’ proposal raises more questions than it gives answers. There may be good reasons for giving the employees a say in connection with corporate governance issues. On the other hand, it is not obvious that increasing employees’ powers at the expense of shareholders’ would benefit the company or society. Why should employees be better suited to monitor and control management of the company than the shareholders? In addition, Chayes seems to assume that customers are better suited to monitor management than shareholders. Why should this be so? Also, should all customers, or only some, have influence? Would

¹⁸ See Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* p. 244.

¹⁹ See Abram Chayes, *The Modern Corporation and the Rule of Law*, in *The Corporation in Modern Society* (Edward S. Mason, ed.) p. 25 ff. at 40-41.

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the size of the customer make any difference? Is it realistic to think that it is possible to have a body that can represent all the interests? Even if this were possible, would the interests of the employees not frequently conflict with the interests of the customers, or even with the interests of the company? Would the shareholders, who have a direct stake in the company, not have an interest in influencing management, at least if they were able to do so?²⁰

It seems as if Chayes fails to see that shareholders, who do have the right to influence, may very well be the ones best equipped to do so.

A third theory, known as “managerialism”, is based on the notion that shareholders and other constituencies are concerned with their own welfare only, whereas corporate management does not pursue any particular interest, except the interests of the company.

One of the scholars supporting the managerialism theory is Bayless Manning who has argued that shareholder democracy is a “myth” which has created “an impression in the public mind ... that a degree of shareholder supervision exists, which in fact does not”.²¹

According to Manning, the misperception of the role of the shareholders has diverted attention from the real problems of holding managements responsible. The a priori legal conclusion that the shareholders “own the company” should be abandoned and substituted by the conception that the only thing shareholders “own” is their shares of stock. Manning proposes that shareholders of a corporation have no voting rights. Rather, shareholders should be treated like a holder of a voting trust certificate, having all economic rights in the deposited stock, but no power to elect or replace the trustees by vote.²²

Control of management would, according to Manning’s theory, rest with a governmental or non-governmental body. The shareholders’ interests would be protected by a system of adequate and periodic disclosure as well as the provision of a market through which shareholders may sell their shares.²³

The problem with Manning’s theory is that it seems to presuppose that management is always able and motivated to act in the interests of share-

²⁰ See the criticism of Abram Chayes’ theory by Melvin A. Eisenberg in *The Structure of the Corporation, A Legal Analysis* p. 20 ff.

²¹ See Bayless Manning, Book Review, 67 Yale Law Journal 1477 at 1489 (1958) (Review of J.A. Livingston’s, “The American Stockholder”).

²² See Bayless Manning, Book Review, 67 Yale Law Journal 1477 at 1490 (1958).

²³ See Bayless Manning, Book Review, 67 Yale Law Journal 1477 at 1490-91 (1958).

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holders and society, irrespective of whether any mechanisms exist that may monitor, control or otherwise create an incentive for management to pursue other interests than its own. It is difficult to see how management should be motivated as suggested by Manning without being directly responsible to any constituency.²⁴

According to the neo-classical school of economists, a company can be viewed as a nexus of contracts, some in writing, some unwritten, among owners of production factors and customers. These contracts stipulate the rights and duties, including the payoff system, regarding the participants. The shareholders are the residual claimants or risk bearers; they receive the difference, if any, between the inflows of resources and the payments to management. Managers and shareholders may have different interests, but management has a strong incentive to pursue the shareholders' interests.

The neo-classical school of thought thus argues that the various market forces' disciplining of managements is actually the most efficient manner of motivating management. The rationale behind this is that the market forces are the cheapest way of monitoring and thereby creating incentives for management and that legal regulation is superfluous and unnecessarily costly for companies.

Management may be motivated to act in the interest of the shareholders either by economic incentives (e.g. stock options) or by being monitored. Management may be viewed as the shareholders' agents, and the costs of having the agents adhere to the interests of the principals (here: the shareholders) are known as the "agency costs". The point made by the neo-classical school is that the various markets that discipline managers are better at reducing agency costs than is legal regulation.

For a discussion of these questions, see Easterbrook & Fischel, *The Proper Role of Target's Management in Responding to a Tender Offer*, 94 Harvard Law Review 1161 at 1168-74 (1981), Eugene Fama & Michael Jensen, *Separation of Ownership and Control*, 26 Journal of Law & Economics 301 (1983), Eugene Fama & Michael Jensen, *Agency Problems and Residual Claims*, 26 Journal of Law & Economics 327 (1983) and Michael Jensen & William Meckling, *Theory*

²⁴ In his article *The Corporation: How much power? What scope?* in *The Corporation in Modern Society* (Edward S. Mason, ed.) p. 85 ff. at 104, Carl Kaysen points out: "It is not sufficient for the business leaders to announce that they are thinking hard and wrestling earnestly with their wide responsibilities if, in fact, the power of unreviewed and unchecked decision remains with them, and they remain a small, self-selecting group".

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of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 Journal of Financial Economics 305 (1976).

One of the versions of the neo-classical school of economists emphasizes that all companies compete in the capital market to obtain the cheapest possible capital. Investors who consider investing in companies too risky because of corporate managements generally performing badly, will pull their funds out of the stock market and invest in other, safer and more attractive markets. If this happens, it will be comparatively expensive for companies to obtain their capital from the stock market. This price mechanism will, according to the theory, restrict management's possibilities of abusing their position and thereby ensure that shareholder interests will be pursued.²⁵

Another version of the theory claims that managers are players in a market, the market for "corporate control", which will, on a current basis, make evaluations of managers. Such evaluations, which will be made by future, prospective employers, affect the career prospects of the managers. The market will compare the different managers and the competition among these will have a disciplining effect so that shareholder interests will be promoted.²⁶

The general problem attached to this theory is that it presupposes that the markets for stock, managers, etc. are quite "transparent" and that investor decisions are made on the basis of a full review of all relevant pieces of information. Such transparency hardly exists in the United States' stock markets and to an even lesser degree in Denmark where the flow of information regarding listed companies is more limited than is the case in the United States.

Moreover, the investor behavior envisaged in the event that corporate managements do their job badly is a slow and indirect consequence, which may not have a very strong motivating effect on managements.

Similarly, managers will naturally consider how their acts are perceived by others, including future employers. However, there is little reason to believe that the market for corporate control, which by its nature is an in-

²⁵ See Daniel Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, in *Knights, Raiders, and Targets* p. 499 ff. at 504.

²⁶ See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 Journal of Political Economy 110 (1965). See also Eugene Fama, *Agency Problems and the Theory of the Firm*, 88 Journal of Political Economy 288 (1980) and Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in *Knights, Raiders, and Targets* p. 314 ff.

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direct monitoring mechanism, will be able to motivate management as efficiently as the shareholders of the company.

It is probably fair to say that the Berle and Means approach enjoys a strong support among a large number of, if not most, economists. Few believe that “toothless” shareholders are in the interest of the company or society at large. Neither does mere “dumping” of the shares of a company once problems have occurred represent a very attractive solution to the problems.

The fact that Berle and Means’ theory is still considered right by many is, *inter alia*, reflected in the SEC’s recent issue of Rule 19c-4 that restricts the right of American stock exchanges to list shares without or with limited voting rights.²⁷ A majority of the comments that the SEC received in connection with the hearing that preceded the adoption of Rule 19c-4 underscored the importance that commentators attached to management being accountable to shareholders. An excerpt from a release issued by the SEC in connection with Rule 19c-4 reads as follows:

“According to these commentators, corporate management have used disparate voting rights plans to insulate themselves from shareholders and the market for corporate control. They testified that such insulation leads to entrenched, inefficient corporate managements acting in their own best interest instead of the best interest of the company and its shareholders”.²⁸

One of the most recent recommendations based on Berle and Means’ view is expressed in Bevis Longstreth’s conclusion in his statement to the Senate in October, 1989:

“Due to the deepening of the castle moat and the heightening of its walls, shareholders of public corporations are becoming less and less able to hold management to account. And due to changes in investment management techniques and products, making exits easier, and the multiplicity of interests within the “ownership” group, creating diffusion and the potential for conflicts, shareholders are becoming less and less interested in holding management to account”.²⁹

²⁷ This rule is discussed under XI.2.4.1.

²⁸ See Securities Exchange Act of 1934, SEC Release No. 34-25891/July 7, 1988, SEC Docket Vol. 41, No. 6, p. 435.

²⁹ Statement made by Bevis Longstreth before the Sub-committee on Securities of the Senate’s Banking Committee on October 3, 1989. See also Longstreth, *Takeovers, Corporate Governance, and Stock Ownership: Some Disquieting Trends*, 16 *Journal of Portfolio Management* 54 (1990).

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Back in the 1920'es, William Ripley pointed out that shareholders do in fact own the company and, therefore, should have a voting right which is fair compared to the risk connected to the stockholding. According to Ripley, the shareholders should have this right to vote in order to be able to influence management and, if necessary, remove it. Division of ownership is acknowledged by Ripley, but, in his view, should not lead to the shareholders being prevented from collectively influencing management. See William Ripley, *Main Street and Wall Street* p. 78 ff. For a number of different views on the role of the shareholders in connection with management of companies, see Donald E. Schwartz (ed.), *Commentaries on Corporate Structure and Governance*, The ALI-ABA Symposiums 1977-1978 (1979).

The importance of management being held accountable by the owners is also illustrated by Jørgen Nørgaard's article on the problem of lack of owner influence on independent institutions, at the 29th Nordic Juristic Meeting 1981, Part II, Exhibit 10, p. 3 ff. As succinctly pointed out by Nørgaard (p. 3): "The goal for the owners is – broadly stated – to increase the income as much as possible and reduce the costs as much as possible. Any failure to reach these goals will be felt by the owners on their wallets – and the road from here to intervention is by experience short" (freely translated).

2.6. Pursuing the interests of shareholders. We have now established assumptions about the common interests of shareholders of a company. Further, we have reviewed various theories regarding what role shareholders should play in connection with the corporate governance issue.

In the following we will consider further how the common interests of the shareholders may be pursued in the most rational manner. To recapitulate: Is this done by monitoring and controlling management of the company actively, or should shareholders rather forget about influencing and instead sell their shares if they are dissatisfied with management?

There are conceptually two means by which to motivate management to act in the best interest of the shareholders.

One way is by giving management a direct economic stake in the company, e.g. by granting management stock options or securities convertible into shares. By making management feel like owners of a company, the conflict between the shareholders' interests and the interests of management discussed under 2.3. may be eliminated.

Most Danish companies have not adopted such incentives for management, or have only done so in a very limited scale. As to all those companies that have not created "carrots" for their managements, the other kind of motivating factor, the monitoring and controlling of management, be-

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comes important. It is, therefore, appropriate at this point to consider the various ways of monitoring and controlling management.

As it is believed by the neo-classical school of economists, there is hardly any doubt that the various market forces have a disciplining effect on management's behavior. The participants in the stock market may thus "penalize" the management of a company by showing an unwillingness to invest in the company's shares, as a consequence of which the market price for such shares will drop. A drop in the stock price will, in turn, put the focus on management by suggesting that it is not performing optimally. In addition, a lower stock price may affect the credit rating of the company, a fact that may also cast doubt on management's abilities. Knowing these facts of life and knowing that dissatisfied shareholders may dispose of their shares, management will obviously be motivated to perform well. Also, it is fair to assume that the "market for corporate control", i.e. the future, prospective employers and their assessment of management's performance, plays a role.

Other monitoring mechanisms include demands for competitive prices and quality by the markets where the company seeks to sell its products or services. Also, the influence of a company's financial sources, typically banks, obviously works to keep management alert.

It is a characteristic feature of all the above mentioned controlling and monitoring factors, perhaps with the exception of the influence of the company's bank connection, that they only exercise an indirect and often very slow influence on management. The penalizing effect of a disappointed market only appears after things have gone wrong. This does not, of course, mean that the markets' possible negative reaction does not play a role in the minds of the members of management even before problems have occurred. But it remains a fact that the influence by the stock market, like the influence by the markets for products or services and corporate control, is an indirect one.

The most direct and efficient monitoring and controlling of management will be obtained by having active shareholders. By using the shareholders meetings to question and, if necessary, criticize or remove management, a strong motivating effect is established. Moreover, active shareholders that show an interest in and have powers to make the necessary or desirable structural changes in the company's business, including by means of charter amendments, constitute a healthy system of checks and balances vis-a-vis management.

As touched upon earlier, it may, from the viewpoint of each single shareholder, appear difficult and time-consuming as well as expensive to

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keep an eye on the management of a company. Being able to influence management requires that the shareholder on a current basis obtains relevant information about the company and its plans. Likewise, he must prepare for and participate in the shareholders' meetings, which takes time and, in some cases, requires that he retains advisers with economic or legal expertise. It may, therefore, appear attractive for the shareholder to act as a "free rider", i.e. abstain from trying to understand or affect the company's business but rather sell the shares, should he not feel satisfied with management.

The problems in connection with being an active shareholder will be reduced if the shareholder is a professional investor or if e.g. the shareholder is an institutional investor that has a major portfolio of shares and a professional management. Similarly, the creation of shareholders' associations may reduce the problems attached to exercising influence.

The problem inherent in the free rider attitude lies in the consequences it will have if it spreads and becomes generally accepted by shareholders. The prevailing of the free rider attitude means that there will be no direct monitoring or control of management and, consequently, the strongest motivation for management to act in the best interest of the shareholders will disappear. Due to the differences between the interests of shareholders and the interests of management it is likely that such shareholder passiveness will result in the value of the shareholders' investment not being maximized. In a worst case scenario the free rider approach may even lead to the company being declared bankrupt and the shareholders losing their entire equity investment.

For a general discussion of the free rider-problem, see Robert Charles Clark, *Vote Buying and Corporate Law*, 29 Case Western Reserve Law Review 776 at 783 ff. (1979), and Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 Yale Law Journal 49 (1982).

In sum, what may appear to each single shareholder as the most attractive, or, at least, the least troublesome and costly, solution to a bad management of the company will typically, seen from the viewpoint of the shareholders as a group, be an expensive and often risky affair that could hardly be considered a solution to the problem. In other words, the shareholders have a collective interest in retaining influence of the company and its management.

The exact costs connected to controlling and monitoring management – and thereby the benefits that shareholders will reap from doing so rather than remain-

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ing passive – depend on the shareholders' ability to install efficient systems of watching and affecting managerial behavior.

2.7. Shareholders' interest in contested takeovers. As concluded under 2.6., shareholders should, in their own interest, remain actively involved in holding management accountable for its acts or omissions.

The focus in the following will be on the role that contested takeovers may play in the corporate governance context.

Since contested takeovers are only "hostile" to incumbent management, and because management and shareholders do not always have the same interests, it would make little sense for shareholders to have management decide whether or not the shares should be sold to an acquiror. Leaving this decision to management would deprive the shareholders of the opportunity to sell their shares at a perhaps favorable price. Therefore, it would be in the interest of the shareholders to allow anybody wishing to make a bid for the company's shares to do so and have the shareholders decide whether to accept the bid or not.³⁰

There is another aspect of contested takeovers, or the threat of contested takeovers, which serves the interests of the shareholders. In the event of a contested acquisition, target-management or part thereof will be removed. The right to remove management, whether this is done by a contested acquiror or any other shareholder or group of shareholders, is critical for the ability of the shareholders to hold management accountable. Removal of the board and thereby indirectly the managers, is the ultimate step towards bringing an end to bad management. The shareholders have no right to intervene directly in the acts by the management, but they certainly may have it removed.

If an acquiror, or any other shareholder who has the necessary power, is free to remove management, such threat of removal will have a disciplining effect on management's behavior. Members of management will know that unless they perform well, they may find themselves out of office. In addition, management knows that contested acquirors will offer a premium price for the company's shares compared to the market price in order to induce the shareholders to sell their shares. Such a premium price will only be offered if the acquiror has a fair belief that he will be able to obtain a profit that makes the acquisition worth while from a business

³⁰ This, of course, does not mean that there should be no regulation of the takeover process itself.

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point of view. It is only possible to obtain such a profit if the capital invested in the company is employed in a more efficient manner or valuable assets are disposed of in a profitable fashion. Knowing about these mechanisms, management will be motivated to consider more carefully how to use the funds invested in the company in a way that will lead to the highest possible stock price and the lowest possible hidden or unexploited assets.

As it appears, shareholders have an interest in allowing for contested takeovers to take place for various reasons.

The fact that contested takeovers have a disciplining effect on managerial behavior does not mean that shareholders should rely on contested takeovers only and forget about other means of holding management accountable. The influence that shareholders may exercise at shareholders' meetings, provided that they have not surrendered their right to influence, is obviously of great importance.

Similarly, the stock market mechanisms of penalizing management that performs badly as well as the market for corporate control play major roles in this connection. Moreover, the markets for the company's products or services and the bank connection of the company will motivate management to do a good job.

It is thus important to view contested takeovers as one out of several motivating factors. But it is also crucial to realize that the disciplining effect of contested takeovers is one of the best reasons for management to perform well. Sometimes it may prove to be the only efficient monitoring device that shareholders have, since at least some of the other motivating factors do not have sufficient strength or work too slowly to sufficiently protect the shareholders' interests.³¹

In connection with the debate among American scholars it has been argued that constant takeover threats may lead management to focus on preparing defenses and providing short-term profits for the shareholders rather than concentrating on long-term planning.³²

While takeover threats will normally make management consider the possibilities of adopting defenses, it should be noted that under Danish law, as opposed to American law, by far the most defenses require shareholder involvement and approval.³³ So far, this seemingly has not deterred

³¹ The whole discussion regarding motivation is particularly important in events where the "internal" control fails or is inefficient, cf. 2.3.

³² See IV.3.3.

³³ See under XI.2.1.2.

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Danish managements from proposing and often succeeding in having offensive devices adopted.³⁴

However, it is likely that the desire of managements to propose defensive devices and spend time on “strategic planning” will be reduced if the shareholders express their intent not to adopt defensive devices that will insulate management from shareholder control.

As to the alleged focus by management on short-term goals it should be noted that no basis exists for concluding that contested takeover threats generally create incentives for managements to plan on a more short-term basis than is in the interest of shareholders. It is more likely that management will pursue goals that it perceives will be well-received by the shareholders, and such goals are not limited to short-term economic benefits, but include any plans that are expected by shareholders to increase the value of their investment.

Due to the constraints on debt financing imposed by § 115, Subsection 2, of the Companies Act and Danish tax law³⁵, the possible negative effects of highly leveraged transactions experienced in the United States in recent years do not pose a similar threat in Denmark.

3. Society’s interest in contested takeovers

As stated under 2.3., the shareholders’ prime interest is to maximize the value of their equity investment in the company. This interest is promoted and protected by establishing an efficient system of disciplining management, cf. 2.6. One of the elements of such a system is the right of an acquiror, or any other shareholder or group of shareholders, to remove the management of a company, cf. 2.7.

The next question is if these interests of shareholders are shared by society as such. Maximizing shareholder wealth is not, per se, a goal that society would want to pursue.

However, society and the shareholders have a common interest in Danish companies being competitive compared to foreign competitors. Only by having competitive companies will the Danish society benefit from jobs offered to Danish employees as well as revenues paid in the form of taxes and other duties to state and local authorities.

Shareholders pursue competitiveness in order to protect their investment and to achieve an increase of the value of the shares they hold. The more

³⁴ See the study referred to under XIII.5.1.

³⁵ See IX.

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competitive a company is, the better are the chances that the shareholders' investment will prove successful.

To achieve competitiveness it is important to understand that the business world, like almost any other thing, does not present a static picture. Rather, it is in a constant flux due to changes in consumer behavior and demands, the appearance of new suppliers, changes in the economic and legal structure of the markets, etc. Only if companies succeed in adapting to such changes will they remain competitive. Companies which perform well today may face serious trouble tomorrow if they fail to respond to changes in the markets for their products or services.

Management which lacks the skills or motivation to initiate or adopt the necessary changes in business strategies etc. should be removed. Removal in this case would be in the best interest of society as well as the shareholders. The more difficult it is to remove management, the more society and shareholders will suffer due to the lack of flexibility of the company. If it is impossible for shareholders to intervene, the ultimate result may be that the company "loses the race", and society suffers loss of jobs and revenues.

There is another aspect of the competitiveness issue that should be borne in mind. If investors lose faith in the shares of Danish companies because they do not believe that such companies will remain competitive, the stock market will lose its attraction to investors. This will lead to smaller amounts of money being invested in Danish shares, which, in turn, means that the funds raised through the stock market will be more expensive to the companies.

Both society and shareholders of a company thus have a common interest in the shareholders retaining the right to effect removal of and thereby motivate management to keep alert.

The question remains, however, if contested takeovers have "side effects" which cannot be reconciled with the interests of society. Since there is hardly any doubt that the above mentioned motivating effects of contested takeovers also benefit society, the following discussion can be narrowed down to evaluating if there are particular drawbacks connected to contested takeovers, which are unacceptable when compared to the advantages connected to the concept.

There are scenarios where the effects of a given contested takeover are difficult to assess. The consequence of some contested takeovers may be the closing down of plants and factories, the laying off of employees, the elimination of one of the suppliers in a market and the loss of a taxpayer.

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At first blush, such consequences may appear always to be negative, seen from society's viewpoint. However, if viewed in the context, the closing down may be a part of a desirable development towards more competitive undertakings. Frequently, companies that are shut down are the weaker participants in the "race" and, therefore, may be in a position where they would under all circumstances be forced to give up within a not too distant future.

In many cases the loss of jobs as a consequence of the closing down of a factory will be counterbalanced by new jobs created with other companies in the business that can now increase their market share. In other cases there is little doubt that jobs will be lost and no new ones created.

A similar picture may be drawn with respect to the revenues that society loses in connection with a company going out of business. If other companies pick up the activities of the company that has been shut down, society may at the end of the day receive unchanged revenues. If, on the other hand, e.g. a foreign competitor has acquired the company in order to shut it down, it is not at all certain whether the country will be able to recoup the loss of revenues.

Sometimes the purpose of an acquisition is to obtain a profit by selling certain undervalued assets of the company after the acquisition. Among the assets of a company may be real property, the value of which is not fully reflected in the price quoted for the company's shares. By selling the property, the acquiror may reap the benefits from such "hidden" values. If the mere purpose of the acquisition is to gain access to undervalued assets, the question is if this is in society's interest. Sometimes the company will continue its operations, and in other events the company will be closed down and the employees laid off. It is impossible to tell if, in general, society will benefit from such transactions, which in some cases will allow undervalued assets to be employed for better purposes and in other instances will merely harm the interests of society.

The fact that a contested acquiror will have to pay a premium price for the target-shares will, ordinarily, be a strong incentive for him to exploit the potential of the target-company in the best possible fashion in order for his acquisition to make sense from a business point of view. Frequently, this will lead to a more efficient use of the capital invested in the target-company. On the other hand, not all contested acquisitions are likely to lead to such increased efficiency. The desire by some managers to build empires may sometimes lead to acquisitions that do not carry with them any benefits for society.

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Some acquisitions may constitute a step towards concentration in the particular line of business where the target-company operates. This may be the case if one competitor attempts to eliminate another by acquiring the latter and, upon the acquisition, closing down its operations. Concentration frequently harms consumers, who will be facing increased prices once competition is reduced or has ceased to exist.

The examples discussed here serve to illustrate the point that contested takeovers, despite their motivating effect on management, sometimes have side effects that are extremely difficult, if not impossible, to evaluate, but which, at least in some instances, probably do not coincide with the interests of society.

The important point is, however, that this is not an inherent or typical feature of contested takeovers. Any corporate acquisition, be it "friendly" or contested, may lead to loss of jobs, closing down of factories, loss of revenues for society, etc. Also, the creation of concentrations or monopolies may be founded upon friendly just as well as contested acquisitions. There are numerous examples of friendly corporate acquisitions that have had one or more of these consequences. This has not given rise to demands to outlaw friendly acquisitions.

The fact that contested and friendly acquisitions are not different in this regard may be illustrated by referring to a statement made by the President of the United States' Council of Economic Advisers that reads:

"Although extensive research has established that takeovers tend to be beneficial, not every takeover is successful in attaining its originally contemplated benefits, and there are many examples of takeovers that, in hindsight, appear to have been misguided. Takeovers should not, however, be singled out in this regard because investments in physical plant, research and development, petroleum exploration, and numerous other activities also often appear misguided in hindsight."³⁶

Since there is no reason to believe that contested takeovers, in general, have more harmful side effects than friendly acquisitions, there is no basis for concluding that it would be in society's interest to rule out contested takeovers. On the contrary, the point still stands that society and shareholders have a common interest in the beneficial effects connected to contested acquisitions. Both shareholders and society should support a corporate environment that creates the best possible conditions for companies to adapt to changes in the business world. Contested takeovers are

³⁶ See *Economic Report of the President* p. 191 (February 1985).

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one of the remedies available and society has no interest in preventing this remedy from being used.

This is not meant to suggest that any company whatsoever should be subject to takeovers. Some companies, in particular public utilities, have special tasks where security of supply or the defense of the country play a role. For such companies it makes little sense merely to discuss a maximization of the value of the shareholders' investment. As to these kinds of special companies it may sometimes seem appropriate to have special laws that prevent contested acquisitions. The advisability of having such laws was illustrated when a foreign acquiror in the spring of 1989 attempted to acquire control of the semi-public utility SEAS, see also XIII.4.3.

The focal point is not how to prevent contested acquisitions but how to create a "level playing field" that allows shareholders to decide on the fate of a contested takeover attempt but also protects the interests of the shareholders, including, in particular, minority shareholders.

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1. Danish law

1.1. Introduction – Danish sources and basic structure of regulation.

In the following, the term “takeover regulation” is used to describe the regulation of the takeover process itself, i.e. the acquisition of shares of a company for the purpose of obtaining control, and the possible responses by the target-company. Regulation which does not directly govern takeovers but which, nevertheless, may affect the possibilities of making takeovers or adopting defensive means, is not included in the term in the sense it is used here. Consequently, for example, tax law and trade regulation fall outside the designation.¹

While statutory provisions within a variety of different areas of law have an impact on the possibilities to make contested takeovers, no specific statutory provisions exist that directly govern (contested) takeovers. The Companies Act² does, however, include provisions which create certain limits for the fashion in which a takeover or defensive strategy may be structured. Companies listed on Denmark’s sole stock exchange, the Copenhagen Stock Exchange (“Københavns Fondsbørs”), are also governed by the Act on the Copenhagen Stock Exchange (“Lov om Københavns Fondsbørs”)³ as well as the orders promulgated pursuant to the Act. The Stock Exchange Act contains the principal provisions applicable to the Copenhagen Stock Exchange, including regarding the purpose of the exchange, its organization and business as well as listing requirements and admission to participate in the trade on the Stock Exchange.⁴ The detailed

¹ However, issues relating to those two fields of law are briefly dealt with under IX. and XII., respectively.

² See the Act on Public Companies (“Aktieselskabsloven”), Consolidation Act No. 434 of June 20, 1989, amended by Act No. 308 of May 16, 1990, and Act No. 289 of May 8, 1991. Under Danish law undertakings may be incorporated either in the form of an “aktieselskab” (A/S), i.e. a public company, or as an “anpartsselskab” (ApS), i.e. a private company. Only an A/S can have its securities listed.

³ Consolidation Act No. 536 of September 8, 1988, as amended by Act No. 290 of May 8, 1991, hereinafter referred to as the “Stock Exchange Act”.

⁴ The Stock Exchange Act, § 39, also contains a prohibition against insider trading, see also Rule 5 of the Stock Exchange Rules of Ethics. On January 23, 1991, the

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listing requirements and regulation of stock exchange trading are found in a number of orders issued by the Ministry of Industry pursuant to § 40 of the Stock Exchange Act.

On October 18, 1990, the Finance Inspectorate ("Finanstilsynet", see below) issued the following orders: (1) Order No. 706 on the Copenhagen Stock Exchange, hereinafter referred to as the "Main Order"; (2) Order no. 707 on the conditions for admission to the official listing of securities at the Copenhagen Stock Exchange, hereinafter referred to as the "Order on Listing Requirements"; (3) Order No. 708 on the conditions for admission for listing of small and medium-sized companies on stock market III, hereinafter referred to as the "Stock Market III Order"; and (4) Order No. 709 on the requirements for the prospectus to be published before securities may be admitted for official listing at the Copenhagen Stock Exchange, hereinafter referred to as the "Prospectus Order".

Orders Nos. 707, 708 and 709 are by and large identical with orders Nos. 813, 814, and 815, all dated November 13, 1986, which, in turn, are by and large based on the principles found in Orders Nos. 526, 528, and 527, respectively, all dated November 10, 1983. Order No. 706 is basically identical with Order No. 812 of November 13, 1986, which introduced several new provisions dealing with, inter alia, the organization of the Copenhagen Stock Exchange as well as with stockbroker companies. The reform that created the basis for the current regulation of the stock market is discussed by Kåre B. Dullum in *National-økonomisk Tidsskrift*, No. 1/1986, p. 77 ff. See also *Stock Exchange Reform*, report prepared by a committee established by the Ministry of Industry, October 1985. For a discussion of the legal aspects of public offerings at the Copenhagen Stock Exchange, see Eskil Trolle, *Ugeskrift for Retsvæsen* 1984.B249.

§ 40, item 11, of the Stock Exchange Act contains an authority to the Ministry of Industry granting the Ministry the right to promulgate rules regarding disclosure obligations in connection with acquisition of shares as part of a takeover. So far the Ministry of Industry has not used this authority. Effective from July 1, 1991, a new provision has been inserted in the Companies Act for the purpose of authorizing the Ministry to imple-

Ministry of Industry tabled a bill (No. L85) in the Danish Parliament which would alter § 39 and add to this provision a number of new provisions in the Stock Exchange Act governing insider trading. The principal scope of the bill is to implement the EEC Directive on coordination of insider trading regulation, dated November 13, 1989 (1989/592/EEC). For a discussion of insider trading under Danish law, see Erik Werlauff & Per Schaumburg-Müller in *Ugeskrift for Retsvæsen* 1988.B73 and Poul Erik Skaanning-Jørgensen in *Revision & Regnskabsvæsen* No. 8/1987, p. 10.

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ment (parts of) the EEC-Directive on disclosure of major stock transactions (see 1.2. below and VII.1.2.1.), cf. § 28 c.

The Copenhagen Stock Exchange is an independent ("selvejende") institution managed under the supervision of a board that lays down the policy of the Exchange, while a management handles the day-to-day business.⁵ The Stock Exchange is monitored by the Finance Inspectorate, a governmental agency under the supervision of the Ministry of Industry.⁶

§ 12 of the Stock Exchange Act contains an authorization for the Board of the Copenhagen Stock Exchange to issue rules on disclosure obligations for issuers, rules of ethics as well as rules regarding the organization, function and application of the trade systems and the information system. Of particular interest in this context is the Board's adoption on November 3, 1987 of the Stock Exchange Rules of Ethics and rules on Information Obligations for Issuers of Listed Securities.⁷ These two sets of rules create the main body of regulation pertaining to takeovers in Denmark. In addition, customs and usages, referred to in the introduction to the Rules of Ethics as "good stock exchange custom", may be of relevance for the construction and interpretation of the rules issued by the Board of the Copenhagen Stock Exchange.

The Board of the Stock Exchange must see to it that issuers of listed securities and stockbroker companies comply with the Stock Exchange Act, the orders promulgated by the Ministry of Industry, and the Stock Ex-

⁵ See § 5, Subsections 1 and 2 of the Stock Exchange Act.

⁶ For the sake of convenience, the designation "Finance Inspectorate", rather than the official term "Supervisory Authority of Financial Affairs" is used here. The duties of the Finance Inspectorate are set forth in Chapter 10 of the Stock Exchange Act.

⁷ The Rules of Ethics and the Information Obligations for Issuers of Listed Securities came into force on January 1, 1988, and replaced the initial rules of ethics which had been adopted in 1979. The Rules on Information Obligations for Issuers of Listed Securities were amended on January 24, May 23, and June 20, 1989. Updated versions of both sets of rules were issued in August 1989. However, on March 2, 1990, both sets of rules were amended again. The new rules and their history are presented by Poul Erik Skaanning-Jørgensen, Erik Bruun Hansen & Lene Nielsen in *Revision & Regnskabsvæsen* No. 3/1988, p. 33 ff. Of lesser interest in this context is the adoption by the Board of the Copenhagen Stock Exchange of rules regarding the deliverability of bonds.

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change Rules of Ethics, cf. § 10, items 4 and 5 of the Stock Exchange Act.⁸

The Board of the Stock Exchange may order the board, the managers or the auditors of a stockbroker company or of a listed company to provide information regarding such company necessary to ensure compliance with the Act, the orders promulgated pursuant to the Act and the rules issued by the Board of the Stock Exchange, cf. § 13, Subsection 2.

Violations of the Act as well as orders issued pursuant to the Act and the rules issued by the Board of the Copenhagen Stock Exchange, must be reported to the Finance Inspectorate, cf. § 13, Subsection 1, of the Act.

While § 44, Section 4, of the Act states that orders promulgated by the Ministry of Industry pursuant to the Stock Exchange Act may provide for enforcement by means of fines, no penalties are directly provided for with respect to violations of the rules issued by the Board of the Copenhagen Stock Exchange. However, pursuant to § 46 of the Stock Exchange Act, the Finance Inspectorate may order issuers or stockbroker companies to comply with the rules issued by the Board of the Stock Exchange. § 46 presupposes that attempts are made to bring violations to an end by means of negotiations before an order is given. Typically, negotiations will be conducted by the Board of the Stock Exchange in the first place, while the Finance Inspectorate comes into the picture if the preliminary negotiations do not lead to a satisfactory solution. Failure to comply with an order by the Finance Inspectorate may be penalized by fines according to § 44, Subsection 3, of the Stock Exchange Act. Also, the Inspectorate may compel the board, managers or auditor of an issuer or stockbroker company to follow its orders by means of daily or weekly fines, see § 45. Consequently, even violations of the rules issued by the Board of the Stock Exchange may be punished, albeit indirectly only.⁹ It is noteworthy, however, that the penal system described here only aims at violations by issuers and stockbroker companies and not others, e.g. acquirors of shares.

If it is deemed to be desirable, the Finance Inspectorate may publicize orders issued by the Inspectorate. Another means is the right for the Board of the Stock Exchange and the Inspectorate to express their criticism publicly. Finally, the Inspectorate may take a more drastic step and sus-

⁸ Although no separate reference is made in § 10 to the Information Obligations for Issuers of Listed Securities, the Board also has to ensure compliance with these rules.

⁹ This two-tier penal system resembles the system set forth in Chapter 6 of the Act on Good Marketing Practices ("Markedsføringsloven").

pend or discontinue the listing of an issuer's securities on the Stock Exchange, cf. § 46 of the Act.

Decisions made by the Copenhagen Stock Exchange under the Act may be appealed to the Finance Inspectorate within 4 weeks.¹⁰ Decisions made by the Inspectorate cannot be appealed to any other administrative authority, however, "questions of law"¹¹ may be submitted to the Ministry of Industry's Appeal Board ("Industriministeriets Erhvervsankenævn") within another time limit of 4 weeks. Any decision made by any of the above mentioned entities can be brought before the ordinary courts within 8 weeks after the decision has been made.¹²

1.2. EC Regulation. As Denmark is a member of the EC, EC law is relevant when considering Danish law. Provisions under EC law may either be directly binding upon citizens in Denmark (regulations) or impose on member states a duty to enact national legislation for the implementation of the EC rules (directives).

The EC-Commission has on several occasions stated that it considers mergers and acquisitions within the European Communities as a vehicle to increase the efficiency of European business and achieve increased economic growth that can satisfy the needs required to complete the internal market.¹³

Making European business more competitive is one of the key issues in the "1992-program" that has the purpose of revitalizing the industry of the EC-countries.¹⁴ The creation through mergers and acquisitions of larger

¹⁰ Cf. § 43, Subsection 1, of the Stock Exchange Act. Compare the corresponding provision in § 159 c, Subsection 1, of the Companies Act regarding decisions by the Stock Exchange pursuant to rules issued on the basis of the authority in § 28 c of that Act.

¹¹ The test whether or not a matter includes questions of law is likely to be a difficult one. Most problems contain legal aspects of some kind, but how much is required in order to create the basis for appeal? See the identical rule in § 159 c, Subsection 2, of the Companies Act.

¹² See § 43, Subsection 3, of the Stock Exchange Act.

¹³ See "*Completing the Internal Market*", White Paper from the Commission to the European Council, June 1985, p. 36, item 143 and p. 5, item 8.

¹⁴ The signing by the EC-countries in February 1986 of the Single European Act, which came into force on July 1, 1987, and constitutes an addendum to the Treaty of Rome, has created the legal basis for a coordination of the industrial policy within the EC-countries. Article 130 f of the Single European Act states, inter alia, that the aim of the Community shall be to strengthen the scientific and technological basis of European industry and to encourage it to become more

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business entities is considered crucial in connection with the competition from other parts of the world, in particular the United States and Japan. Prior to the preparation of the Commission's White Paper on the completion of the EC internal market the EC-Commission, in a report on the competitiveness of European industry said that the current concern "over the competitiveness of Community industry arises from a widely held but vague general feeling that the Community is in danger of "losing the race"".¹⁵

As will be seen later, the existing Danish regulation of takeovers only deals with part of those problems that are connected to takeover activity. The reason for this is probably in part that it is expected that regulation will take place at the EC-level of the takeover process.

In September 1990, the EC-Commission issued a proposal for a 13th Council Directive on "Company law concerning takeover and other general bids".¹⁶

One of the fundamental principles of the Draft Takeover Directive is that all shareholders of a target-company who are in the same position receive equal treatment. Also, they must have the opportunity to make an informed assessment before deciding whether to accept a takeover offer. Target-management must act in the interest of all shareholders and may not frustrate a bid. Moreover, the Draft Takeover Directive seeks to avoid "false markets" for shares of any of the companies involved in the bid and restrictions in the target-company's conduct

competitive at the international level. Pursuant to Article 130 f one of the means by which this goal should be achieved is to enable undertakings to exploit the Community's internal market potential fully by removing legal and fiscal barriers among the EC-countries.

¹⁵ See EC-Commission, Dossier, *The Competitiveness of the Community Industry* p. 7 (1982).

¹⁶ COM (90) 416 Final – SYN 186, Brussels, September 19, 1990. Although it is not unlikely that the text of the draft mentioned here will be changed in the final version of the directive, the draft will be commented on where relevant throughout this book. The proposed directive is hereinafter referred to as the "Draft Takeover Directive". The Draft Takeover Directive must, in order to be effective, be adopted by the EC-Council. The Stock Exchange Act, § 40, item 16, contains an authority for the Ministry of Industry to implement EC legal provisions on stock exchange issues. Earlier versions of the Draft Takeover Directive, of which the first was prepared in 1987, are discussed in *Business Europe*, January 9, 1989, p. 4, *Securities Regulation & Law Report*, January 6, 1989, p. 26, *BNA's Corporate Council Weekly*, January 4, 1989, p. 5, and *Financial Times*, December 23, 1988, p. 1.

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of business beyond a reasonable time due to the occurrence of offers. See generally the preamble and Articles 6a, 7, 8, 10, 12, 16 and 17 of the Draft Takeover Directive. The Draft Takeover Directive is probably meant to provide a minimum level of regulation, and it hardly affects the member states' rights to maintain or introduce more far-reaching or detailed provisions in their national laws, insofar as such provisions further the principles contained in the directive. Member states are required to designate a supervisory authority or authorities that must monitor compliance with the rules of the directive, see Article 6 of the Draft Takeover Directive. It is likely that the Danish Finance Inspectorate would be the supervisory authority in Denmark designated pursuant to Article 6. In that case it should be expected that a number of the functions of the Finance Inspectorate will be delegated to the Board of the Copenhagen Stock Exchange, which would be possible under the directive. The scope of the Draft Takeover Directive is restricted to takeover or other general bids (as defined) for the securities (as defined) of listed companies, cf. Article 1(1). If adopted in its present form, the Directive would have to be transposed into national law by January 1, 1992, such national laws to come into force no later than January 1, 1993, cf. Article 22(1) and (2). The particular provisions of the Draft Takeover Directive will be discussed below in connection with the discussion of the various subject matters under Danish law.

On December 12, 1988, the EC-Council adopted a directive on the information to be published when a major holding of shares of a listed company is acquired or disposed of.¹⁷

The purpose of this directive is to create increased "transparency" in connection with transfer of major stockholdings. Member states were obligated to take the measures necessary for them to comply with the directive before January 1, 1991, see Article 17(1), of the directive.

There is another directive, or rather draft directive, which, if adopted, would be of relevance in this context. The draft fifth company law directive on the structure and organization of public companies¹⁸, *inter alia*, deals with the right for companies to issue low-vote and no-vote shares. Also, the Draft Fifth Directive would regulate the use of proxies.

¹⁷ Council Directive 88/627/EEC of December 12, 1988, hereinafter referred to as the "Disclosure Directive".

¹⁸ This directive has been on its way for several years but because of, among other things, disagreement on the role of employees (Britain on one side and Continental European countries on the other), no directive has been adopted so far. The draft dealt with here is the amended proposal submitted by the Commission to the Council on August 19, 1983 (see O.J. No. C 240/2 of 9.9.1983) as amended again in December 1990, cf. COM (90) 629 Final – SYN 3, Brussels, December 13, 1990, hereinafter referred to as the "Draft Fifth Directive".

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The development at the EC-level discussed here has been accompanied by changes in national laws affecting mergers and acquisitions in a number of European countries. For example, Great Britain and France have relaxed their regulation of the financial markets. Other countries have followed or should be expected to follow. Generally, the EC-Commission has responded favorably to this deregulation at the national level. However, there is no doubt that the EC-Commission envisages that the national deregulation will be replaced, at least to a certain extent, by EC regulation.

1.3. Preliminary observations. One of the characteristics of Danish regulation within the corporate acquisition area is the role played by the Board of the Copenhagen Stock Exchange. In addition to supervising the existing rules, the Board has adopted, and from time to time changes, the prime source of regulation, i.e. the Stock Exchange Rules of Ethics and the rules on Information Obligations for Issuers of Listed Securities.

The fact that the Board itself issues and administers the rules, seen in conjunction with the fact that the statutory framework leaves considerable discretion with the Board in connection with the operation of the Stock Exchange, gives the persons and companies dealing with or at the Stock Exchange a legal position that is quite different from what would be the case if a more detailed framework by means of statutes existed.

Another feature of the takeover regulation is the (indirect) penal system.

Before evaluating the implications of the choice of regulation made in Denmark, it is useful to consider in what ways takeovers are regulated in other jurisdictions.

2. The United States

In the United States, contested takeovers are regulated on the federal as well as on the state level.

On the federal level issuance and distribution of securities are governed by statutory provisions enacted by the federal government. In addition, the Federal Securities and Exchange Commission, SEC, has issued a number of regulations, forms and releases on the basis of authorizations given in the federal legislation. SEC is the federal executive agency in charge of monitoring the federal securities regulation and policing violations thereof.

The federal regulation of issuance and distribution of securities is primarily found in the Securities Act of 1933 (15 U.S.C. §§77 a ff.) and the Securities Exchange Act of 1934 (15 U.S.C. §§ 78 ff.) as well as regulations issued by the SEC pursuant to authorizations in the two Acts. The 1933-Act requires informa-

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tion to be filed with the SEC and disseminated to potential investors whenever a public distribution of securities is being made by issuers or controlling persons of issuers. The 1934-Act requires disclosure on a continuing basis with the purpose of facilitating trading in the securities on the basis of current information. In addition, the 1934-Act requires disclosure on the occasion of particular transactions about which it is deemed appropriate to inform the investors. Two particular features of the legislation within this area should be emphasized: firstly, as a general rule all securities must be registered with the SEC prior to sales to the public, see the 1933-Act, § 5; secondly, quite elaborate disclosure obligations apply to sales or other dispositions of securities. Both the 1933-Act and the 1934-Act contain provisions dealing with insider trading, cf. in particular § 17 of the 1933-Act and §§ 10(b) and 16 of the 1934-Act. Cf. also Rule 10 b-5, issued by the SEC pursuant to § 10(b) of the 1934-Act. In addition to the above Acts, a number of federal laws have been enacted, which deal with particular securities transactions or securities issued by particular issuers, see for example the Investment Company Act of 1940 (15 U.S.C. § 80 a-1 ff.). For a discussion of the SEC's role in connection with international corporate acquisitions, see Daniel Goelzer, Robert Mills, Catharine Gresham & Ann H. Sullivan, *The Role of The U.S. Securities and Exchange Commission in Transnational Acquisitions*, 22 *The International Lawyer* 615 (1988).

During the 1960'es, tender offers became more and more common, and in 1968 the federal legislature decided to add new provisions to the existing rules in the Securities Exchange Act of 1934 with the purpose of, i.a., protecting the shareholders of the target company who at that point in time very often had to decide whether to accept an offer for their shares under a considerable time constraint and often on the basis of only limited information.¹⁹ The amendment, known as the Williams Act, includes provisions applicable to all share acquisitions as well as provisions which apply to tender offers only.²⁰

All the North American States have adopted so-called "Blue Sky Laws", i.e. state laws dealing with issuance and distribution of securities as well as takeovers in that state.

The designation "Blue Sky Laws" originates from Kansas' adoption of the first law of this nature in 1911. The purpose of the law was to protect local farmers against shrewd businessmen who would try to sell to the farmers securities, which, in fact, were secured by little more than the blue sky. Nowadays the term also comprises state laws with the purpose of avoiding abusive tactics in con-

¹⁹ See Section 13(d)-(e) and 14(d)-(f). The amendment of the Securities Exchange Act of 1934, Pub. L. No. 90-439, 82 Stat. 454, has been codified as 15 U.S.C. §§ 78 m (d)-(e), 78 n (d)-(f).

²⁰ See VII.2. for a further discussion of this distinction.

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nection with contested takeovers. Apart from the state regulation of contested takeovers, the securities regulation found in the state laws are less restrictive than the federal securities laws.

The state statutes on takeovers are ordinarily found in each state's corporation statute, which applies to companies incorporated in such state. In addition, several state statutes dealing with, i.a., banks, investment companies and insurance companies provide special regulation of takeovers involving such businesses.

Moreover, the American stock exchanges, including the New York Stock Exchange, have issued a number of rules pertaining to listing and trading on the stock exchanges. The majority of the rules issued by the stock exchanges are less restrictive than the federal legislation.

As the federal laws and rules are the most extensive and detailed, the emphasis in this book will be on the federal regulation.

For a discussion of the Williams Act, see Thomas Lee Hazen, *The Law of Securities Regulation* p. 336 ff. and Robert Charles Clark, *Corporate Law* p. 546 ff.

3. Great Britain

The current British corporate statute, the Companies Act 1985, as amended by the Companies Act 1989, only contains few provisions of importance for contested takeovers.²¹

Most of the rules that are relevant for contested takeovers are found in The City Code of Take-overs and Mergers (the "City Code") and The Rules Governing Substantial Acquisitions of Shares ("SAR"). Both these

²¹ British company law acknowledges public as well as private companies. While public companies – known as public limited companies (plc) – must have an authorized minimum allotted nominal capital of £ 50,000 and must have a minimum of two directors, no minimum capital requirement applies to private companies (where the limited liability is indicated with the word "limited" at the end of the name). Moreover, private companies must only have one director. There are a number of other distinctions between the public and the private company that will not be addressed here. Since private companies cannot offer shares to the public for subscription according to Section 81 of the Companies Act, the use of the word "company" in the following is restricted to public companies.

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sets of rules have been issued and are administered by The Panel of Takeovers and Mergers ("The Take-over Panel")²².

The City Code contains 10 general principles that have the nature of standards for good business practice, and 38 rules which partly serve to explain the contents of the general principles and partly stipulate in detail the takeover procedure. In the event that the use of the general principles and the use of the rules would lead to different results, the general principles must be applied.

Former versions of the two sets of rules were issued by the Council for the Securities Industry, which, however, was dissolved on March 31, 1986. Revised versions of both sets of rules were published in January 1988, but since then additional revisions have been made.

The Take-over Panel is headed by a chairman and a deputy chairman who are appointed by the Governor of the Bank of England, who also appoints a further non-representative member. In addition, membership of The Take-over Panel comprises representatives of a variety of bodies that all have an interest in a proper regulation of takeovers. The following bodies are represented on The Take-over Panel: The Association of British Insurers, The Association of Investment Trust Companies, The British Merchant Banking and Securities Houses Association, The Committee of London and Scottish Bankers, The Confederation of British Industry, The Financial Intermediaries, Managers and Brokers Regulatory Association, The Institute of Chartered Accountants in England and Wales, The International Stock Exchange, The Investment Management Regulatory Organization, The National Association of Pension Funds, The Securities Association, and The Unit Trust Association, cf. the introduction to the City Code, 2(a).

The Take-over Panel's day-to-day operations are managed by its executive, headed by the Director General, see the introduction to the City Code, 2(b).

Neither the City Code nor the SAR are statutes. Rather, they are rules voluntarily accepted and adopted by the business community. The powers that have been vested in The Take-over Panel are based on a cooperation and acceptance from the parties that constitute The City of London. Due to this lack of statutory basis, the panel has only limited means by which to sanction violations of the City Code and the SAR. However limited The Take-over Panel's possible sanctions may seem, they have proven quite efficient. At various occasions where it was deemed necessary, the panel has issued public statements or expressed criticism in connection with takeover battles. The parties subject to criticism virtually always follow the panel's views.

²² For an exposition of the background for the creation of The Take-over Panel, see Peter Frazer, *The Regulation of Takeovers in Great Britain*, in Knights, Raiders, and Targets p. 436 ff.

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In this connection it should be noted that the Bank of England, The International Stock Exchange and other British associations as well as governmental authorities assist The Take-over Panel in policing the rules. One of the means by which The International Stock Exchange may sanction violations of e.g. the City Code is by delisting the shares of a company. The extralegal sanctions include denial of the use of facilities of British brokerage houses. This support that the panel receives from associations and authorities is reflected in the introduction to the City Code where under 1(c) it reads:

“The Code has not, and does not seek to have, the force of law. It has, however, been acknowledged by both government and other regulatory authorities that those who seek to take advantage of the facilities of the securities markets in the United Kingdom should conduct themselves in matters relating to takeovers in accordance with best business standard and so according to the Code.

Therefore, those who do not so conduct themselves may find that, by way of sanction, the facilities of those markets are withheld.” .

If a party is in doubt about the interpretation or construction of the City Code or the SAR, he may – and according to the Code he should – consult the executive of The Take-over Panel in advance.

The Code encourages both principals and their advisors to make full use of this service. It is even stated that taking legal or other professional advice on the interpretation or application of the Code is not an appropriate alternative to obtaining a view or ruling from the executive.²³

A party that does not agree to the ruling or statement made by the executive may ask for the matter to be reviewed by the panel.²⁴ In practice, this is very rarely seen. If the executive of The Take-over Panel deems that a matter is particularly unusual, important or difficult, he may refer such matter to the panel for decision without giving a ruling.²⁵ In special cases where the panel e.g. finds a breach of the Code and proposes to take disciplinary action, or where it is alleged that the panel has acted outside its jurisdiction, the matter may be appealed to a special Appeal Committee.²⁶

Recently it was established that rulings by The Take-over Panel are subject to review by the courts, cf. *R. v. Panel on Take-overs and mergers*,

²³ The introduction to the City Code, 3(b).

²⁴ The introduction to the City Code, 3(c).

²⁵ See the introduction to the City Code, 3(b).

²⁶ See the introduction to the City Code, 3(f). The Take-over Panel's day-to-day operations are described by Peter Frazer, *The Regulation of Take-overs in Great Britain*, in *Knights, Raiders, and Targets* p. 436 ff. at 438 ff.

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*Ex Parte, Datafin plc.*²⁷ However, the courts have taken the stand that, unless the position of the panel is clearly wrong or unfair, the courts will not intervene in concrete matters that are before the panel. Ordinarily, the role to be played by the courts will be limited to a subsequent review of the panel's rulings in order to avoid repetition of doubtful or wrong decisions. Moreover, the courts will review disciplinary sanctions imposed by the panel.

In short, the courts generally prefer to cooperate with The Take-over Panel rather than intervening in matters pending before the panel.

In *R.v. Panel on Take-overs and mergers, Ex Parte, Datafin plc*, the court of appeal, inter alia, stated²⁸: "I should expect the court to allow contemporary decisions to take their course, considering the complaint and intervening, if at all, later and in retrospect by declaratory orders which would enable the panel not to repeat any error and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules. This would provide a workable and valuable partnership between the courts and the panel in the public interest ..."

Generally, the British regime governing takeovers is considered to operate smoothly and satisfactorily.²⁹

As is the case in Denmark, Great Britain only has one stock exchange, The International Stock Exchange.³⁰ The International Stock Exchange has issued what is known as the "Yellow Book", officially referred to as the "Admission of Securities to Listing". The Yellow Book contains rules for listing of shares as well as trade on the Exchange. With respect to the takeover process itself, the Yellow Book chiefly implements the City Code and the SAR by reference.

The principles laid down in and the background for the City Code and the SAR are described by M.A. Weinberg, M.V. Blank and A.L. Greystoke, *On Take-overs and Mergers*. See also Sir Alexander Johnston, *The City Take-over Code*.

²⁷ (1987) 2 W.L.R. 699 (C.A.).

²⁸ (1987) 2 W.L.R. 699 at 718 (C.A.).

²⁹ See, for example, Peter Frazer, *The Regulation of Takeovers in Great Britain*, in *Knights, Raiders, and Targets* p. 436 ff. at 440. For a criticism of the use of non-statutory rather than statutory regulation, see Robert Falkner, *Non-statutory Takeover Panel: Advantage or Anachronism?*, *International Financial Law Review*, p. 15 ff. (February 1990).

³⁰ However, The International Stock Exchange has a number of departments at different locations in Great Britain.

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4. France

The French Companies Act ("Loi sur les Sociétés Commerciales")³¹ contains various provisions of relevance for contested takeovers, but by far the most detailed and elaborate regulation is found in rules issued by authorities and other bodies that also monitor the observance of such rules.

In 1967, the Commission des Opérations de Bourse (COB) was established, in part inspired by the American SEC.³² The COB is an administrative authority that has as one of its tasks to monitor and control that shareholders and the public receive correct, relevant and sufficient information regarding securities and security transactions.³³ The COB must also ensure that the French stock exchanges are operating satisfactorily³⁴, and to this end it has issued rules regarding the stock exchanges. Moreover, the COB supervises the stockbrokers and has powers to issue rules pertaining to corporate acquisitions.³⁵ Of special interest in this connection are the rules on public offers and acquisitions of controlling holdings of shares ("Règlement No. 89-03 de la Commission des Opérations de Bourse relatif aux offres publiques et aux acquisitions de blocs de contrôle")³⁶.

In contrast to its model, the SEC, the COB has a more limited field of responsibility and – until 1989 – had very limited powers. The latter fact was changed as a result of an Act adopted on August 2, 1989³⁷, after the occurrence of a couple of financial scandals which gave rise to concerns regarding investor protection. In addition to containing provisions on dis-

³¹ Act No. 66-537 of July 24, 1966, as amended on companies ("Sociétés"). The Act has been supplemented by various decrees and ordinances. By far the majority of listed companies in France are "sociétés anonymes" (abbreviated as S.A.). For this reason the following comments will be limited to sociétés anonymes that have features which correspond to those of the Danish "aktieselskaber".

³² See Ordinance 67-833 of September 28, 1967, as amended ("1967-Ordinance").

³³ Article 3 the 1967-Ordinance.

³⁴ Article 1 of the 1967-Ordinance

³⁵ 1967-Ordinance, Article 4-1.

³⁶ The rules – hereinafter referred to as the "COB-rules" – have been confirmed by Arrêté of September 28, 1989.

³⁷ Act No. 89-531 of August 2, 1989 on protection and transparency in the financial market ("sur la sécurité et la transparence du marché financier") (hereinafter "the 1989-Act"). The 1989-Act changed the provisions of a number of laws and ordinances, including the 1967-ordinance.

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closure of share transactions and on takeover offers, the 1989-Act thus strengthened the structure and boosted the powers of the COB.³⁸

The COB has powers to impose on a listed company the obligation to provide additional or correcting information to the public to ensure a complete and fair picture of the company.³⁹ To further enforce the body of regulations monitored by the COB it may, inter alia, initiate and conduct investigations. Also, the COB may, with the assistance of the courts, issue injunctive relief or seize property of violators. The powers of the COB also include the right to fine violators with up to 10 million francs or 10 times the profits made.⁴⁰

The so-called "Stock Exchange Council" ("Conseil des bourses de valeurs")⁴¹ monitors that transactions regarding listed securities take place in accordance with the relevant rules. The Stock Exchange Council has authority to approve the proposed payment in connection with public offers.⁴² Moreover, the Stock Exchange Council has powers to suspend trading of securities, powers which the Council has delegated to the

³⁸ See Chapter I of the 1989-Act on these changes regarding the COB. The strengthening of the COB's structure included an increase of the number of members from 5 to 8 and a change of the right to nominate members to the COB so that not only government representatives but also representatives from various other sectors may have an influence on the COB, cf. Article 1.

³⁹ 1967-Ordinance, Article 3.

⁴⁰ See Articles 2 to 11 of the 1989-Act (changing the 1967-Ordinance). The COB also cooperates with the public prosecutor in cases where criminal sanctions are involved.

⁴¹ The Stock Exchange Council is an independent body, composed of 13 members, of which 10 are appointed by stockbrokers, one is appointed by the listed companies, one is appointed by employees of the stockbrokers and the association of stockbrokers, while the last member is appointed by the Ministry of Economy, cf. Article 5 of Act No. 88-70 of January 22, 1988 (the "1988-Act"). The 1988-Act is the statutory basis on which the Stock Exchange Council rests. By the 1988-Act the Council of Brokers ("Chambre syndicale des agents de change"), was replaced by Conseil des bourses de valeurs as a part of the reorganization of the stockbroker business.

⁴² The decisions by the Stock Exchange Council may be appealed to the Paris Court of Appeals with the exception that certain questions, including disciplinary issues, must be appealed to an administrative authority, cf. the 1988-Act, Article 5(5) and Decree 88-603 of May 7, 1988, Article 2 ff.

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Stockbroker Association ("Société des Bourses Françaises"), which is responsible for the day-to-day management of the stock exchanges.⁴³

Pursuant to authority granted in the 1988-Act, the Stock Exchange Council has issued the so-called "Règlement général du Conseil des bourses de valeurs", which contains provisions governing takeovers.⁴⁴

The Ministry of Finance is charged with coordinating the regulation of contested takeovers and ensuring that the exchange and merger control regulation is complied with. Representatives of the Ministry of Finance, the COB and the Stock Exchange Council meet and discuss questions pertaining to takeovers within the framework of the so-called "Takeover Supervisory Board" ("Comité de Surveillance des Offres Publiques d'Achats").

The French regulation of takeover offers is, inter alia, discussed by Didier Martin & Christian Persiaux in their article *La Loi du 2 Aout 1989 sur la Sécurité et la Transparence du Marché Financier*, *Option Finance*, No. 83, p. 29 ff., October 9, 1989. See also Jean-Pierre Bertrel, *La Reforme des OPA/OPE*, *Gazette du Palais*, February 28 – March 1, 1990, p. 7 ff., and Alice Pezard, *La Nouvelle Réglementation Française des Offres Publiques d'Achat*, *La Revue Banque*, No. 507, p. 675 ff., July – August 1990.

5. The Federal Republic of Germany

The chief source of takeover regulation in The Federal Republic of Germany is found in the "Guidelines on Voluntary Public Purchase Offers and Offers for Exchange" ("Leitsätze für öffentliche freiwillige Kauf- und Umtauschangebote bzw. Aufforderungen zur Abgabe derartiger Angebote in amtlich notierten oder im geregelten Freiverkehr gehandelten Aktien bzw. Erwerbsrechten"). These rules were issued in 1979 by the Exchange Experts Commission.⁴⁵ The rules are voluntary and are not issued pursuant to any statute.

⁴³ Société des Bourses Françaises replaces the former Stockbroker Association, Compagnie des Agents d'échange, as a consequence of the 1988-Act.

⁴⁴ In the following, this set of rules will be referred to as "the General Rules". On September 28, 1989, the Stock Exchange Council, among other things, added to the General Rules new provisions regarding mandatory offers, see Article 5-3-1 ff.

⁴⁵ Börsensachverständigen-Kommission beim Bundesfinanzministerium. The rules have been published in BMF-Nachrichten 6/1979 p. 1 ff.

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Unlike e.g. the United States there is no central agency which is concerned with creating a “level playing field” for investors.

While the German Stock Corporation Act (“Aktiengesetz”)⁴⁶ contains provisions that affect the making of contested acquisitions as well as defensive steps, it does not attempt to regulate the takeover process.

The Federal Republic of Germany has 8 stock exchanges, of which those in Frankfurt and Düsseldorf are the largest. Although the stock exchanges have issued rules pertaining to, inter alia, trading on the exchanges, we will have to look at the guidelines mentioned above with respect to regulation of takeovers.

The German regulation of contested acquisitions is discussed by Dr. Christoph E. Hauschka & Thomas Roth, in their article, *Übernahmeangebote und deren Abwehr im deutschen Recht*, Die Aktiengesellschaft, 7/1988, p. 181 ff. See also Peter Hommelhoff & Detlef Kleindiek, *Takeover-Richtlinie und Europäisches Konzernrecht*, Die Aktiengesellschaft 3/1990, p. 106 ff. and Marcus Lutter & Henning W. Wahlers, *Der Buyout: Amerikanischer Fälle und die Regeln des deutschen Rechts*, Die Aktiengesellschaft 1/1989, p. 1 ff.

6. The Netherlands

Although the Dutch Civil Code (“Burgerlijk Wetboek”) does contain provisions that pertain to takeovers, the prime source of takeover regulation is found in a set of rules known as the “Merger Rules” (“Fusiegedragregels”).⁴⁷ The Merger Rules were issued in 1975 by the so-called “Social Economic Council” (“Sociaal Economische Raad”)⁴⁸ and have subsequently been amended several times.

⁴⁶ Dated September 6, 1965, as amended, Federal Gazette III 4121-1.

⁴⁷ Incorporation under Dutch law may take the form of a so-called “naamloze vennootschap”, abbreviated as N.V., and corresponding to what is known under Danish law as an “aktieselskab”, or in the form of a so-called “besloten vennootschap”, abbreviated as B.V., which is the equivalent of the Danish “anpartsselskab”. Since the shares of a B.V. cannot be listed, the following comments are limited to N.V.s.

⁴⁸ A body consisting of 45 members, of which one-third represent the employers, one-third labor unions, while the remaining members are independent experts, appointed by the government. The Social Economic Council plays an important role in the legislative procedure in Holland. The council, inter alia, participates in the preparation of new laws and issues recommendations and comments in connection with questions regarding industry and trade as well as economics. In

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In spite of their name, the Merger Rules are not limited to mergers but include acquisitions of shares ("aandelenfusie").

The Merger Rules are of non-statutory nature. Nevertheless, the so-called "Merger Commission" ("Commissie voor Fusieaangelegenheden")⁴⁹, a body established by the Social Economic Council for the purpose of policing the Merger Rules, has certain means by which to "sanction" violations.

The Merger Commission may thus take the initiative to publicize any failure to observe the Merger Rules.⁵⁰ In addition, the commission may publicly criticize a company with the consequence that members of the Amsterdam Stock Exchange will refuse to cooperate with that company.⁵¹ As a practical matter, the Merger Commission will attempt to police the observance of the Merger Rules by initiating negotiations with the party or parties involved, perhaps accompanied by public statements regarding the commission's interpretation of the rules. Only if such steps do not lead to a satisfactory result, will the commission use its sanctions.⁵²

Holland's sole stock exchange, the Amsterdam Stock Exchange, an independent entity under the supervision of the Ministry of Finance pursuant to the Stock Exchange Act⁵³ has adopted two sets of rules regarding the listing and trading of securities on the Stock Exchange.⁵⁴

The Merger Rules and the role played by the Merger Commission are described and discussed by P. Sanders and W. Westbroek, *BV and NV, Het nieuwe on-*

addition, the council has been charged with certain supervisory functions under laws pertaining to special lines of business.

⁴⁹ The Merger Commission is composed of twelve members, of which four are appointed by labor unions, three by employers associations, one by the Amsterdam Stock Exchange, while the remaining four are independent persons, appointed by the Social Economic Council, cf. Article 25 of the Merger Rules.

⁵⁰ In the Merger Rules, the term "openbare kennisgeving", i.e. public statement is used, cf. Article 32.

⁵¹ Article 32 of the Merger Rules uses the term "openbare berisping", which could be translated as "public criticism" or "public sanction".

⁵² It is the prevailing view that a violation of the Merger Rules may give rise to a claim for damages although the question has not been decided by the courts, cf. Steven R. Schuet and others, *Dutch Business Law* p. 208.

⁵³ See the so-called "Beurswet" 1914.

⁵⁴ See the Stock Exchange Rules ("Fondsen Reglement (Manual), Reglement voor de Notering and Reglement voor de Effectenhandel"). Even the constitution of the Amsterdam Stock Exchange contains provisions pertaining to listing and trading of securities on the Stock Exchange.

dernemingsrecht p. 419 ff. and by P. van Schilfgrade, *Van de BV en de NV* p. 273 ff.

7. Switzerland

Until recently, no regulation existed in Switzerland dealing with takeovers. In 1989, as a response to plans about legislation regarding takeovers, the Association of Swiss Stock Exchanges adopted a Swiss Take-Over Code ("Schweizerischer Übernahme-Kodeks, Code Suisse des Offres Publiques d'Achat (OPA)"), which came into force on September 1, 1989.

Although of an extra-legal nature, the Swiss takeover code is aimed at all public offers relating to the acquisition of shares of Swiss public companies traded on the Swiss stock exchanges.⁵⁵ The Commission for Regulation of the Association of Swiss Exchanges is charged with monitoring the compliance with the Code and may take "all appropriate steps to ensure fulfilment of the Code".⁵⁶ It may in this connection publish observations, recommendations, and decisions.

In order to further implement the Code, the Commission will issue rules of procedure, particularly for the purpose of hearing the views of the acquiror and the target-company.⁵⁷

Proceedings before the Commission are expected to "be simple" and "take into account the short period within which decisions will be taken".⁵⁸ The Commission's decisions shall, in principle, be taken by a sub-committee of 3 members, however, an acquiror or a target-company may request that a recommendation or decision taken by the sub-committee be submitted to the full Commission.⁵⁹

The new Swiss Take-Over Code is briefly explained by Nedim Peter Vogt in *International Financial Law Review*, p. 46 (December 1989). For further details, see Christian J. Meier-Schatz, *Rechtliche Betrachtungen zu neueren Entwicklungen in der schweizerischen "Takeover-Szene"*, *Schweizerische Juristen-Zeitung* 4/1991, p. 57 ff. For a discussion of Swiss takeover law in general, see Rudolf Tschäni, *Unternehmensübernahmen nach Schweizer Recht* and Rolf Watter, *Unternehmensübernahmen*.

⁵⁵ See Article 2 of the Code.

⁵⁶ See Article 9 of the Code.

⁵⁷ See Rule 10 of the Code.

⁵⁸ See Article 10.1, Section 2, of the Code.

⁵⁹ See Articles 10.1 and 10.2 of the Code.

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8. Sweden

There is no statutory takeover regulation in Sweden, although the Swedish Companies Act ("Aktiebolagslagen") contains certain provisions that have an impact on corporate acquisitions.

In 1971, the Stock Exchange Committee of the Swedish Business Society ("Näringslivets Börskommitté"), which is a non-statutory body having as its members, inter alia, the Stockholm Chamber of Commerce and the Swedish Association of Industries, adopted a set of recommendations regarding, among other things, public offers for shares.

In June, 1988, a new set of recommendations was adopted by the Committee, referred to as the "Recommendation regarding Public Offers for Shares (1988)" ("Rekommandation rörande offentligt erbjudande om aktieförvärv").

As the designation suggests, the rules are entirely voluntary and merely a recommendation by the committee. Since the members of the committee represent substantial interests in Swedish business, it is likely that the recommendations, despite their nature, will have a significant influence on corporate acquisitions.

Sweden has one stock exchange, the Stockholm Stock Exchange, and, in addition, quite a large over-the-counter market. The rules issued by the organized markets for shares are of lesser importance for our purposes and will not be dealt with here.

The Recommendation regarding Public Offers for Shares (1988) may be found in the publication "*Börsregler, handlingsregler för börs och OTC*", Hägglöf & Ponsbach Fondskommission AB, Juristförlaget, Stockholm (3rd edition, 1988) p. 201 ff. An earlier version of the Recommendation (from 1971) is discussed by Jan Sandström in his article *Take-over Bids* in *Stock Exchange Law and Corporation Law*, Report from a Symposium in Lund, February 27, 1984 (Carl Martin Roos, ed.), at p. 39 ff. In February, 1991, an addendum was made to the Recommendation regarding management buy-outs, effective April 1, 1991. The aforementioned Stock Exchange Committee has also issued a Recommendation on disclosure obligations in connection with acquisitions and dispositions of major holdings of shares (issued in 1984 and amended in February, 1991).

9. Danish law – revisited

9.1 Introduction. When comparing Danish regulation of takeovers with the regulation of other countries, a somewhat varied picture emerges.

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The two countries that have known contested acquisitions for the longest time, the United States and Great Britain, have each quite extensive rules pertaining to corporate acquisitions. The United States' regulation of takeovers is chiefly found in statutory federal law and state law. In Great Britain, on the other hand, the prime source of regulation is the City Code and the SAR, i.e. voluntary rules. Among the other countries discussed, most have chosen to regulate by non-statutory means.

Statutory regulation gives rise to few problems in terms of determining the nature of the regulation. Therefore, we will focus on the use of non-statutory regulation. We have seen two types of non-statutory regulation. One type, known from e.g. Great Britain, Switzerland, and Sweden, are sets of non-statutory rules in the "purest" sense; they have been adopted by private bodies that are not established pursuant to a statute or according to rules promulgated pursuant to a statute. These rules are extra-legal.

The other concept includes rules that are not statutes but are issued by bodies established pursuant to statutes or rules promulgated thereunder. The Danish takeover regulation found in the rules issued by the Board of the Copenhagen Stock Exchange belongs to this category.

The question we want to focus on now is how we should qualify legally this hybrid between statutory and extra-legal regulation.

In the report that created the basis for the reform of the Copenhagen Stock Exchange in 1986 (dated October, 1985, prepared by a committee appointed by the Ministry of Industry), the question of the means of regulation is briefly discussed (p. 64-65). After stating (p. 64) that violation of the (then) existing ethical rules cannot lead to sanctions "in a legal sense", the report recommends that the Rules of Ethics of the Stock Exchange should, as a main rule, not be set forth in statutes. The reason for this is, according to the report, that "the usual procedures under administrative law as well as the requirements of intent or negligence, proof, penalties, etc., would then apply" (p. 65).

In the report (p. 65) the committee further recommends that the Board of the Stock Exchange and the Ministry of Industry review the (then) existing ethical rules for the purpose of evaluating the need for sanctions. According to the report, such sanctions ought to be transformed into or repeated in a Ministerial Order.

Not all share the view referred to in the text above. In a report prepared by a committee appointed by the Danish Association of Financial Analysts ("Den Danske Finansanalytikerforening") on the legal position of minority shareholders (1989) the committee proposes that a number of aspects of takeovers be

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regulated by “real statutory provisions” (“egentlige lovregler”) (p. 40). However, the report does not clearly explain why this ought to be so.

The statement in the 1985-report quoted above suggests two implications of using statutes rather than non-statutory regulation: first, that statutes are, but non-statutory regulation is not, governed by the “usual procedures under administrative law”; second, that the operation of the penal system depends on whether statutory regulation is applied or not.

These two issues constitute a useful starting point for analyzing the nature of Danish takeover regulation and we will, therefore, give them some further thought.

9.2 Public and private law. The statement in the 1985-report is confusing in that it presupposes that a clear distinction exists between the implications of using statutory rather than non-statutory regulation. In doing so, the report disregards the development in Danish jurisprudence affecting the frontiers between public (“offentlig”) and private (“privat”) law. The views expressed in the quotation above are thus excessively formalistic.

It is not possible to maintain a clear distinction of where private law ends and public law begins, and vice versa.

The following example may illustrate this point.

The law of obligations (“obligationsretten”) is part of what is labelled “private law”. Its focus is the regulation of the legal relationship between contracting parties.

As a point of departure, the law of obligations allows parties the “freedom” to enter into the contracts they wish (“aftalefrihed”).⁶⁰ A contract which has come legally into existence is binding upon the parties to it.

A party bound by an agreement cannot normally be freed from his obligations even though the motive for the other party to the contract to pursue his rights under the agreement is less laudable or perhaps even bad.

However, in Danish jurisprudence and case law, a *mala fide*-doctrine (“chikane”-regel) has developed. Although a party has been granted certain rights pursuant to an agreement, he may, according to this doctrine, be barred from exercising his rights if he has no bona fide reason to do so and the exercise of the right would cause harm to the other party.

⁶⁰ The freedom of parties to contract as they may wish is discussed by Gomard, *Almindelig kontraktsret* p. 18 f., Henry Ussing, *Aftaler* p. 186 f. and Stig Jørgensen, *Kontraktsret*, Vol. I, p. 25 ff.

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This theory was developed by N.P. Madsen-Mygdal in *Festskrift til Henry Ussing* (1951) p. 348 ff. See also the court decision by the Danish Supreme Court *Jensen v. Gulf Oil A/S* (U 1981.300, Sup. Ct.) and the reflections regarding this case by Mogens Munch in *Ugeskrift for Retsvæsen* 1981.B.298 ff.

The mala fide-doctrine is interesting because it has many features in common with the misuse of power-doctrine ("magtfordrejningslæren"), one of the important doctrines in Danish administrative law. (Madsen-Mygdal's article referred to above is thus called "Problems of Misuse of Power in Private Law" ("Magtfordrejningsproblemer i Civilretten"). It seems fair to say that this is an example of how principles of public law may have an area of application that goes beyond the public law area.

The point made here is further illustrated by the fact that certain activities by private parties are subject to standards that to some extent remind us of the standards which public authorities must adhere to. For example, the Act on Banks and Savings Banks ("Lov om banker og sparekasser m.v.") stipulates in § 1, Subsection 6, that banks and savings banks must operate in accordance with "honest business practice" and "good banking practice". Although these concepts are very general and vague, they probably embody notions of misuse of power and equality.

For a discussion of the demarcation between private and public law, see Gormard, *Introduktion til Obligationsretten* p. 7 ff.

The above is not intended to mean that it is not useful to use definitions such as "public law" and "private law" as tools of analysis or that we cannot define the meaning of the word "public authority" the way it should be understood in the context of e.g. the Act on Public Administration ("Forvaltningsloven"), the Act on Publicity ("Offentlighedsloven") or the Act on the Ombudsman ("Ombudsmandsloven").

The point is that when we want to examine certain features of the Copenhagen Stock Exchange we should focus on the particular functions of the Exchange rather than initiating our analysis by attempting to label the Exchange as "public" or "private".

The principal question in our analysis is what role legislature intended the Copenhagen Stock Exchange to play and what standards it wanted the Stock Exchange to adhere to.

9.3. The functions of the Copenhagen Stock Exchange. The functions of the Copenhagen Stock Exchange that we want to discuss can be divided into two categories. The first category may be designated as "rule-making", i.e. the preparation and issuance of general rules aimed at regu-

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lating the behavior of the participants in the activities conducted at the Stock Exchange. The second category includes decisions made to ensure compliance with the rules issued by the Exchange.

9.3.1. Rule-making. The Stock Exchange Rules of Ethics and the Rules on Information Obligations are issued in the Exchange's capacity as rule-maker.

The question we want to focus on here is if, and if so to whom, these rules are binding in the sense that violators would face sanctions (not necessarily penalties) of some kind.

For the purpose of our inquiry we will first consider the authority ("hjemmel") for and thus the validity ("gyldighed") of the rules. Second, we will focus on their contents, and, third, the means of enforcing them set forth in the Stock Exchange Act.

§ 12 of the Stock Exchange Act authorizes the Board of the Copenhagen Stock Exchange to issue the two sets of rules dealt with here and thus to regulate in detail within the framework of the statute. By granting this authority to the Board of the Copenhagen Stock Exchange, the Act thus vests the rule-making power that legislature has in the Board.

When acting in its capacity as a rule-maker, the Board of the Copenhagen Stock Exchange plays the same role as any public body that has been granted the authority to lay down detailed regulation pertaining to a specific area.

The rules discussed here are of a general nature, addressed to citizens and seeking to regulate their behavior.

Provided that such general rules fall within the boundaries of the authority pursuant to which they were issued and provided that the contents of the rules have been publicized⁶¹, they should ordinarily be considered valid.

§ 12 of the Stock Exchange Act is worded broadly, and the language of the Stock Exchange Rules of Ethics and the Rules on Information Obligations probably falls within the boundaries set forth in § 12.⁶²

Moreover, although the rules are not published in the Danish Law Gazette ("Lovtidende"), they are communicated to all interested parties

⁶¹ See Jon Andersen, *Forvaltningsret* p. 20 f. and Claus Haagen Jensen in *Forvaltningsret, almindelige emner* p. 135.

⁶² This does not mean to say that the practice by the Board of the Stock Exchange in connection with the rules necessarily always falls within the purposes which the Stock Exchange Act seeks to further.

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through the mass media and, likewise, changes of the rules are communicated via press releases etc.

Altogether, we may assume that the rules discussed here are valid.

The authority for public authorities to issue orders is discussed in detail by Mogens Moe, *Juristen & Økonomen* 1981, p. 228 ff.

The next question is if the Board of the Stock Exchange has exercised the powers conferred on it by the Act to issue rules that seek to bind the citizens. The focus is, in other words, on the contents of the rules.

Perhaps some commentators would argue that, at least, the Rules of Ethics merely constitute a recommendation and do not attempt to impose on citizens any obligations or restrictions. The very term, "Rules of Ethics", suggests that this point may have some merits. On the other hand, however, the language used in the rules themselves leaves little doubt that the rules do not merely seek to make recommendations.

See, for example, the words in Rule 3.1.1. ... "are under an obligation to ensure ..." and 3.1.2. ... "it is the responsibility of ... to ensure ..". Also, Rule 4.2 uses the word "must" when describing the obligation of the transferor of a controlling shareholding to inform the acquiror of his duties pursuant to the rule.

It should be noted that these are only examples and that throughout the entire set of rules terms are used which clearly reflect the intent on the part of the Copenhagen Stock Exchange to regulate and not just to recommend.

But what if the rules issued by the Board of the Stock Exchange are violated? Natural persons or legal entities are only bound by the rules if failure to follow these can be sanctioned in some fashion.

Both issuers and stockbroker companies may be ordered by the Finance Inspectorate to follow the rules discussed here. If they do not comply with such order, they may be fined. In addition, issuers may experience that the listing of their shares is suspended or discontinued, cf. 1.1. above. It is, therefore, fair to conclude that the Rules of Ethics and the Rules on Information Obligations are binding upon issuers and stockbroker companies.

Since no sanctions are provided for in the Act aimed at violations made by others, the rules are not legally binding on natural persons or entities that do not belong to either of the two categories mentioned. It follows from this that e.g. acquirors of shares are bound by no particular body of regulation.

However, one may raise the question if acquirors could be viewed as having a duty to adhere to the rules based on a contractual relationship. Could we view the rules as terms of a standard contract which anybody

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participating in the activities at the Stock Exchange could be said to submit to, simply by making use of the services and facilities provided by the Exchange? It is frequently seen that contracts are entered into without being signed by both parties but simply because the parties act in a way which shows that a consensus exists between the parties to the effect that the terms of the contract are to govern their relationship.

Under Danish law, a party may bind himself even though he does not explicitly accept the terms of a contract if his acts (and sometimes his passiveness) can be construed as an acceptance of the terms of the contract, see Gomard, *Almindelig kontraktsret* p. 58 ff. and Ussing, *Aftaler* p. 393 ff.

Stating that anybody who purchases shares of a listed company by doing so submits himself to the rules issued by the Board of the Stock Exchange would be to stretch the concept of being bound by one's acts very far, however. Of those buying shares some have probably no knowledge of the rules and even fewer are familiar with their contents. The Stock Exchange is not a marketplace where those buying and selling meet in person to exchange their goods and have the opportunity to become acquainted with rules aiming at regulating their trading.

We do not have a basis for concluding that acquirors are legally bound by the rules at focus here.

The prime sources of motivation for them are the ethical or moral sanctions attaching to violations. The publicizing of the failure to follow the rules is likely to be considered embarrassing by many companies.

The notion of moral norms and moral sanctions, and the motivating effects such sanctions may have, is further discussed by Alf Ross in *Skyld, Ansvar og Straf* p. 165 ff.

9.3.2. Decision-making. The second category of the functions of the Copenhagen Stock Exchange encompasses specific decisions made to ensure compliance with the above mentioned rules.⁶³

The threshold question here is whether such decisions should be viewed as merely of guidance with no binding effect, or if they should be considered as binding and thus imposing on private parties restrictions in their freedom (financially or otherwise) to act.

⁶³ Decisions by the Board of the Stock Exchange made pursuant to the Stock Exchange Act regarding other matters, such as, e.g., the listing of shares (see Chapter 4 of the Act) are not dealt with here.

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The Stock Exchange provides facilities and renders services which create an organized, public market for shares of companies. Provided that the listing requirements are met, any company can be listed at the Exchange. Likewise, anybody may invest in the securities traded on the Exchange, provided, of course, that the various requirements regarding trading are observed. The Stock Exchange is thus public in the sense that the public has access to the facilities and services of the Exchange.

Chapter 1 of the Stock Exchange Act states the purposes of the Stock Exchange, while Chapters 2 and 3 contain provisions regarding the organization of the Exchange as well as the conduct of its operations.

The Board of the Copenhagen Stock Exchange and its acts and decisions are part of the regime created by statute. An important part of the Board's function is to be a "watchdog". The Board must thus seek to ensure observance of the body of regulation created by the Act, the ministerial orders and the rules issued by the Board itself.

Altogether, the system set forth in the Stock Exchange Act could seem to reflect an intent on the part of legislature to make the Board of the Copenhagen Stock Exchange an instrument of the government.

However, legislature did not empower the Board of the Stock Exchange to issue sanctions, should its decisions not be followed. The Finance Inspectorate may order an issuer or a stockbroker company to comply with a decision by the Board, and in the event that the violator fails to follow such order he may be fined. But in such case it is the order of the Inspectorate – and not the decision by the Board of the Stock Exchange – that is binding.

Against this background, my conclusion is that the decisions by the Board of the Stock Exchange are not legally binding.

An analysis of the extent to which the Copenhagen Stock Exchange could be considered a public authority in the various contexts this term is used falls outside the scope of this book.

For a general discussion of the definition of public authorities, see Poul Andersen, *Dansk Forvaltningsret* p. 61 ff., Lis Sejr in *Forvaltningsret, almindelige emner* p. 60 ff., Asbjørn Jensen et al., *Forvaltningsloven* p. 28 ff. and Karsten Loiborg in *Juridisk grundbog*, Vol. 4, *Forvaltningen*, p. 37 ff.

The Danish Central Bank ("Danmarks Nationalbank") which could be said to resemble, at least to a certain extent, the Copenhagen Stock Exchange, is for many purposes considered to be a public authority, see, e.g. Poul Andersen, *Dansk Forvaltningsret* p. 69 and Bent Christensen, *Nationalbanken og Forvaltningsret* p. 15 ff. and Karsten Loiborg in *Juridisk grundbog*, Vol. 4, *Forvaltningen*, p. 39. The Danish National Radio ("Danmarks Radio") is also considered a

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public authority in many regards, see e.g. Asbjørn Jensen et al., *Forvaltningsloven* p. 28.

For a discussion of the similar issue in connection with the Danish Securities Center ("Værdipapircentralen"), see Christen Boye Jacobsen, *Lov om en værdipapircentral* p. 31.

A discussion of the legal status of the Stockholm Stock Exchange may be found in an article by Mats Tjernberg in *Svensk Jurist Tidning* 1/1991, p. 40 ff.

9.3.3. Some further aspects. Considering that the rule-making function by the Board of the Stock Exchange is, at least in some respects, of a binding nature, the question is how the general principles of administrative law should be applied to such function.

A number of notions are found in Danish administrative law which serve to protect the citizens. In addition to various formal rules, the aforementioned principle of misuse of power and the principle of equal treatment are examples of substantive rules that aim at protecting citizens. The notion of equal treatment is discussed by Bent Christensen, *Forvaltningsret, Hjemmelsspørgsmål* p. 107 ff. and Poul Andersen, *Dansk Forvaltningsret* p. 426 ff.

The activities conducted by the Board of the Stock Exchange differ from the activities by typical public authorities (such as, e.g., governmental agencies under a Ministry). The fact that the Stock Exchange is a market place where shares are traded entails that the Board of the Stock Exchange will have to consider, for example, the impact that a rule adopted by the Board would have on the willingness of investors to enter the market. Our concern is if the principles of administrative law leave sufficient flexibility with the Board.

We need not be too concerned about this, however. Administrative law creates a framework within which bodies that are authorized to issue rules, make acts or render decisions which are binding upon the citizens must discharge their duties, but the framework is not so rigid that all the exercise of authority must be carried out in a uniform fashion by all bodies.

Rather, when determining the legal criteria that a body should follow, the paramount standard is the purpose of the regulation administered by that body.⁶⁴

⁶⁴ See Bent Christensen, *Forvaltningsret, Hjemmelsspørgsmål* p. 91 ff. See also Bent Christensen, *Nationalbanken og Forvaltningsret* p. 76 ff. regarding the criteria of relevance for the Danish Central Bank when exercising its rights to regulate the provision of funds.

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According to § 10 of the Stock Exchange Act, the Board of the Exchange must see to it that the operations of the Exchange are conducted in an expedient and appropriate manner. § 11 of the Act adds that the Exchange must aim at having the trade and quotation conducted in a manner which ensures that the trade and the pricing at the Exchange are performed in a fair and “transparent” fashion, providing, within the framework of the law, an equal treatment of all those involved.

This does not entail that the principles of administrative law are not applicable, but rather that the Board of the Copenhagen Stock Exchange, when administering the rules, has been granted a flexibility which makes it easier for the Board to choose the means by which to pursue the goals set forth in the Act. The purposes of the Stock Exchange as set forth in the statute influence the substance of the general principles and rules of administrative law.

For example, when stating that a principle of equality must apply (§ 11), the Act fails to specify the criteria as to who should enjoy equal treatment and, therefore, one will have to consider the purposes of the activities of the Stock Exchange as expressed in the provisions of the Act. As a consequence of this, the Stock Exchange would have to take into consideration, when applying the equality standard in connection with its issuance of rules, the impact that the rule will have on e.g. the trade and pricing in the stock market.

In his book, *Nationalbanken og forvaltningsret*, Bent Christensen gives very illustrative examples of how the Danish Central Bank may treat the Danish banks differently, based on the particular objects that the Central Bank is expected to pursue, see p. 89 ff.

9.4 Penalties. It is a fundamental principle under Danish law that no act or omission can be punished, unless such punishment is provided for in a law or in rules issued pursuant to powers conferred by law.⁶⁵ The principle “nulla poena sine lege” is set forth in § 1 of the Civil Criminal Code (“Borgerlig Straffelov”)⁶⁶ but also applies to acts or omissions that are made subject to punishment in special laws outside the Code, see § 2 of

⁶⁵ See Vagn Greve et al., *Kommenteret straffelov, alm. del* p. 94 ff., Knud Waaben, *Strafferettens almindelige del* p. 70 ff., and Stephan Hurwitz, *Den danske kriminalret, alm. del* p. 80 f.

⁶⁶ Consolidation Act No. 607 of September 6, 1986, as amended.

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the Civil Criminal Code.⁶⁷ It is frequently seen – and fully recognized – that legislature elects to provide for sanctions in a statute but leaves it up to the relevant public authorities to lay down the rules the violation of which may be penalized pursuant to the Act.⁶⁸

The Stock Exchange Act is an example of how penalties may be set forth in the Act whereas the right to issue rules the violation of which may lead to the penalties is delegated to a separate body.

As outlined under 1.1., the existing penal system pertaining to violations of the rules issued by the Board of the Stock Exchange only makes it possible to punish such violations in an indirect fashion. This is not a feature inherent in the concept of having a non-statutory regulation. There is thus nothing to prevent an Act from authorizing the Board of the Copenhagen Stock Exchange to punish violations directly. The existing statute does not provide for this, but the question is if there is not a need for direct penalties.

The present regime with its two-tier sanction mechanism seems to be unnecessarily complicated and slow. It would, therefore, be preferable if the Board of the Copenhagen Stock Exchange were directly authorized to punish violations of the Stock Exchange Act as well as ministerial orders issued pursuant to the Act and rules issued by the Stock Exchange. Also, there ought to be a clear indication in the rules issued by the Stock Exchange of the penalties applicable to violations.

We have already touched upon another clear flaw in the existing penal system: the fact that violations made by, for example, an acquiror, may be criticized but are not subject to any penalty by the Board. The Stock Exchange Rules of Ethics contain provisions, some of which deal with the relationship among shareholders, e.g. rule 4, discussed further under VIII.2.1. Therefore, it would seem appropriate, in connection with a future revision of the Stock Exchange Act, to establish means by which violations made by shareholders or others may also be penalized.

The Draft Takeover Directive would require member states to adopt legislation that gives the supervisory authorities, or those to which the powers of such authorities have been delegated, “all the powers necessary for the exercise of their functions”, cf. Article 6(2). Adoption of the draft would thus mandate a change of the present Danish regime.

There is another issue which comes to mind in this connection. As described in detail under VII.1.2., the Companies Act together with the rules

⁶⁷ See also Knud Waaben, *Strafferettens almindelige del* p. 70.

⁶⁸ See Vagn Greve et al., *Kommenteret straffelov, alm. del* p. 94.

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issued by the Stock Exchange creates a system according to which acquisitions and dispositions of major shareholdings must be notified to the company, which, in turn, must notify the Stock Exchange. The problem, however, is that since there are no sanctions if the rules issued by the Stock Exchange are not complied with by acquirors, it may be very tempting for acquirors not to follow these rules and thus not inform a target-company immediately (as is indicated in the Stock Exchange Rules) about the acquisition of shares, but instead stick to the 4-week deadline in the Companies Act (§ 28 b, Subsection 1). There clearly seems to be a need for sanctions if acquirors fail to file notifications on a timely basis.

The Disclosure Directive changes this state of affairs and imposes on member states to provide for a legal duty to disclose certain major acquisitions/dispositions of shares within 7 calendar days, see Articles 4 and 15. The latter provision states that “appropriate sanctions” should be provided for in cases where the provisions of the directive are not complied with. The recent amendment of § 161, Subsection 3, of the Companies Act (effective July 1, 1991) has been adopted in order to establish the legal basis for such a sanction system. For further details, see VII.1.2. and 1.2.1.

As suggested in Article 33(4) of an earlier proposed text for the Draft Fifth Directive⁶⁹, one possibility to sanction failure to disclose share acquisitions on a timely basis would be to suspend the rights to vote attaching to the shares thus acquired.

A similar principle is reflected in Chapter 3 a of the Danish Act on Banks and Savings Banks (Consolidation Act No. 740 of November 30, 1989, as amended by Act No. 306 of May 16, 1990). According to § 7 c, Subsections 2 and 3, of the Act, the Finance Inspectorate is empowered to “cancel” the votes attaching to shares acquired in violation of § 7 b, Subsection 1, of the Act.

9.5 Conclusions. At least as a concept, there is an advantage in that the body that has issued the Stock Exchange Rules of Ethics and the Rules on Information Obligations, and which is authorized to amend these two sets of rules, is one and the same body that also monitors compliance with the rules. This system thus creates a high degree of flexibility by enabling the Board of the Stock Exchange to adjust and amend the rules and the practice in connection therewith if and when it is deemed appropriate.

⁶⁹ Prepared by the Council, 9128/89, DRS 45, October 16, 1989.

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On the other hand, there is no doubt that such a system with so much power vested in the Board of the Stock Exchange also requires a very high degree of professionalism and skills among the members of the Board.

In addition to the flaws of the present regulation already mentioned, the main issue, as we shall see later, is if the substantive regulation provided by the Board satisfies the needs of society.

As we have seen, neither the protection of the citizens created by the application of administrative law nor our interest in creating an efficient penal system mandates the use of statutory regulation of the takeover process.

VII Stock acquisitions

1. The existing Danish regulation of stock acquisitions

1.1. Introduction. Though it has yet to be seen which transactional pattern contested acquisition activity in Denmark will follow, it is reasonable to assume that at least the main features of such transactions will follow the pattern that we have seen in other European countries. Accordingly, we should assume that contested acquisitions will frequently be initiated by the purchase of shares or blocks of shares in the stock market by means of privately negotiated transactions. Following such single purchases, the acquiror should be expected to make a public offer for the shares of the target-company.

The present Danish regulation pertaining to stock acquisitions is scarce. Except for certain disclosure obligations and the duty to make a compulsory bid for the remaining shares when acquiring a controlling holding¹, no regulation exists as regards share purchases.

Although the regulation of takeovers does not make any distinction between the various kinds of share purchases it is useful for the purposes of the following exposition to make a division between transactions resulting from a private negotiation between a limited number of shareholders and an acquiror, on the one hand, and a public offer made for the shares of a company, on the other hand.

The Draft Takeover Directive only pertains to “takeover” and “other general bids”. In Article 2 of the draft, such bids are defined as offers made to the holders of securities of a company to acquire all or part of such securities in return for payment in cash or in exchange for other securities. The term “securities” is defined in Article 2 as “transferable securities carrying voting rights in a company or conferring entitlement to obtain transferable securities carrying such rights”.

1.2. Privately negotiated stock acquisitions. Leaving aside the special obligations that are imposed on acquirors who acquire a controlling holding of shares of a company, the only obligations that are attached to ac-

¹ See VIII.2.1. for a further discussion of the duty to make a compulsory bid.

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quisition of shares through privately negotiated transactions are disclosure obligations.

§ 28 a and § 28 b of the Companies Act² entail that an acquiror that has acquired stock representing at least 5 percent of the voting rights³ of a company, or stock having a nominal value of at least 5 percent of the company's share capital, but a minimum of DKK 100,000, must notify the company. As regards companies listed on the Copenhagen Stock Exchange, the 4-week "window period" in § 28 b, Subsection 1, has been replaced by the requirement in rule 3.3 of the Rules of Ethics, according to which notification must be effected immediately after the threshold has been reached.⁴ The effect of the word "immediately" is slightly diluted as a consequence of the official comment to § 36 of the Information Obligations for Issuers of Listed Securities. While a shareholder must notify the issuer when the Danish Securities Center ("Værdipapircentralen")⁵ or the bank administrating his securities investments has informed him that the threshold in § 28 a, Subsection 1, has been reached, he is allowed time to

² The Companies Act was amended by Act No. 289 of May 8, 1991, inter alia, for the purpose of implementing the Disclosure Directive. The amendment is effective from July 1, 1991. While § 28 a and § 28 b stipulate the disclosure rules pertaining to all companies, § 28 c authorizes the Ministry of Industry to issue additional rules regarding disclosure obligations in connection with listed shares. As the Disclosure Directive mandates more extensive disclosure rules than those implemented by § 28 a and § 28 b, it should be expected that the Ministry will issue additional rules shortly.

³ Under § 28 b, Subsection 2, of the Companies Act, a company must keep and continually update a list of notices filed pursuant to § 28 a. According to the explanatory memorandum attached to the bill which introduced the new disclosure requirements in 1991, the list must include treasury stock ("egne aktier") to the extent holdings of such shares reach the thresholds found in § 28 a. This is consistent with the position taken by the Ministry of Industry under the former disclosure rules. See for a sceptical view on this, Bent Græsvænge & Niels Thomsen, *Aktieselskabsloven med kommentarer* p. 156. See also Niels Thomsen, *A/S-loven med kommentarer* p. 175, where no such scepticism is voiced.

⁴ The original Danish text of rule 3.3 states that notification must take place "straks". The term "immediately" is probably the English word which comes closest to "straks".

⁵ In 1989 the traditional paper share certificates were abandoned and replaced by an electronic trading, quotation and registration system. Approximately 45 stockbroker companies carry out the trading and report all transactions to the Copenhagen Stock Exchange. Registration of all securities transactions are made through the Securities Center.

verify the information about the transaction, if necessary, prior to such notification.

According to § 36 of the Information Obligations for Issuers of Listed Securities, a company must notify the Copenhagen Stock Exchange immediately upon receiving notification from a shareholder that has reached the 5 percent threshold. The company has the right to verify the shareholder's notification prior to notifying the Stock Exchange.⁶

The purpose of having very short notices in connection with acquisition of major stockholdings is to ensure that the public will be informed at all times of the development in the composition and distribution of the share capital of listed companies.⁷

Once the 5 percent threshold has been reached, a shareholder must notify the issuer of changes in his stockholding. This continuing duty to notify applies to additional stock purchases as well as dispositions of stock that lead the holding to reach or fall below thresholds at 5 percent intervals from 10 to 100 percent (i.e. 10, 15, etc.), as well as one-third and two-thirds of the total number of votes or aggregate share capital.⁸ It follows from rule 3.3 of the Copenhagen Stock Exchange Rules of Ethics that such changes must be notified within the same time limit as the one pertaining to initial 5 percent acquisitions. Similarly, the issuer must in turn notify the Copenhagen Stock Exchange immediately, cf. § 36 of the Information Obligations for Issuers of Listed Securities.

Failure to comply with § 28 a and § 28 b of the Companies Act may be fined pursuant to § 161, Subsection 1, while no legal sanctions exist in case the above Stock Exchange Rules are not complied with, see VI.9.4. Once the Ministry of Industry exercises its authority to issue rules pursuant to § 28 c of the Companies Act as to when to disclose transactions in shares, penalty by means of fines may be stipulated under § 161, Subsection 3.

It is not a requirement that an acquiror discloses the background for or the purpose of his stock acquisition, including information on whether the shares were purchased as a passive investment or in order to acquire control of the company. With the modification found in § 28 a, Subsection 2, according to which shares, the votes of which are held by undertakings

⁶ See the official comments to § 36 of the Information Obligations for Issuers of Listed Securities.

⁷ See the official comments on rule 3.3. of the Rules of Ethics.

⁸ Moreover, notification must be filed if the stockholding in question drops below the 5 percent threshold triggering the duty to notify in the first place, cf § 28 a.

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controlled⁹ by the acquiror, will have to be included when calculating his holding of shares, an acquiror will not have to disclose if he controls other persons or entities owning shares or cooperates with others for the purpose of acquiring or consolidating control. As a result, it may be difficult for a target-company and its shareholders to determine at an early point if an acquiror plans to take over the target-company.¹⁰

There is nothing to prevent an acquiror from silently acquiring the shares of a company up to the 5 percent limit and then, while at the same time filing the notification of his acquisition, initiating massive purchases of shares of the target-company. When planning the stock purchases that are made after the 5 percent threshold has been reached, the acquiror may want to take advantage of the flexibility created by the 5 percent intervals in § 28 a. Within each 5 percent interval the acquiror may acquire shares without notifying the company right away.

1.2.1. The Disclosure Directive. The Disclosure Directive imposes on member states a duty to enact legislation which requires natural persons and legal entities to notify the issuing company and the competent national authority in the event that the proportion of voting rights of that company held by the person or legal entity reaches, exceeds, or falls below one of the thresholds of 10 percent, 20 percent, one-third, 50 percent and two-thirds, see Article 4(1) of the directive.

However, member states that apply a single threshold of 25 percent need not apply the thresholds of 20 percent and one-third. Likewise, member

- ⁹ On the basis of any of the factors listed in § 2, Subsection 2, i.e.:
- the holding of a majority of the voting rights of a company;
 - shareholdership in a company combined with the right to appoint or remove a majority of the members of the board;
 - shareholdership in a company combined with the right to exercise controlling influence on the company on the basis of its charter or pursuant to an agreement with such company;
 - shareholdership in a company combined with control of a majority of the voting rights pursuant to an agreement with other shareholders; or
 - the holding of shares of a company combined with the exercise of controlling influence on such company.

For a discussion of § 2, Subsection 2, of the Companies Act, see Werlauff in Juristen 1991, p. 114 ff.

- ¹⁰ As we shall see under 2, American federal law provides a much more extensive regulation of share purchases.

states that apply a threshold of 75 percent need not apply the threshold of two-thirds.

Notification must be made within 7 calendar days from the time when the shareholder in question learns of the acquisition or disposal or from the time when, in view of the circumstances, he should have learned thereof, cf. Article 4(1) of the Disclosure Directive.

The new Danish disclosure provisions more than satisfy the threshold requirements found in the Disclosure Directive, cf. the discussion above on § 28 a and § 28 b of the Companies Act.

As regards the 7 day deadline for disclosures provided for in the Disclosure Directive, it will be recalled that the statutory 4-week period in § 28 b, Subsection 1, has been narrowed down to a duty to disclose “immediately”, cf. Rule 3.3. of the Copenhagen Stock Exchange Rules of Ethics. At first blush it could seem as if the time limits within which disclosure must be made are tighter under Danish law than required by the Disclosure Directive. “Immediately” typically means that disclosure must be effected earlier than 7 calendar days.

Nevertheless, the Disclosure Directive imposes on the Danish legislature a duty to adopt regulation which legally binds acquirors to disclose within the 7 day deadline. In view of the fact that the rules issued by the Copenhagen Stock Exchange are not legally binding upon acquirors¹¹, it is necessary to have provisions adopted which bind acquirors. The only deadline binding on acquirors at present is the 4-week period set forth in § 28 b, Subsection 1, of the Companies Act.

Another change that will have to be made in Danish law is the system by which acquisitions and dispositions of shares are reported. At present, shareholders notify the issuer, which, in turn, notifies the Stock Exchange, cf. above. In the future, shareholders will have a duty not only to notify the issuer, but also the competent authority, cf. Article 4 of the Disclosure Directive.

A third change of Danish law would be mandated by the provisions in Article 7 of the Disclosure Directive, which stipulates which interests would have to be included when calculating if a threshold has been reached. Article 7 thus states that, for these purposes, the following shall be regarded as voting rights held by a person or entity¹²:

¹¹ See the discussion under VI.9.3.1. and 9.4.

¹² For a discussion of article 7, see 4.2.1.2.

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- “– voting rights held by other persons or entities in their own names but on behalf of that person or entity,
- voting rights held by an undertaking controlled by that person or entity,
- voting rights held by a third party with whom that person or entity has concluded a written agreement which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the company in question,
- voting rights held by a third party under a written agreement concluded with that person or entity or with an undertaking controlled by that person or entity providing for the temporary transfer for consideration of the voting rights in question,
- voting rights attaching to shares owned by that person or entity which are lodged as security, except where the person or entity holding the security controls the voting rights and declares his intention of exercising them, in which case they shall be regarded as the latter’s voting rights,
- voting rights attaching to shares of which that person or entity has the life interest,
- voting rights which that person or entity or one of the other persons or entities mentioned in the above indents is entitled to acquire, on his own initiative alone, under a formal agreement; in such cases, the notification prescribed in Article 4(1) shall be effected on the date of the agreement,
- voting rights attaching to shares deposited with that person or entity which that person or entity can exercise at its discretion in the absence of specific instructions from the holders.”

1.3. Public offers. For the purposes of the following discussion, the term “public offer” refers to offers made, through mass-media or otherwise, to a large number of shareholders of a company with the object of acquiring a major part of the company’s voting stock. This definition of public offers is not limited to offers which, if accepted, would lead to the acquiror controlling the target-company.

The special obligations pertaining to acquirors that acquire control are not dealt with here but are discussed under VIII.2.1. below.

Initially it should be noted that the disclosure obligations discussed under 1.2. above also apply to stock acquisitions by means of public offers.

An acquiror need not inform the target-company or the Copenhagen Stock Exchange prior to making a public offer for the shares of the target-company.

Danish law is silent as to how a public offer should be communicated to the shareholders of the target-company.

Since the shareholder list of a company is not available to its shareholders¹³, public offers are ordinarily made through the daily newspapers.

There are no formal requirements under Danish law as to the contents of a public offer, but in order to be contractually binding it must meet certain minimum requirements, such as identifying the acquiror, specifying the shares comprised by the offer, and setting forth the price offered.¹⁴ Also, the offer must be drafted in such a way that there is no doubt that it is, in fact, an offer and not merely an invitation to the target-shareholders to offer their shares for sale.¹⁵

Although it is probably not required for the offer to qualify as legally binding, the offer should also stipulate when and how payment for the shares is to take place, including if the tendering shareholders will receive cash payment or shares of the acquiror.

Likewise, a reasonable period within which the offer is open for acceptance should be stipulated. No regulation exists prescribing such minimum opening period.¹⁶

No particular requirements exist as to what a public offer document must include as a minimum. Typically, the above mentioned terms of the offer will be set forth in the offer document.

¹³ The target-company, however, must comply with requests from any shareholder for a transcript of the list of notices regarding transactions in major stockholdings, cf. § 28 b, Subsection 3, of the Companies Act.

¹⁴ See Ussing, *Aftaler* p. 33 ff. and Stig Jørgensen, *Kontraktsret*, Vol. 1, p. 67 ff.

¹⁵ The distinction between an offer and an invitation to make an offer was one of the issues dealt with in *Fona v. Rabuchin* (U1985.877, Sup. Ct.). See also the comments on the case by Else Mols in *Ugeskrift for Retsvæsen* 1986.B. p. 43 f. Also, see Gomard, *Almindelig kontraktsret* p. 27 f. and 78 f. and Lennart Lyng Andersen & Jørgen Nørgaard, *Aftaleloven med kommentarer* p. 50 ff. The Dutch Merger Rules distinguish between a "firm" offer ("vast bod"), i.e. an offer which stipulates the price or exchange ratio offered, and an "invitation to tender" ("tenderbod") where no price or exchange ratio is indicated by the offeror, cf. Article 1. Both the firm offer and the invitation to tender are regulated by the Merger Rules.

¹⁶ The Copenhagen Stock Exchange in its practice for a while recommended a 3 week minimum opening period, but recently seems to accept 2 week opening periods as well.

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It is possible for an acquiror to make his offer conditional on the acquisition of a certain minimum percentage of the target-company's shares. Since acquirors ordinarily want to be sure that they are only committed to buy shares tendered if the acquisition leads to a controlling interest in the target-company, it is likely that public offers will always be conditional upon the acquiror receiving a minimum percentage of shares of the target-company. Moreover, the right to cash out minority shareholders under § 20 b of the Companies Act only pertains to shareholders owning more than 90 percent of the company's share capital and votes, which means that some acquirors may want to make 91 percent ownership/votes a condition.

In connection with § 20 b of the Companies Act it should be noted that the right to cash out only applies in the relationship between a (parent) company and its subsidiary, as defined in § 2 of the Act. If the acquiror is a natural person, this condition, if nothing else, would give him an interest in establishing a company that would have the purpose of acquiring the target-company. After the takeover, the acquisition-vehicle becomes the parent company and the target-company becomes its subsidiary so that a right is established for the parent to cash out the minority shareholders of the subsidiary. For a general discussion of § 20 b of the Companies Act, see Thomsen, *A/S-loven med kommentarer* p. 148 ff. and Gormard, *Aktieselskaber og anpartsselskaber* p. 168. For a discussion of the particular problems that arise when the charter of the subsidiary contains a "cap" on the voting rights, see Jørgen Nørgaard & Erik Werlauff, *Ugeskrift for Retsvæsen* 1988.B 377. The correlate to this right to cash out on the part of the acquiror is a right on the part of the minority shareholders to require that their shares be cashed out if the majority shareholder owns more than 90 percent of the share capital/votes of the company, cf. § 20 d of the Companies Act.

However, once an acquiror has acquired a controlling interest, his obligation to make a bid for the remaining shares of the company pursuant to Rule 4 of the Copenhagen Stock Exchange Rules of Ethics cannot be subject to conditions, e.g. be contingent upon the receipt of a certain percentage of acceptances. This problem may be avoided by making the entire initial public offer conditional upon receipt of the desired percentage of shares so that the acquiror runs no risk of getting stuck with a controlling interest but without having the possibility to eliminate minority shareholders.

It follows from what has been said above that partial offers for the shares of a company are only viable if they do not, if accepted, result in the acquiror gaining control.

Save for the above situations, in the absence of regulation with respect to conditions, Danish contract law is based on a principle of "freedom of

contract”, which means that an acquiror may, generally speaking, make his offer subject to any conditions he deems desirable.¹⁷ Accordingly, it is possible for an acquiror to make his bid contingent upon e.g. the provision of the necessary financing once a sufficient number of target-shareholders have tendered their shares or upon the “dismantling” by the shareholders of shark repellents¹⁸ in the company’s charter.

Once an offer is made public or has otherwise come to the knowledge of the shareholders of the target-company, it is binding upon the offeror as long as it remains open.¹⁹ Ordinarily, Danish contract law will only allow an acquiror to withdraw an offer made if the offer contains a reservation providing for such right of withdrawal²⁰ or if a condition of the offer is not met.

There is a difference under contract law between reserving a right of withdrawal in an offer and making the offer contingent. In the former case the offeror has a right to pull out even though a final agreement has been entered into. In the latter situation, acceptance by the offeree does not make the agreement final; the effectiveness of the agreement is suspended until the conditions are met.²¹

Changes or revisions of a public offer already made by the acquiror would under Danish law generally be subject to the same limitations as those applying to withdrawals of an offer.

1.4. Preliminary observations. A special feature of the Danish regulation pertaining to stock acquisitions is the summary nature of the disclosure obligations. These obligations are triggered when the 5 percent threshold is reached, but only include an obligation to state the size of the acquiror’s holding, whereas no background information or information about the acquiror’s plans is required. The question here is if these disclosure obligations are sufficient or if we need more extensive regulation.

¹⁷ The freedom of contract concept is discussed by Gomard, *Almindelig kontraktsret* p. 18 f., Ussing, *Aftaler* p. 186 f., and Stig Jørgensen, *Kontraktsret*, Vol. I, p. 25 ff. For a historical background, see also Gomard in *Danske og norske lov i 300 år*, p. 537 ff. (Copenhagen, 1983).

¹⁸ See XI.2. for a discussion of this device.

¹⁹ See Gomard, *Almindelig kontraktsret* p. 68 f., Ussing, *Aftaler* p. 45 ff. The acquiror is free to withdraw his offer provided that notice of such withdrawal comes to the knowledge of the offerees prior to or simultaneously with the offer being withdrawn, cf. § 7 of the Act on Contracts (Consolidation Act No. 600 of September 8, 1986) and Ussing, *Aftaler* p. 46 f.

²⁰ See Ussing, *Aftaler* p. 50 and Stig Jørgensen, *Kontraktsret*, Vol. I, p. 67 f.

²¹ For a description of such suspensive effect, see Ussing, *Aftaler* p. 447 ff.

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Another point of interest is the absence of a distinction between different types of acquisitions. No distinction thus exists on the basis of the “private” nature of a transaction as opposed to a “public” offer. Save for the special mandatory offer requirements that apply when a controlling holding is acquired, all stock purchases are treated uniformly. The question one may raise is if this state of the law is desirable.

Before we consider these two main issues further it may be useful, by way of illustration, to examine the legal system of a jurisdiction where takeover regulation is far more extensive. Therefore, we will take a closer look at the federal takeover regulation of the United States, which contains very detailed disclosure obligations and, moreover, acknowledges a distinction between “privately” negotiated share purchases, on the one hand, and “public” offers, on the other.

2. Regulation of stock purchases under the United States federal law

2.1. Introduction. The American Williams Act contains provisions that apply to any acquisition of stock and, in addition, includes rules which are restricted to tender offers.

2.2. Rules pertaining to all stock purchases. According to Section 13(d) of the Williams Act, any person who directly or indirectly (for instance through a “dummy”) is the beneficial owner²² of more than 5 percent of the shares of a class of equity securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, must disclose his holding of such shares to the issuer, the SEC, and each exchange where the security is traded. Disclosure must take place within 10 days after any acquisition which led the acquiror to cross the 5 percent threshold.²³

When disclosing his ownership of shares under Section 13(d), an acquiror must follow the requirements set forth in Schedule 13 D. While Section 13(d) contains the main principles, Schedule 13 D sets forth in

²² The Williams Act does not include a definition of beneficial ownership. However, Rule 13 d-3, promulgated by the SEC, determines that a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, relationship, or otherwise, has or shares voting power and/or investment power. This means that if a person has the power either to vote, or to direct the voting of, a security, or if he has the power to dispose of such security, he will be considered a beneficial owner for the purposes of Section 13(d).

²³ Certain exemptions apply to the disclosure requirement. Since these exemptions are not relevant for our purposes, we will not deal with them here.

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detail the disclosure obligations. An acquiror must thus disclose information about his identity and background as well as the source and the amount of funds or other consideration used or to be used in making the purchases. Moreover, the acquiror must state the purpose of the transaction, such statement to include any plans which the acquiror may have regarding, *inter alia*, the acquisition by any person of additional securities of the target-company, extraordinary corporate transactions such as merger, reorganization or liquidation, sale or transfer of a material amount of the issuer's assets or any of its subsidiaries and changes in the present board of directors or management of the target-company.²⁴ The acquiror must indicate the aggregate number and percentage of the class of equity securities beneficially owned by him. Finally, the acquiror must describe any contracts, arrangements, understandings, or relationships between himself and any other person with respect to any of the target-company's securities. Consequently, the acquiror will have to disclose, *inter alia*, any voting arrangements and any proxies given.

Persons – including legal entities – who act as a group and cooperate in order to acquire, hold or dispose of shares will be considered as one person in this respect.²⁵ This means that the 5 percent limit will be crossed if two persons as part of a joint cooperation agree each to acquire 2.6 percent of a company's shares.

After having crossed the 5 percent threshold, any person who has filed a disclosure statement under Section 13(d) of the Williams Act must promptly file an amendment to such disclosure statement if a material change occurs in the facts set forth in the statement. According to Rule 13d-2, any acquisition or disposition of securities in an amount equal to 1 percent or more of the class of securities is deemed to be "material" in this context.

²⁴ In addition, the acquiror must state his plans with respect to any material change in the present capitalization or dividend policy of the target-company, any other material change in the target-company's business or corporate structure, changes in its charter or by-laws, causing a class of securities of the company to be delisted from a national securities exchange, a class of equity securities of the target-company becoming eligible for termination of registration pursuant to Section 12(g)(4) of the Securities Exchange Act of 1934, or any action similar to any of those enumerated.

²⁵ See Section 13(d)(3).

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2.3. Rules pertaining to tender offers only.

The Congressional Research Service has prepared a report to the American congress on the level of contested takeover activity, dated June 16, 1987. According to the report, tender offers have amounted to between 2.9 and 4.5 percent of the total number of published mergers and acquisitions in the period 1982-1986. The study is based on information about “friendly” as well as “hostile” transactions involving at least 10 percent of a company’s shares or assets and provided that the payment for such shares or assets has been at least USD 500,000 and further provided that at least one of the parties to the transaction is an American company. Computed on the basis of the values involved, tender offers represented 44.4 percent of the total merger and acquisition activity in 1985 (which was the most recent figure available at the time when the study was prepared). Of the total number of tender offers, contested tender offers amounted to 42.6 percent in 1982 and 26.7 percent in 1986. However, based on the values involved, contested tender offers have increased from 36.2 percent in 1982 to 52.2 percent in 1985 (the most recent figure) of the total tender offers. It seems that there is a trend towards contested tender offers decreasing in number but increasing in terms of the value involved. However, as to the most recent trend, see II.1.

The advantage for acquirors associated with tender offers as opposed to privately negotiated acquisitions is that the acquiror can acquire shares, perhaps even control, without being dependent on the management of the target-company being cooperative. Another advantage for acquirors is that tender offers may be made at very short notice, which to a certain extent can prevent other prospective acquirors from making competing bids. However, the time element subjects the shareholders of the target-company to considerable pressure to sell their shares. Even if the acquiror offers a premium price for the shares compared to the market price, the shareholders may wish to ascertain if there are other potential buyers willing to pay an even higher price. The time pressure often leaves the shareholders without this option. The desire to protect the shareholders of the target-company in this situation has led to special provisions in The Williams Act applying to tender offers only.

2.3.1. What is a tender offer? Neither the Williams Act nor the regulations issued by the SEC pursuant to the Act contain any definition of a tender offer. The absence of such a definition has led to some uncertainty with respect to the area to which the particular tender offer regulation applies. This uncertainty is reflected not only in the practice of the SEC, but also in the practice of the courts.

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In a number of court cases, the SEC has proposed the use of a so-called “8-factor test” in order to determine when a purchase offer is a tender offer. The 8 factors that characterize a tender offer have been described as follows²⁶:

- (1) active and widespread solicitation of public shareholders is made for the shares of an issuer;
- (2) solicitation is made for a substantial percentage of the issuer’s stock;
- (3) the offer to purchase is made at a premium over the prevailing market price;
- (4) the terms of the offer are firm rather than negotiable;
- (5) the offer is contingent on the tender of a fixed (minimum) number of shares and is often subject to a fixed maximum number of shares being purchased;
- (6) the offer is open only for a limited period of time;
- (7) target-shareholders are subject to pressure to sell their stock; and
- (8) public announcement of a purchasing program concerning the target-company precedes or accompanies rapid accumulation of target-stock.

Far from all American courts have applied the 8-factor test.²⁷ However, the test gives a useful indication of the typical features of a tender offer.

In *Hanson Trust plc v. SCM Corp.*²⁸ the court, when determining whether a tender offer had been made, evaluated if, based on the facts, there would be a likelihood that the shareholders of the target-company would not obtain all relevant information in order to make a fully informed sales decision, unless the disclosure requirements under the Williams Act pertaining to tender offers were observed. Rather than applying the 8-factor test, the court’s analysis is based on an evaluation of the

²⁶ See SEC Proposed Rules on Substantial Securities Acquisitions during and following a Tender Offer (Release No. 34-24976; File No. S7-33-87), October 1, 1987, Note 16. See also Ralph Ferrara, Meredith Brown & John Hall, *Takeovers – Attack and Survival* p. 23.

²⁷ In the following cases the 8-factor test was applied, although the courts did not make it a requirement that all of the eight conditions were met in order to reach the conclusion that a tender offer had been made: *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2 945 at 950 (9th Cir. 1985), *Wellman v. Dickenson*, 475 F. Supp. 783 at 823 ff. (S.D.N.Y. 1979), aff’d, 682 F.2d 355 (2nd Cir. 1982), Cert. denied 460 U.S. 1069 (1983). *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773 (S.D.N.Y. 1979) is an example of a court being sceptical as to whether the 8-factor test should be applied at all.

²⁸ 774 F.2d 47 at 56-57 (2nd Cir. 1985).

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purpose which the Williams Act serves and, in particular, a determination of whether there is a need for protecting the shareholders of the target-company as provided for in the Williams Act.

According to the *Hanson Trust*-case, the decisive factor in the analysis is if, based on the particular facts of each case, there is a need to apply the protective provisions governing tender offers in the Williams Act. If, as is often the case, a publicly announced offer is made, aimed at all the company's shareholders, with the purpose of acquiring a controlling block of the company's shares, containing a premium price compared to the market price, conditional upon the acquisition of a certain minimum percentage of the company's shares and with a short acceptance period, the offer would qualify as a tender offer under the 8-factor test. However, the same result would probably follow if the purpose test is used.

If a transaction is made with the participation of an acquiror and a limited number of shareholders of which all are sophisticated and professional investors, or at least have experience and knowledge in the area of securities trading, no demand for protection exists, provided that the shareholders receive all relevant information regarding the offer to purchase their shares. Similarly, single transactions which are made in the open market and without the use of public offers to the shareholders, for instance through newspapers, will ordinarily not be comprised by the tender offer rules, still provided that the tendering shareholders are experienced and knowledgeable in this area and receive all relevant information in order to make an informed decision. In other words, it is likely that the analysis expressed in the *Hanson Trust*-case and the 8-factor test mentioned above will often lead to similar results.

2.3.2. Disclosure obligations in connection with tender offers. If a tender offer upon consummation would lead to an acquiror being the beneficial owner of more than 5 percent of the equity securities of any class of such securities, Section 14(d) of the Williams Act imposes on an acquiror certain disclosure obligations which go beyond the obligations under Section 13(d) of the Act. Schedule 14 D-1, which sets forth the information to be included in such a tender offer statement, must be sent to the target-company, the SEC, and other persons who have made an offer for the target-company's shares, on the day when the tender offer is made. In addition to the disclosure requirements resembling the requirements under Section 13(d), a person making a tender offer will have to disclose, inter alia, any transaction between the acquiror and the target-company or any of its affiliates within the target-company's three most recent fiscal years.

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However, no disclosure need be made with respect to any transaction if the aggregate amount involved in such transaction was less than 1 percent of the target-company's consolidated revenues for the fiscal year in which the transaction occurred. Also, any contacts, negotiations or transactions within the target-company's three most recent fiscal years between the acquiror or its subsidiaries and the target-company or its affiliates concerning merger, consolidation, or acquisition, a tender offer, election of directors, sale or other transfer of a material amount of assets, must be described in the tender offer statement.²⁹ The acquiror must identify all persons employed, retained, or to be compensated by the acquiror or by any person on the acquiror's behalf, to make solicitations or recommendations in connection with the tender offer.³⁰ Where an acquiror is not a natural person but e.g. a company, particular disclosure requirements apply regarding the acquiror's financial condition³¹. Finally, an acquiror must disclose additional information if material to a decision by the shareholders of the target-company when deciding whether to tender their shares. The obligation to furnish such additional information includes:

- (a) any present or proposed material contracts, arrangements, understandings or relationships between the acquiror or any of its executive officers, directors, controlling persons, or subsidiaries and the target-company or any of its executive officers, directors, controlling persons, or subsidiaries;
- (b) to the extent known by the acquiror after reasonable investigation, the applicable regulatory requirements which must be complied with or approvals which must be obtained in connection with the tender offer;
- (c) the applicable antitrust laws;
- (d) the applicability of the margin requirements of Section 7 of the Securities Exchange Act of 1934 and the regulations promulgated thereunder³²;
- (e) any material pending legal proceedings relating to the tender offer;

²⁹ Item 3 of Schedule 14 D-1.

³⁰ Item 8 of Schedule 14 D-1.

³¹ Item 9 of Schedule 14 D-1.

³² Section 7 of the Securities Exchange Act of 1934 authorizes the Federal Reserve System to issue rules which limit the amount of credit that may be obtained on the basis of collateralized securities. The Federal Reserve has promulgated regulations U, T, and G regarding loans or credit granted by banks, brokers, and other lenders, respectively. In addition to these margin requirements, the Federal Reserve has promulgated regulation X, which prevents U.S. citizens from obtaining loans or credit from foreign lenders if a similar loan or a similar credit granted by an American lender would violate the margin rules.

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- (f) such additional material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not materially misleading.³³

As will be seen, an acquiror is subject to very elaborate disclosure requirements when acquiring the target-company by means of a tender offer.

2.3.3. Substantive protection of the shareholders of the target-company. In addition to the disclosure obligations to which an acquiror is subject, The Williams Act contains provisions which ensure the shareholders of the target-company a certain substantive protection.

According to Section 14(d)(5), shareholders of the target-company who have tendered their shares have the right to withdraw shares deposited pursuant to the terms of a tender offer at any time during the offering period.³⁴

If an acquiror makes a tender offer for less than all the outstanding shares of a class (a partial bid), he must, if he receives acceptances for shares exceeding the number he wishes to buy, make his acquisitions from the shareholders on a pro rata basis, cf. Section 14(d)(6).³⁵

Tender offers must be open to all shareholders of the target-company or of the relevant class of shares; offers may not be restricted to certain shareholders (the so-called “all-holders”-rule). Moreover, all shareholders of a class must be offered the same price for their shares, cf. rule 14d-10.

An acquiror who, after making a tender offer, increases the price offered must pay all shareholders the highest price paid to any shareholder. This means that also shareholders who tendered their shares prior to the increase of the offer must receive the higher price.³⁶

Pursuant to the authority granted in Section 14(e), the SEC has issued rule 14e-1, according to which a tender offer must be open for acceptance

³³ Item 10 of Schedule 14 D-1.

³⁴ Pursuant to Section 14(d)(5), the right to withdraw shares deposited pursuant to a tender offer is limited to a 7 day period after the tender offer is made. However, this time limitation has been abandoned by the SEC in connection with the promulgation of Rule 14d-7, as a consequence of which the right to withdraw may be exercised during the whole acceptance period of the tender offer.

³⁵ Section 14(d)(6) is limited to shares which are deposited pursuant to a tender offer within 10 days after the offer is made. However, the SEC has abandoned this time restriction, cf. Rule 14d-8.

³⁶ Compare rule 4 of the Danish Stock Exchange Rules of Ethics discussed under VIII.2.1.

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for at least 20 business days.³⁷ If the acquiror makes any changes in the price offered to the shareholders of the target-company, or if he changes the number of shares he wishes to acquire, the tender offer shall be open for acceptance for an additional 10 business days, calculated from the time of the change. The question of what constitutes a change has, in some instances, given rise to doubt.

In *Allied Stores Corp. v. Campeau Acquisition Corp.*³⁸ an acquiror announced via the Dow Jones Information Tape on the morning of the day when a tender offer was to expire that the acquiror would use his voting rights in the target-company to give the shareholders of that company a \$3 dividend, provided the acquiror was successful in obtaining the number of shares desired. The court deemed that this information was, in effect, an increase in the price offered in the tender offer. Accordingly, the court ordered the acquiror to extend the tender offer for 10 business days.

The SEC has indicated that even abandoning a minor condition for a tender offer by the end of the opening period must lead to an extension of the offer.³⁹

While a tender offer is open for acceptance, the acquiror may not acquire shares in the company or of that particular class of shares in any other fashion, including on different terms, cf. Rule 10b-13.⁴⁰ A tender offer may, for example, be made contingent upon the acquisition of a certain minimum number of shares of the company, and this is virtually always the case. Tender offers are frequently also conditional upon the neutralization of the target companies' defensive mechanisms⁴¹, provision of

³⁷ According to section 14(e) it is unlawful to make untrue statements of material facts or to omit to state any material fact necessary in order not to make the statements, in the light of the circumstances under which they are made, misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer. The fact that a crucial provision like Rule 14e-1 is not found in the Williams Act itself but issued pursuant to the above authority illustrates the considerable powers which have been vested in the SEC.

³⁸ 86 Civ. 7837 (S.D.N.Y., October 10, 1986).

³⁹ Cf. Exchange Act Release No. 24296 (April 3, 1987). According to this release, the acquiror cannot avoid an extension by reserving in advance the right to make changes in the tender offer.

⁴⁰ Rule 10b-13 has not been issued pursuant to authorities granted in the Williams Act but pursuant to the authority provided in Section 10(b) in the 1934-Act.

⁴¹ See also XI.3.1. about neutralization of "poison pills".

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the necessary financing⁴², or the necessary permissions being granted by the relevant authorities, e.g. with respect to antitrust issues.

The fact that an acquiror obtains control of a company does not trigger an obligation for the acquiror to make an offer to the other shareholders to buy the remaining shares.⁴³

3. Preliminary deliberations

3.1. Introduction. The American stock market, which is the world's largest, provides for the trading of volumes of shares that cannot be compared to the Danish stock market.

While Denmark has only 1 stock exchange, the Copenhagen Stock Exchange, and a small over-the-counter (OTC) market, there are 10 stock exchanges in the United States, of which the New York Stock Exchange (NYSE) is the largest and the most prominent. However, a considerable part of the trading in securities takes place over the counter and in particular via the NASDAQ-system. NASDAQ is an abbreviation of the National Association of Securities Dealers Automated Quotation System. In 1984, NASDAQ's share volume amounted to two-thirds of the share volume of NYSE and nearly ten times the volume of the American Stock Exchange (Amex), see Deborah A. De Mott, *Comparative Dimensions of Takeover Regulation*, in *Knights, Raiders and Targets* p. 398 ff. at 425, note 9.

Generally speaking, regulation of a "thin" market with limited trading volumes and a small number of listed companies cannot carry the burden of very extensive regulation which may be suited for a market with vast volumes of trading and a large number of listed companies. It is, in other words, important to avoid a regulatory framework which impedes investments in the market because investors perceive that it is too burdensome to invest or trade compared to the prospects offered by the market.

Nevertheless, there is a basis for making certain preliminary assumptions with respect to the need for further regulation, and, in this connec-

⁴² In *Newmont Mining Corp. v. Pickens* (1987-1988 transfer binder) Fed.Sec.L.Rep. (CCH) 93,519 (9th Cir. November 6, 1987), the court stated that an acquiror may make a tender offer even if the financing of the acquisition is not in place at the time of the offer. See also *Cities Service Co. v. Mesa Petroleum Co.*, 541 F. Supp. 1220 (D. Del. 1982).

⁴³ As will be seen under VIII.2.1., rule 4 of the Danish Stock Exchange Rules of Ethics imposes on an acquiror an obligation to make an offer to all the other shareholders in such a situation.

tion, the need to consider the impact of private (negotiated) purchases versus public (tender) offers.

From a purely economic viewpoint it can be argued that any further regulation of stock acquisitions will increase transaction costs and thus constitute a barrier to efficiency, cf. the discussion under IV.3.4. This may not be quite correct, however, since adequate regulation is likely to be perceived by investors as an advantage with the result, *ceteris paribus*, that larger quantities of funds flow into the stock market, thereby making financing cheaper for companies.

In addition, it should be considered if – save the efficiency aspect – a desire for equity or equality suggests that certain aspects of takeovers need to be further regulated.

3.2. Disclosure obligations. As opposed to Danish law, the Williams Act's provisions on disclosure obligations are very extensive and aim at creating a high degree of "transparency".

In this connection it is noteworthy that the disclosure obligations under the Williams Act are not limited to identifying the acquiror and the company in which he holds shares as well as the number of shares held by him. The Act contains very detailed requirements that give the public information about the fashion in which the acquiror has financed his acquisition, his plans with respect to the target-company and its incumbent management, and any kind of relationship and cooperation between the acquiror and others regarding the shares in question.

Much has been said about the rationale for mandating disclosure in connection with corporate transactions.⁴⁴ One can say that there are two reasons for imposing disclosure obligations. First, that it is desirable to have a stock market which is as transparent as is required to achieve maximum efficiency. The more knowledge investors have about the market and the securities in the market, the more likely it is that capital will be allocated to uses whereby the maximum value is obtained. On the other hand, if disclosure obligations are too elaborate and extensive, transaction costs will reach a level where the net effect will be counter-efficiency. The other reason is a desire to ensure that all investors receive what is considered to

⁴⁴ See e.g. William H. Beaver, *The Nature of Mandated Disclosure*, Report of the Advisory Committee on Corporate Disclosure to the SEC, 95th Congress 1st Session 618-656 (House Comm. Print 95-29, 1977) and Homer Kripke, *Can The SEC Make Disclosure Policy Meaningful?*, *Journal of Portfolio Management*, Vol. 2, No. 4, p. 32 ff. (1976).

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be an “equal” treatment. If disclosure is made selective, some investors will benefit at the expense of others.

§§ 10 and 11 of the Danish Stock Exchange Act, that contain the major principles for the stock exchange’s operations, reflect a desire to achieve efficiency as well as equality.

While the notion of efficiency is not defined in the Act, the general understanding of the word is perhaps the one described under I.2.2.

It is more troublesome to determine the exact meaning of the principle of equality set forth in § 11. In the disclosure context it is, however, likely that it has been the intention of the legislature to create a “level playing field” in the sense that all investors who invest in the stock market receive, or have equal access to, identical information about the companies listed on the exchange and their securities. It is probably right to determine the category of persons who must be treated alike as all investors because they all act on the basis of information available and are equally harmed if information is conveyed selectively or manipulations are made. This construction is supported by § 39 of the Act dealing with insider trading which states that purchase or sale of listed securities may not be effected by anybody in possession of non-public information, provided that such information must be assumed to be material for the pricing of the securities involved.⁴⁵

Against this background it is fair to conclude that adequate disclosure obligations are of vital importance to efficiency as well as equality. When evaluating the Danish disclosure obligations, the focus should, therefore, be on these two purposes.

3.3. The need for separate regulation of public offers. The American model suggests that public (tender) offers should be made subject to more rigid and extensive regulation than “private” stock purchases.

Public offers addressed to all or a large number of shareholders of a company will, by their very nature, involve shareholders with very varied backgrounds. Some shareholders may be large institutional investors or sophisticated and professional individuals who are in a strong position to evaluate a public offer. Others may be persons whose knowledge and degree of sophistication are limited. The categories of shareholders, in other words, represent a heterogeneous group of people, some of which need more protection than others. A public offer made to all or a large number of shareholders does not give some shareholders special treatment but of-

⁴⁵ See also § 3 of the Information Obligations for Issuers of Listed Securities.

fers to any and all shareholders the same terms and conditions on a “take-it-or-leave-it”-basis.

The same demand for protection does not exist if the shareholders involved in a transaction are a limited number of sophisticated and/or professional investors, who are themselves able to assess the value of their shares and negotiate for the sale of the same.

Put differently, the two different concepts of share acquisition raise different questions.

In this connection it should be noted that shareholders who are parties to a negotiated sale of their shares are, on average, likely to be in a stronger position than the average shareholder who receives a public offer. Typically, negotiated transactions involve blocks of shares that are not insignificant, for which reason it should be expected that the selling shareholder, even though he may not always be sophisticated and professional himself, has access to the advice of professional advisors and, therefore, does not need the same kind of protection as smaller shareholders. Assuming that this line of thought is correct, it is right to assume that shareholders who sell their shares pursuant to a privately negotiated agreement, generally speaking, need less protection than shareholders who receive a public offer for their shares. It is, in other words, more important to ensure that the terms and conditions of a public offer are acceptable than it is to focus on the process and contents of a privately negotiated transaction.

It is not possible, on a general basis, to give an answer to the question if a distinction between various types of stock acquisitions and the existence of special requirements pertaining to public offers can be reconciled with the notion of maximum efficiency. Obviously, the answer depends on the special requirements made with respect to public offers. Some requirements may obstruct while others would promote efficiency. For the purposes of our analysis I will, however, at this point consider such a distinction “neutral” in terms of efficiency.

While the plurality in *Edgar v. Mite Corp.* (457 U.S. 624 (1982)), arguably, considered the American Williams Act to be “neutral” as regards the relationship between acquirors and target-companies, several financial economists disagree, see e.g. Daniel Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Texas Law Review 1 (1978) and Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 Journal of Law & Economics 371 (1980). It is a fact that the Williams Act imposes on acquirors disclosure obligations and also establishes minimum acceptance periods for public offers, for which reason there seems to be little basis for arguing that the Williams Act is neutral.

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Establishing two different “classes” of acquisitions can easily be reconciled with the equal treatment standard set forth in § 11 of the Stock Exchange Act since shareholders in identical situations would be treated alike.

3.4. Minority protection issues. There is another aspect on which the American experience as outlined has not shed light and that is the impact on other shareholders of a change of control of a company resulting from one or a few negotiated stock transactions or from a partial bid. This issue is tied to the notion of minority protection, and will be further discussed under VIII.

4. Danish regulation – revisited

4.1. Introduction. On the basis of the assumptions set forth above, we will now consider how stock acquisitions in Denmark may be regulated, still disregarding the obligation to make a mandatory bid pursuant to the Copenhagen Stock Exchange Rules of Ethics, Rule 4.

First, we will focus on the regulation pertaining to all share acquisitions, including disclosure obligations. Second, we will consider which special regulation is required as regards public offers in particular.

4.2. General requirements regarding stock purchases

4.2.1. Disclosure obligations

4.2.1.1. Thresholds. According to § 28 a and § 28 b of the Companies Act, and rule 3.3. of the Copenhagen Stock Exchange Rules of Ethics, an acquiror must disclose his stockholding when he reaches 5 percent of the votes of the company or of its total share capital, however, a minimum of DKK 100.000. After reaching the 5 percent triggering point, changes in the shareholder’s stockholding that lead it to reach or fall below any of the thresholds specified in § 28 a, Subsection 1, must be disclosed to the company.⁴⁶

It is of importance for the shareholders of a company as well as the market, to become acquainted with major share transactions as early as possible. Not only does the transfer of shares indicate to the market that the shares attract investor interest, but it may also signal a change of the ownership structure of the company. Such changes are relevant for the

⁴⁶ See 1.2. for further details.

shareholders and the market since they may be followed by changes affecting the value of the company.

However, the question is at what level the thresholds should be fixed to accommodate our desire to achieve increased transparency in the market, on the one hand, and to avoid excessive regulation, on the other.

When we look at other jurisdictions we get a somewhat varied picture.

The United States and Great Britain, both with large and sophisticated financial markets, use low thresholds. We saw under 2.2. above that the triggering point under U.S. federal law is 5 percent and that once this threshold has been crossed, any purchase or disposal of shares equal to one percent or more of the class of shares must be disclosed. In British law the triggering point used to be 5 percent but was reduced to 3 percent in 1989 (cf. Section 134 of the Companies Act 1989). Moreover, increases of at least 1 percent will have to be reported.

Among the Continental European countries some use fixed thresholds, such as, e.g., France (fixed at 5, 10, 20, 33.33, 50 or 66.66 percent, cf. Article 356-1 of the Companies Act), and the Federal Republic of Germany (25 and 50 percent, cf. Section 20 of the Stock Corporation Act), whereas others (e.g. the Netherlands and Switzerland) do not impose disclosure obligations except in the event that a public offer is made. As regards EC member states, the thresholds set forth in the Disclosure Directive constitute the minimum requirements that must be imposed on acquirors of shares after January 1, 1991.

Until the coming into force (on July 1, 1991) of the Danish disclosure obligations referred to above, the duty to disclose was triggered when the holding of a shareholder would reach 10 percent of the votes/share capital of the company.⁴⁷ In many companies listed at the Copenhagen Stock Exchange, 10 percent of the votes represents a considerable influence, but not control. Depending on the spread of a company's shares even 5 percent of the votes would give the holder some influence. With this in mind and taking into consideration that early disclosure of major stockholdings increases market transparency, the lowering of the triggering point from 10 to 5 percent is definitely an improvement. However, for the same reasons, it may be considered to add to the 5 percent interval system applying to changes once the disclosure obligation has been triggered, an obligation to disclose which is tied to changes which represent 2.5 percent of the votes/share capital already held by the shareholder. Lowering such a supplementary threshold even further would probably lead to disclosure requirements in events where stock purchases have little or no impact on the

⁴⁷ See the former version of § 28 a.

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other shareholders and the market. In that case we should not burden acquirors with additional duties to disclose.

4.2.1.2. Interests to be included when calculating the threshold. Except for the aforementioned provision in § 28 a, Subsection 2 (on shares the voting rights of which are held by undertakings controlled by the acquiror), the existing Danish rules do not contain anything about shares held by natural persons or entities who are controlled by the acquiror or who cooperate or act in concert with him. When determining if the duty to disclose is triggered, we generally look at the shares of each shareholder individually without regard to relations that he may have with others.

Frequently, acquirors may, by means of ownership or otherwise, be able to control votes regarding shares held by others. Also, cooperating or acting in concert entails that the parties involved are, for all practical purposes, to be considered as one shareholder. In such cases the shares in question should be regarded as being owned by one and the same shareholder for the purpose of determining if the disclosure threshold has been crossed. As just stated, the existing Danish regulation, with one exception, does not provide for this, but the changes following the transformation into Danish law of the Disclosure Directive will, see 1.2.1. above.

The troubling aspect of Article 7 of the Disclosure Directive (dealing with the voting rights which should be regarded as voting rights held by the person or entity in question) is that it does not include cooperation or concerted practice ("samordnet praksis") where no written agreement exists between the parties to such cooperation or practice.

It is likely that there will frequently be no written agreement in these cases although the impact of the cooperation or concerted practice may be as strong as if a written agreement had been concluded.

Article 7 read in conjunction with Article 8 of the Disclosure Directive addresses the situation where the cooperation or concerted practice arises out of the control by a natural person or entity over an undertaking.⁴⁸

Article 8 states that for the purposes of the directive "controlled undertaking" shall mean any undertaking in which a natural person or legal entity:

- (a) has a majority of the shareholders' or members' voting rights; or

⁴⁸ Compare the text under 1.2. dealing with the notion of controlled undertakings under the Danish Companies Act.

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- (b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in, or member of, the undertaking in question; or
- (c) is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights pursuant to an agreement entered into with other shareholders or members of the undertaking.

For the purposes of the above, "a parent undertaking's rights as regards voting, appointment and removal shall include the rights of any other controlled undertaking and those of any person or entity acting in his own name but on behalf of the parent undertaking or of any other controlled undertaking".

However, we still face problems in the event that cooperation or concerted practice exists but where no control can be said to exist.

The British City Code may be a source of inspiration in this respect. When defining the concept of "acting in concert", the definition section of the City Code states:

"Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate, through the acquisition by any of them of shares in a company, to obtain or consolidate control (as defined below⁴⁹) of that company".

This definition of "acting in concert" provides a useful model for the similar problem under Danish law. It includes not only agreements but also understandings – formal as well as informal – and thus goes further than the Disclosure Directive. On the other hand, by making it a requirement that some kind of joint activity must exist and by stating that the purpose of the joint activity must be to obtain or consolidate control, the definition does not go too far to make it a useful criterion.⁵⁰

The City Code provides further guidance by stipulating that certain scenarios create a presumption that the natural persons or entities involved act in concert with other persons/entities in the same category, unless the contrary is established. Such presumption exists among the following:

- "(1) a company, its parent, subsidiaries, and fellow subsidiaries, and their associated companies, and companies of which such companies are asso-

⁴⁹ In the definition section of the City Code "control" is defined as "a holding, or aggregate holdings, of shares carrying 30 per cent or more of the voting rights of a company, irrespective of whether the holding or holdings give de facto control".

⁵⁰ Compare the discussion of the similar concept in the Draft Takeover Directive under 4.3.4.5.

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ciated companies, all with each other (for this purpose ownership or control of 20 percent or more of the equity share capital of a company is regarded as the test of associated company status);

- (2) a company with any of its directors (together with their close relatives and related trusts);
- (3) a company with any of its pension funds;
- (4) a fund manager (including an exempt fund manager⁵¹) with any investment company, unit trust or other person whose investments such fund manager manages on a discretionary basis, in respect of the relevant investment accounts;
- (5) a financial or other professional adviser (including a stock broker) with its client in respect of the shareholdings of the adviser and persons controlling, controlled by, or under the same control as the adviser (except in the capacity of an exempt market-maker⁵²); and
- (6) directors of a company which is subject to an offer or where the directors have a reason to believe a bona fide offer for their company may be imminent."

See also the French Companies Act, Article 356-1-3 (inserted by the 1989-Act) which stipulates that certain scenarios will give rise to a presumption that the persons or entities involved are acting in concert ("agissant de concert") if the acts by such parties were made to carry out a common purpose ("politique commune").

4.2.1.3. Contents of obligation to disclose. The existing Danish rules only require that an acquiror who reaches the threshold discloses his name and address, the number of shares held as well as their nominal value, and the class to which they belong, cf. § 28 b, Subsection 1, of the Companies Act. He need not disclose anything else. The Disclosure Directive does not mandate a change of the law as it is.

In order to create an adequate protection of the interests of the target-shareholders and the market it is probably necessary to extend the duty of an acquiror to disclose beyond merely stating the above information.

We have seen under 2.2. that the Williams Act imposes very extensive disclosure obligations that include the financing of and background for the transaction, information regarding persons with whom the acquiror has

⁵¹ As defined in the definition section of the City Code.

⁵² As defined in the definition section of the City Code.

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entered into agreements, understandings etc. with respect to the target-shares, as well as the plans of the acquiror regarding purchase of additional shares, extraordinary corporate transactions involving the target-company, etc.; but are these very extensive disclosure obligations adequate in a “thin” stock market like the Danish?

It is material for both target-shareholders and the market as such to know if there are persons or entities that hold shares on behalf of, cooperate or act in concert⁵³ with the acquiror. Information of this nature may help to show the purpose of the acquiror’s share acquisition and may, at least sometimes, give an indication of his chances of acquiring control of the company, should he wish to do so.

Also, acquirors ought to have a duty to disclose if share purchases have been made merely as passive investments or if the acquiror is planning to acquire control. In order for the system to provide adequate disclosure while operating smoothly, it would probably be advisable not to require a great deal of details when having acquirors disclose their plans. It would suffice if they include a brief statement in connection with the disclosure of their stockholding, indicating whether or not they have developed plans for acquiring control. Such information would indicate to the target-shareholders and the market whether or not to expect further steps on the part of the acquiror, and they may thus on an informed basis assess the possible impact and prospects in connection with the acquiror’s share purchases.

It would, of course, be possible to require disclosure of additional information, for example, whether the acquiror, if he were to acquire control, has plans to merge, reorganize, liquidate, or sell the company’s assets, or change its dividend policy. Also, disclosure could include possible plans to remove incumbent management, lay off employees, or to have the company delisted from the Stock Exchange.

However, such additional disclosure requirements would probably not be desirable in connection with all disclosures of stock acquisitions.

There are two reasons for this.

First, this kind of information would not be very useful as to acquisition of small blocks of shares at an early point in time where it is premature to assume that the acquiror has developed detailed plans or where plans developed by him are likely to be changed subsequently. Also, to make a disclosure system meaningful we should not devise a concept which is virtually impossible to enforce. Typically, attempting to verify the plans of

⁵³ For a discussion of the notion of “acting in concert”, see 4.2.1.2.

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an acquiror in detail at an early point is impossible. It is difficult to “scrutinize the heart and kidneys” of a person⁵⁴.

Mandating detailed disclosure requirements in such events would often be more misleading than providing guidance.

Second, the more detailed the disclosure requirements, the more complex and thus expensive the system will be to operate. Although disclosure to a certain point creates transparency, we do not want to establish a system which is so elaborate that it reduces efficiency.

On the other hand, if an acquiror reaches a substantial percentage of the target-company’s voting rights, e.g. 20 percent, the picture changes. In that case his ability to influence and the likelihood that he has developed definite plans will be so considerable that it is adequate to impose on him to disclose his plans in such detail as is outlined above. In other words, it is likely that the information that would be disclosed at this point is more reliable and useful and thus justifies more extensive disclosure requirements.

Compared to the existing system of disclosure I have proposed that extensive disclosure requirements should apply once acquirors reach e.g. 20 percent of the voting rights of a company. Also, I have suggested that the present content of the duty to disclose is hardly sufficient even in situations where the acquiror has not reached such a high percentage. The point made here is thus that even though the duty to disclose is triggered when a 5 percent threshold is reached, target-shareholders and the market need to know if there are persons or entities holding shares on behalf of or cooperating or acting in concert with the acquiror. Moreover, an acquiror ought to have a duty to disclose if he has purchased the shares as a passive investment or if he is planning to get control.

4.2.1.4. When to disclose. Rule 3.3 of the Rules of Ethics states that stock acquisitions comprised by the disclosure rules must be notified to the issuer “immediately” upon reaching the relevant threshold.

It is important for the other shareholders as well as the market to receive information on stock transactions as soon as they have been effected.

⁵⁴ See the discussion by Jørgen Trolle of the difficulties in determining the plan or purpose of a transaction in the context of allegations of tax evasion in Ugeskrift for Retsvæsen 1973.B 317 ff. at 318. Jørgen Trolle here comments on *Sejer Sørensen v. Ministry of Finance* (U1973.651, Sup. Ct.).

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By means of illustration, the 10 day “window period” under the American Williams Act has enabled acquirors to use so-called “creeping acquisitions”.

Frequently, an acquiror will commence his attempt to take over the target-company by acquiring shares up to the 5 percent threshold stipulated in the Williams Act. Often such acquisitions take place through companies or persons which cannot be directly identified as connected with the acquiror.⁵⁵ Prior to crossing the 5 percent threshold the acquiror will prepare for further acquisitions of shares, including the financing of such purchases. When these preparations have been completed, the 5 percent threshold will be crossed and the acquiror will initiate extensive purchases of shares to accumulate the largest possible number of shares prior to the expiry of the 10-day notification period in Section 13(d) of the Williams Act. Experience has shown that acquirors are sometimes able to acquire up to 20 percent of the shares of a company within the 10-day period. Obviously, this creates a possibility for the acquiror to put himself in the best possible position prior to making a tender offer.

One of the consequences of acquirors using creeping acquisitions is that the board of the target-company will not be informed about the takeover attempt until a very late point in time. This means that the board will have very little time to evaluate the takeover attempt and the effect of such attempt on the shareholders' interests and even lesser chances of contacting other prospective stock purchasers. It has also been argued that creeping acquisitions are unfair to those shareholders of the target-company who tendered their shares to the acquiror before it became apparent that he planned to take over the company. Had such shareholders known that the acquiror intended to gain control of the company and not just wanted to acquire a limited number of shares, they might have asked a higher price for their shares. Also, creeping acquisitions entail that shareholders who tender their shares at a point in time when no disclosure has been made, do not enjoy the full protection provided for in the special rules of the Williams Act dealing with tender offers.

Sometimes creeping acquisitions are used for a different purpose than just described. By initiating purchases of a company's shares an acquiror may bring the company into “play”, i.e. he demonstrates to the stock market that he is interested in acquiring the company's shares. This kind of share purchases, which will often constitute an illegal manipulation, will lead a number of arbitrageurs to start acquiring shares of the company. As a consequence, the share price will rise and, at a convenient time, the acquiror will start selling his shares at a higher price than he paid for the same shares a short time ago. In the interval between

⁵⁵ This kind of activity sometimes involves what is known as “parking stock” which may, depending on the means used and the circumstances, constitute a violation of the federal securities laws, cf. Ralph S. Janvey, *Parking of Stock*, 16 Securities Regulation Law Journal 164 (1988).

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the purchase and sale of the acquiror's shares it is sometimes seen that the shares are "parked" with companies or persons who do not readily appear to be connected with the acquiror.

In view of the inherent risks of abuse connected to creeping acquisitions a number of bills have been proposed with the purpose of eliminating this phenomenon.⁵⁶

The disclosure requirements under the Rules of Ethics are tighter than the disclosure obligations under the Williams Act.

However, as touched upon earlier, the problem is that the only binding time limit within which relevant acquisitions/dispositions must be notified is the 4-week period in § 28 b, Subsection 1, of the Companies Act.

When adopting the relevant rules for the transformation of the Disclosure Directive into Danish law, the legislature⁵⁷ need only impose on acquirors a 7 calendar day deadline, cf. Article 4(1) of the directive. However, rather than relaxing the principle set forth in Rule 3.3 of the Rules of Ethics, the legislature ought to keep the contents of the rule and merely transform it into a legally binding provision.

Consistently with the concerns expressed above, British law requires that notification is filed within 2 days after reaching the relevant threshold, cf. Section 134 of the Companies Act 1989. In French law, notification must take place within 5 business days, cf. Article 356-1 of the Companies Act.

4.2.2. Is there a further need for regulating stock acquisitions by means other than public offers? It may be queried if disclosure requirements are a sufficient means to protect shareholders and investors in a situation where no public offer has yet been made.

In the British SAR a "speed limit" has been established in connection with stock acquisitions.

⁵⁶ See, for example, a bill introduced by senator D'Amato, pursuant to which stock purchases in the open market would be limited to 2 percent of a company's stock if the acquiror already owns 20 percent or more of the shares of the company, S. 227, 100th Cong., 1st Sess. (1987). Senator Metzenbaum has proposed that any purchase of more than 15 percent of a company's shares must be made by means of a tender offer, and that the acquisition of more than 35 percent of a company's shares triggers an obligation for the acquiror to make a tender offer for all the shares of the company, such offer to be open for acceptance for at least 6 months, cf. S. 678, 100th Cong., 1st Sess. (1987).

⁵⁷ In casu the Ministry of Industry, see § 28 c of the Companies Act.

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Thus, acquirors are prevented from acquiring shares in any period of 7 days carrying voting rights in a company representing 10 percent or more of the voting rights if such shares, together with any shares already held by the acquiror, carry 15 percent or more, but less than 30 percent, of the voting rights of the company.⁵⁸ An exception to this rule applies if the shares in question have been acquired from a single shareholder and it is the only such acquisition within any period of 7 days.⁵⁹ Likewise, shares acquired pursuant to a tender offer are exempted.⁶⁰

In this connection, the term “tender offer” is used to describe a cash purchase offer made through two national daily newspapers for the purpose of acquiring shares which would lead the acquiror to hold a maximum of 29.99 percent of the voting stock of a company, having a minimum opening period of 7 days, and including a fixed price or a maximum price.⁶¹

Finally, share acquisitions made immediately before the acquiror announces a firm intention⁶² to make an offer are exempted, provided that the offer will be publicly recommended by, or is made in agreement with, the target-board, and the acquisition is conditional upon the announcement of the offer.

After reaching the 15 percent threshold, the acquiror must notify the target-company and The International Stock Exchange (who will inform The Take-over Panel). Moreover, the 15 percent threshold triggers a duty for the acquiror to notify about any increase of his shareholding in the company exceeding 1 percent of the company's share capital. Notification must take place not later than 12 o'clock noon on the day following the transaction.⁶³

However, while disclosure requirements serve a clear purpose, it is far from certain that there are any beneficial effects in having share purchases slowed down as has been done in Great Britain. The desire to avoid “dawn

⁵⁸ Rule 1 in the SAR.

⁵⁹ The SAR Rule 2(a).

⁶⁰ The SAR Rule 2(b).

⁶¹ See the SAR Rules 4.1 and 4.2 as well as the notes to the two rules. As it appears, the tender offer concept in British law is limited to a very specific type of offer and is substantially different from the corresponding term under American law, cf. 2.3.1.

⁶² As indicated in the text, Rule 2 of the SAR uses the words “firm intention”. According to Rule 2.5 of the City Code, the announcement of a firm intention to make an offer should be made only when an acquiror has every reason to believe that he can and will continue to be able to implement the offer.

⁶³ The SAR, Rule 3.

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raids” is probably most efficiently accommodated by imposing on acquirors of shares a duty to disclose their plans at a very early point. It should be borne in mind that mechanisms whereby stock acquisitions are slowed down are likely to lead to reduced efficiency since it complicates the regulation of the takeover process and thereby makes the process more expensive. Such complication is only acceptable if it leads to definite benefits for the target-shareholders or the market. It is not obvious that benefits of this nature are connected to “speed limits”.

4.3. Public offers

4.3.1. Introduction. While particular requirements are triggered the moment that an acquiror obtains control of a company, no other distinction exists between various types of acquisition techniques.

Public offers⁶⁴ are subject to no particular regulation in Denmark. Typically, when public offers are made, this is done after agreement has been reached between the acquiror and the management of the target-company. Ordinarily, the parties will, prior to making a public offer, discuss the necessary steps to be taken with the Copenhagen Stock Exchange in order to ensure that the Exchange can accept the proposed plans. So far, there has perhaps only been a limited need for specific rules set forth in writing rather than expressed in the practice of the Stock Exchange.

However, it is a weakness of the current system that there is so little guidance to find in writing. The need for clarity is further underscored by the fact that in the future corporate acquisitions may increasingly take the shape of contested takeovers. Where breach of the relevant rules may be decisive for the outcome of an attempt to acquire a company, the demand for clarity and predictability stands out. Against this background, it would be preferable if the requirements pertaining to public offers were set forth in, for example, the Copenhagen Stock Exchange Rules of Ethics⁶⁵.

The following comments specifically address public offers, including competing public offers.

There are no persuasive reasons for, generally, giving new offers which compete with offers already made a special treatment, cf. the principle set forth in Article 20(1) of the Draft Takeover Directive. However, according to Article 20(3) of the draft, persons acting in concert with the acquiror, or on his account, should not be permitted to make a competing bid, unless they obtain the authorization from the relevant competent authority. This seems to be a reasonable restriction

⁶⁴ As defined under 1.3.

⁶⁵ See also the discussion under VI.

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in order to avoid manipulations harming target-shareholders. Also, as we will discuss later, the occurrence of a competing offer may justify changes in the legal position of the original acquiror and the target-shareholders. Under French law, competing bids based on consideration in cash, which compete with a cash bid must be made at a price that exceeds the initial bid by at least 2 percent, cf. Article 5-2-26 of the General Rules. Such a requirement is probably superfluous since it is likely that virtually any competing offer will be made on terms that exceed the terms of the initial offer.

4.3.2. Before an offer is made. Under present Danish law an acquiror has no obligation to announce in advance his plans to make a public offer. Moreover, he has no duty to contact the Copenhagen Stock Exchange or the target-company prior to making a public offer. In the following we will discuss if there is a need to impose obligations on acquirors in these two respects.

There are various reasons why it is desirable to have an acquiror who wishes to make a public offer announce this publicly as early as possible. One is the fact that there is an increased risk of insider trading in the period between the decision to make a public offer and the actual publication of the offer⁶⁶. Another reason is that the target-shareholders as well as the market have an interest in being informed about possible changes of large stockholdings so that they can make their investment decisions on the basis of up-to-date information.

The rules of the British City Code constitute a useful source of inspiration as to how to achieve early disclosure on the part of acquirors. When a potential acquiror has reached the point where he has a firm intention to make an offer, the City Code imposes on him a duty to announce this, provided, however, that he has a real reason to believe that he can and will continue to be able to implement the offer.⁶⁷ This announcement is binding on the acquiror in the sense that he must proceed with the offer, unless the posting of the offer is subject to prior fulfilment of a specific condition and that condition has not been met, or The Take-over Panel has granted an exemption from the obligation to make an offer.⁶⁸ An exemption may,

⁶⁶ This concern is expressed in the preamble to the Draft Takeover Directive.

⁶⁷ See the third of the general principles and Rule 2.5(a) of the City Code.

⁶⁸ See Rule 2.7 of the City Code.

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for example, be granted if it turns out that the offer was made on the basis of incorrect information.⁶⁹

The announcement of a firm intention to make an offer must contain information regarding a number of facts, including the terms of the offer, the identity of the acquiror, details of any existing holding in the target-company which the acquiror owns, controls, or which is controlled by a person acting in concert with the acquiror, or in respect of which he has received an irrevocable commitment to accept the offer, or in respect of which he (or any person acting in concert with him) holds an option to purchase, all conditions to which the offer or the posting of it is subject, and details of any arrangement that exists with the target-company or with an associate of the acquiror or the target-company in relation to the shares of the target-company. Also, the announcement must include confirmation by the financial advisor or by another appropriate third party that resources are available to the acquiror sufficient to satisfy full acceptance of the offer, see Rule 2.5(b) and (c) of the City Code.

The Swedish Recommendation regarding Public Offers for Shares (1988) uses a somewhat similar concept by requiring an acquiror to issue a press release immediately after he has decided to make a public offer, see II.1. of the Recommendation.

The press release must contain the prime terms of the offer, including possible conditions. Moreover, the release must include the number of votes that the acquiror holds or otherwise controls. The acquiror must also state if or to what extent he has been assured acceptance of his offer by target-shareholders. He must indicate the motives for his offer and, to the extent practically possible, the effects of the offer on the target-company, expressed in the effect on each share, where appropriate. Finally, the press release must include a time schedule for the implementation of the offer, see II.2. of the Recommendation.

Similarly, pursuant to article 7(1) of the Draft Takeover Directive, an acquiror should inform the relevant supervisory authority as well as the target-board as soon as he decides to make a bid and then make public his intention of doing so. Article 7(1) refers to Article 11(1)(a) as to the means of publication. Article 11(1)(a) gives an acquiror the option to choose between publication in one or more national or mass-circulated newspapers; or in the national gazette; or in any other fashion affording wide circulation of the information and approved by the relevant supervisory authority.

The system of imposing on acquirors an obligation to announce their intentions once they “firmly” intend to make an offer is very well fit to serve the purpose described above. The particular advantage connected to the British model is that it binds an acquiror, with certain exceptions, to make

⁶⁹ See e.g. statement on *Combined English Stores Ltd. and David Greig Ltd.*, 309 Journal of Business Law (1974).

an offer once he has announced his intention to do so. This is probably an important point since, if no such obligation existed, it would be possible to manipulate the market by stating that a public offer would be made, which would then not happen.

As regards the particulars of the announcement, the provisions referred to above of the Swedish Recommendation represent an adequate balance between the desire for a high level of information, on the one hand, and an interest in avoiding excessive disclosure obligations, on the other.

In some jurisdictions, e.g. France and Great Britain, an acquiror must submit his offer document to an authority in advance for approval.

French law provides for various ways of acquiring large stockholdings. The procedure touched upon here is the so-called "procédure normale". This procedure stipulates detailed requirements according to which any public offer must be submitted to the Stock Exchange Council in advance for approval. A potential acquiror cannot himself submit a request for approval to the Council, but must do this through a financial institution that must issue a guarantee for the obligations of the acquiror pursuant to the offer, see Article 5-2-1 of the General Rules and Article 8 of the COB-rules. The request must include information regarding, inter alia, the objective of the offer, the minimum and maximum number of shares that the acquiror wishes to acquire, and the price or exchange ratio offered, see Article 5-2-5 of the General Rules.

In connection with its assessment of a proposed offer, the Stock Exchange Council will, among other factors, examine the price offered in order to determine if it is fair, see Article 5-2-7 of the General Rules. For a discussion of principles of valuation in connection with corporate acquisitions, see Didier Martin, *Les Critères d'Evaluation et le Droit des Acquisitions*, *Revue de Droit des Affaires Internationales*, p. 301 ff. (1988). In addition to the approval required by the Stock Exchange Council, the COB must approve the prospectus ("note d'information") before an offer can be made, see Article 5-2-8 of the General Rules and Articles 7-9 of the COB-rules.

As to British law, see Section 6, Chapter 2, paragraph 2, of the Yellow Book.

Article 7(2) and (3) of the Draft Takeover Directive would impose on an acquiror an obligation immediately after making public his plans to draw up an offer document that must be communicated to the supervisory authority and to the board of the target-company prior to being made public.

The Draft Takeover Directive leaves it up to the member states to decide whether their supervisory authority must approve a bid in advance before it is made, cf. Article 6(2)(a), but if approval is required under national law prior to publication of an offer, the authority's decision must be made within 3 working days from lodging of the document, cf. Article 6(2)(a).

The question is if requirements to obtain a pre-offer approval are desirable. On the one hand it would ensure that the offer document complies with the

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relevant regulation and thus benefit the shareholders of the target-company. On the other hand, the duty to have offer documents reviewed in advance by e.g. the Board of the Copenhagen Stock Exchange complicates the regulatory system and, moreover, is a time-consuming device. The question, therefore, is if the best solution would not be to create a clear and predictable regulatory framework leaving little doubt about the requirements pertaining to public offers. If the regulatory framework had these features, it would probably be sufficient to impose on acquirors an obligation to file offer documents with the Copenhagen Stock Exchange simultaneously with making the offer. Acquirors would know then that the Stock Exchange would monitor and perhaps review the materials filed with the Exchange, which would give acquirors a strong incentive to adhere to the relevant rules. Also, they would know that failure to follow the rules would easily be detected by one or more shareholders who would probably then involve the Stock Exchange. Altogether it is likely that clarity of regulation and monitoring by the Copenhagen Stock Exchange would make it unnecessary to require pre-offer involvement by the Stock Exchange.

In connection with the Draft Takeover Directive, the requirement (under Article 7(3)) that draft offer documents must be communicated to the supervisory authority and the target-board prior to publication should be read in conjunction with the powers of the supervisory authority under Article 6(2). The latter provision would give the authority powers to prohibit or impose on acquirors to change an offer document that does not comply with the directive.

Under French law⁷⁰, the quotation of shares of the acquiror (assuming it is a listed company) and the target-company are suspended temporarily once the application for an offer has been filed with the Stock Exchange Council. While such a system may be adequate where the takeover process is extended because a pre-bid approval is required and an increased risk exists of insider trading or speculation, we probably should not introduce a general mechanism of this kind if we elect not to have a pre-bid approval system.

The next question is if it is desirable to make it a requirement that the acquiror inform the target-company in advance about his plans and perhaps even invite target-management to discuss his acquisition plans.

⁷⁰ See Articles 5-2-1 and 5-2-11 of the General Rules.

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According to the British City Code, an acquiror who wishes to make a public offer must in the first instance forward the offer to the board of directors of the target-company or to its advisors, see Rule 1(a) of the City Code.

The German Guidelines and the Dutch Merger Rules provide for a similar duty, see Clause B.2. of the Guidelines and Article 4 of the Merger Rules, respectively. The Dutch rules state that the acquiror must invite the target-board to discuss the offer within a 7 day period.

The interests of target-management, like the interests of target-shareholders and the market as such, are properly protected by making it a requirement that acquirors announce their plans once they have decided to make a public offer. The moment such plans become public knowledge, everybody, including target-management, may prepare for the acquiror's further steps. It is difficult to see why an acquiror should have an absolute obligation to inform or talk to the target-management in advance. If he finds it appropriate to inform or talk to target-management, he may elect to do so but he should have no duty in this regard.

4.3.3. Communicating the offer. There are no mandatory means by which public offers must be communicated to target-shareholders under Danish law.

It is important that publication of a public offer is made in a manner that ensures that all target-shareholders as well as the stock market are informed about the offer at the same time and in an efficient manner. To achieve this, the Copenhagen Stock Exchange Rules of Ethics ought to include requirements with respect to publication of offers.

Although the details of the regulation of how to communicate public offers varies in different jurisdictions, the basic principles of regulation are quite similar.

For example, under U.S. law, an acquiror may make the terms of a tender offer available to target-shareholders by means of a so-called "long-form publication" (in a newspaper or newspapers) or by means of a so-called "summary publication", i.e. a brief advertisement that contains a summary of the tender offer and indicates where copies of the full offer may be obtained, see Rule 14d-6, issued by the SEC under the Williams Act. Ordinarily, summary publications are used.

According to the Dutch Merger Rules, public bids must be announced by means of an advertisement in the Stock Exchange Gazette or in the nationwide press. The advertisement may be brief and merely indicate the price or exchange ratio offered, provided that the advertisement contains information indicating that the full terms and conditions of the offer may be obtained from the acquiror, see Article 5 of the Merger Rules.

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The Swedish Recommendation sets forth that the terms and conditions for a public offer must be included in a prospectus which must be sent to all holders of shares comprised by the offer whose addresses are known, and, likewise, the Stockholm Stock Exchange and the media must receive copies of the prospectus, see II.1. of the Recommendation.

Article 11(1) of the Draft Takeover Directive sets forth that member states shall select at least one out of three categories of forms of disclosure. If the first category (a) is selected, the offer document must be published either in one or more national or mass-circulated newspapers; or in the national gazette; or by other means affording wide circulation of the information and approved by the supervisory authority. The second category (b) mandates that the offer must be made available to the target-shareholders at addresses announced in notices in the newspapers and/or the gazette referred to above or by equivalent means approved by the supervisory authority. However, where all the shares covered by the offer are registered, the offer may be published by circulation to all addressees of the offer (this is the third category, (c)).

In our search for a suited model for Danish regulation we may want to look at the system found in the Prospectus Order issued by the Danish Ministry of Industry, which in Chapter 4 prescribes publication of prospectuses to be published before the listing of securities at the Copenhagen Stock Exchange.

In § 18, Subsection 2, it is stated that publication may be made either through an advertisement in a Copenhagen newspaper and, as to companies domiciled in Denmark but outside Copenhagen, also in at least one local paper, or in the form of a leaflet made available free of charge to the public at the Copenhagen Stock Exchange and at the issuer's domicile as well as with the financing bodies handling the financing operations of the particular issuer relating to its application for admission for listing. Moreover, Subsection 3 of § 18 stipulates that steps shall be taken to have either the complete prospectus or a notice stating where the prospectus has been published and where it may be obtained by the public inserted in the Danish Official Gazette ("Statstidende").

The requirements under § 18 represent an adequate solution to how public offers could be communicated to the shareholders of the target-company as well as the market as such.

4.3.4. Terms and conditions of the offer

4.3.4.1. Basic requirements. Although this would probably always be the case in practice, it ought to be a requirement that public offers are made in writing. Moreover, the offer document should identify the acquiror and the target-company, as well as stipulate the details regarding the shares of the target-company that are comprised by the offer, including the minimum

and the maximum number of shares to be acquired by virtue of it. In addition, the offer document must include an indication of the price per share and/or exchange ratio offered by the acquiror and the period within which the offer must be accepted.

See also the Draft Takeover Directive, Article 10 (1)(a), (b), (d), (da), (g) and (j). Article 10(1)(g) would require that the offer document should state how the consideration will be given and, in the case of cash consideration, the arrangements made or to be made for the payment of that consideration. In the case of consideration consisting of securities, the document should give evidence that the acquiror has such securities at his disposal or, if relevant, an undertaking to convene a general meeting of shareholders of the acquiror where the issue of the securities in question could be authorized.

4.3.4.2. The price. Unless a mandatory public offer is made pursuant to Rule 4 of the Copenhagen Stock Exchange Rules of Ethics, no provisions exist containing requirements with respect to the price to be offered or regarding the value of the consideration.

There are two main aspects of disclosure in connection with the price of an offer. The first is whether there ought to be a duty to disclose the rationale or motives for the price/exchange ratio being fixed as it is in the offer. The second is whether the acquiror should have an obligation to state or document the value of the consideration offered.

With respect to the first aspect, the solutions found in foreign law do not create a consistent picture.

Neither the Williams Act nor the City Code contains any provisions that require an acquiror to state the basis on which he has computed the price (or exchange ratio) offered.

As outlined under 4.3.2., the French takeover regulation entails that the Stock Exchange Council evaluates the price offered to ensure its fairness. Nevertheless, the offer document must indicate how the price has been determined, cf. Article 7 of the COB-rules.

The German Guidelines provide that the offer must include a statement of the facts that were decisive for the determination of the price offered, see Clause C.5. of the Guidelines.

Similarly, under Dutch law an acquiror must state in his offer document the motives for the price/exchange ratio offered, see Article 6(1) h of the Merger Rules.

Article 10(1)(g) of the Draft Takeover Directive states that acquirors must indicate the basis of the valuation used in determining the consideration offered.

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This probably would entail that acquirors have to indicate the basis for the price/exchange ratio offered.

Since the target-shareholders may be expected to be familiar with the prices quoted for their shares prior to the offer, they would have little difficulty in evaluating whether or not the offer provides them with a premium on top of the market price. Although a statement by an acquiror of the reason why he is willing to pay the price offered could sometimes signal changes or restructurings which are a prerequisite for the acquiror being successful in his business objectives, the question is if there is a true need for such a requirement. Assuming that we impose on acquirors an obligation to state previous dealings in target-shares, cf. 4.3.4.5., as well as their plans and the expected effects of the acquisition, see 4.3.4.6., there is probably no need to complicate the regulatory system further by mandating disclosure of the rationale or basis for the price offered.

Turning to the second of the above-mentioned aspects of disclosure, we will first take a look at some of the jurisdictions that have focused on this.

The British City Code stipulates that when an offer involves the issue of unlisted securities, the offer document and any subsequent circular from the acquiror must contain an estimate of the value of such securities by an appropriate advisor, see Rule 24.10 of the City Code. Furthermore, the City Code imposes on acquirors extensive disclosure requirements regarding the financial position of the acquiror, including, inter alia, turnover, net profits or losses and dividends per share for the last 5 financial years, see Rule 24.2 of the City Code.

The Swiss Take-Over Code states that, in case of an exchange offer, the acquiror must indicate details of the place where the last three annual reports of the acquiror and a report on the current year are available. If listed securities are offered as consideration, the acquiror must indicate details of the quotations for the last three years; if non-listed securities are offered as consideration, he must include an estimate of the value of such securities by the firm of accountants supervising the offer, see Article 4.5 of the Code.

According to the Swedish Recommendation, offers based on consideration other than cash and/or listed shares must include a description of the consideration, which enables the shareholders to evaluate this. In case alternative consideration is offered, the description must enable shareholders to compare the alternatives, see III.1 and 2 and the exhibit regarding prospectus requirements, item 2, to the Recommendation where further details are set forth.

The Draft Takeover Directive, Article 10(1)(g), imposes on acquirors a duty to state the method used in connection with the determination of the consideration offered. Where the consideration offered includes securities which have been admitted to listing at a stock exchange in one of the member states within the last 12 months, the offer document shall be accompanied by listing particu-

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lars drawn up in accordance with Council Directive 80/390/EEC, see Article 10(3).

If the consideration offered includes securities other than those mentioned above (i.e. non-listed), the offer document must contain all the information equivalent to the information to be found in the aforementioned listing particulars, enabling the offerees to make an informed judgment as to the assets and liabilities, financial position, record and prospects of the issuing company, see Article 10(4).

The Swiss concept outlined above represents a suitable model with respect to information pertaining to the value of the consideration of the offer. If the consideration offered consists of cash and/or listed shares, it is likely to present few problems for target-shareholders to evaluate the offer. Consideration in cash is comparatively easy to handle. This is likely also to be the case as to listed shares where information on the quotations for a reasonable period prior to the offer provides a useful basis for evaluating the current value of target-shares. Perhaps the three year period of the Swiss Rules should be reduced to 12 months, since quotations further back in time have limited interest only.

Things become more complicated where the consideration consists of non-listed securities. In such cases it is important that the offer contains the opinion of an expert stating the value of the shares and the method of valuation used, thus enabling the target-shareholders to ascertain if the value of the consideration offered is reasonable. Instead of having a firm of accountants supervising the offer as it is seen in Switzerland, the concept of impartial expert valuers could be used, as it is known from e.g. § 134 c of the Danish Companies Act regarding mergers, see also VIII.4.4.

To the extent that a public offer is based, wholly or partly, on consideration consisting of securities, it should be stipulated from what date such securities entitle the holders to dividends or interest, see also Article 10(1)(h) of the Draft Takeover Directive.

4.3.4.3. Offering period. We are concerned with two issues regarding the offering period: should we have a minimum period and should we have a maximum period in which an offer may be kept open for acceptance?

In the absence of Danish regulation in this area, it may be useful to initiate our query by having a look at foreign jurisdictions.

As to U.S. law, reference is made to 2.3.3.

The British City Code sets forth that an offer must initially be open for at least 21 days following the day on which the offer document is posted, see Rule 31.1. In the event that an offer is revised, it must be kept open for at least 14 days fol-

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lowing the day on which the revised offer document is posted, see Rule 32.1. An acquiror may not declare his offer unconditional as to acceptances, unless he obtains the consent of The Take-over Panel, on the 60th day after the day the initial offer document was posted, Rule 31.6 of the City Code. (The Take-over Panel will normally only grant an exemption if a competing offer has been announced, if the board of the target-company consents to an extension, or if the target-board announces trading results, profit or dividend forecasts, asset valuations or proposals for dividend payments after the 39th day following the posting of the initial offer document, cf. Rule 31.6(a) and Rule 31.9.). If the acquiror has not received a sufficient number of acceptances after midnight on the 60th day after the day the initial offer document was posted, and provided that The Take-over Panel has not granted an exemption, the offer lapses.

Under French law an offer must be open for acceptance for at least 20 trading days counted from the day of publication, see Article 5-2-9 of the General Rules.

The German Guidelines set forth that the opening period of an offer must be at least 21 days and not more than 60 days, see Clause D.1. of the Guidelines.

Under the Dutch Merger Rules public offers that are made with the approval of target-management need only be open for 20 days, whereas public offers made in an attempt to take over the target-company on a "hostile" basis must be open for acceptance for a minimum of 30 days, see Article 7a(2) of the Rules.

Pursuant to the Swiss Take-Over Code a public offer can be accepted only after a period of 10 working days from the date of publication. It has to remain open for acceptance for at least one month after this later date, but for no more than two months, see Article 3.4. of the Code.

The Swedish Recommendation stipulates that offers must remain open for at least 3 weeks and that the offering period does not commence until the prospectus has been published, see II.3 of the Recommendation.

Article 12(1) of the Draft Takeover Directive sets forth that the period for accepting an offer may not be less than 4 weeks or more than 10 weeks from the date of publication of the offer document. Modifications of the offer period would only be allowed with the permission of the supervisory authority, which must indicate the grounds for its decision, cf. Article 12(2) of the Draft Takeover Directive.

There are various reasons for imposing on acquirors the duty to stipulate a minimum offering period in the offer. First, it ensures that target-shareholders do not feel compelled to tender their shares without having sufficient time to consider the price and other terms of the offer as well as the impact that the offer may have on the target-company. Second, a minimum opening period allows other prospective acquirors to make bids for the target-shares, which may benefit target-shareholders. Third, having a minimum opening period gives target-management time to consider the

offer and provide adequate advice to target-shareholders regarding whether to accept the offer or not.

It seems that a minimum opening period of one month provides a reasonable opportunity for shareholders to consider and decide on an offer. Within this time target-shareholders have opportunity to retain advisors and, moreover, the market has time to respond to the offer. There appears to be no particular reasons for having longer minimum opening periods for contested offers than for other offers as is the case under the Dutch rules.

The second question is if there is a need for a maximum opening period as is seen in e.g. Great Britain, Germany and Switzerland and as proposed in the Draft Takeover Directive.

It is probably desirable to have a “cap” on the offering period in order to encourage acquirors as well as target-shareholders to consummate changes of corporate control within comparatively short spans of time in order to avoid the uncertainty attaching to public offers for e.g. 3 or 4 months.⁷¹ It, therefore, seems desirable to have e.g. a 2 month limitation on the opening period of public offers.

4.3.4.4. Conditions of offers. In the absence of specific regulation, Danish law entails that an acquiror is free to make his offer conditional upon the fulfilment of one or more conditions. The question is if we should limit this right of acquirors.

A comparative outlook shows us that no consensus exists on this issue.

Neither the American Williams Act nor the German Guidelines contain restrictions with respect to the right of acquirors to state conditions.

The British City Code provides that public offers must normally not be subject to conditions which depend solely on subjective judgments by the directors of the acquiror or the fulfilment of which is in their hands, see Rule 13 of the Code. The official comments on this rule state that The Take-over Panel may be prepared to accept an element of subjectivity in certain special circumstances where “it is not practicable to specify all the factors on which satisfaction of a particular condition may depend, especially in cases involving official authorizations, the granting of which may be subject to additional material obligations” for the acquiror. It would also, the comments add, normally be acceptable for an announcement of an offer to be expressed as being conditional on statements or estimates being appropriately verified.

⁷¹ The preamble of an earlier version of the Draft Takeover Directive, prepared by the Permanent Representatives Committee (10854/89, EF 105, DRS 67, Brussels, December 15, 1989), emphasizes the desire to avoid target-companies remaining “under siege” beyond a reasonable time.

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Similarly, under Dutch law conditions may only be inserted in an offer document if they do not, in effect, give the acquiror an unlimited discretion to decide whether the offer should be consummated or not, see Article 11(1) of the Merger Rules.

The Swiss Take-Over Code follows the same line of thinking by stating that an offer can only be subject to conditions that the acquiror himself cannot influence, see Article 3.2 of the Take-Over Code. As examples of such conditions the Code mentions the acquisition of a given percentage of the relevant securities or the registration of the acquiror's shareholding.

The Swedish Recommendation does not impose on acquirors any restrictions with respect to the nature of the conditions allowed. Instead, the Recommendation provides that the tendering shareholders may withdraw their acceptance of the offer until the moment the acquiror announces that the conditions in the offer have been met or, if such announcement is not made, until the moment when the acceptance period expires, see II.4. of the Recommendation.

Article 10(1)(i) of the Draft Takeover Directive provides that conditions must be "beyond the offeror's control" and authorized by the supervisory authority.

It seems reasonable to allow acquirors to make public offers conditional upon, for example, the acquisition of a certain minimum percentage of target-shares or the dismantling of provisions in the target-company's charter that are meant to prevent takeovers. The minimum percentage requirement has particular importance because of the right to cash out minority shareholders pursuant to § 20 b of the Companies Act, which only applies if the acquiror owns more than 90 percent of the target-company's share capital and votes.

A related question is if the use of public offers ought to be restricted to offers which, if accepted, would lead to the acquiror holding a certain (significant) percentage of target-shares. On the one hand one may argue that public offers affect the market price of target-shares and that such "turbulence" is only acceptable if a large number of shareholders have the opportunity to sell their shares. Offers for minor numbers of shares could be said to create too much "noise" compared to the benefits inuring to shareholders. On the other hand it could be argued that acquirors very rarely would make public offers for small numbers of shares since this means of acquiring shares typically leads to the payment of a price above the market price. Minimum requirements are thus likely to be of limited practical importance. The latter point carries much weight and, when viewed together with our interest in avoiding excessive regulation, supports the conclusion that no minimum requirements should be established in this respect.

Other conditions should also be allowed, provided that they are clearly stated and do not leave too much uncertainty with respect to their fulfilment.

However, if a condition is very broadly stated, it may, in effect, leave it to the acquiror's sole discretion whether to proceed with the public offer or not. This uncertainty should be avoided because it gives room for manipulation that is harmful to target-shareholders as well as to the stock market. Once a public offer is made, the price of the target-company's shares will increase and the players in the market will base their decisions on the increased price. If, nevertheless, an acquiror were allowed to withdraw his offer at his discretion, this would be harmful to investors who would be left without protection.

Therefore, conditions ought to be allowed only to the extent that they do not primarily depend on subjective judgments on the part of the acquiror or the fulfilment of which is in his hands, cf. Rule 13 of the British City Code mentioned above.

4.3.4.5. Information regarding existing shareholdings, dealings and cooperation with others. The question here is if, or to what extent, it ought to be a right for the target-shareholders and the stock market to receive information about the size of the acquiror's existing holding of and his recent dealings in target-shares as well as the existence and nature of any cooperation between the acquiror and others.

Information regarding the percentage of target-shares and votes held by the acquiror is material for the target-shareholders and the stock market as information of this nature may give an impression of the strength of the acquiror and the likelihood of him being able to acquire control of the target-company. Therefore, such information regarding the acquiror's existing shareholdings should be made a mandatory part of the information that must be set forth in the offer document.

The regulation of public offers in other jurisdictions is consistent with the view expressed in the text, see, for example, 2.2. and 2.3.2. regarding U.S. law, Rule 2.5(b) of the British City Code (on announcement of a firm intention to make an offer), Article 7 of the French COB-rules, Clause C.6 of the German Guidelines, Article 4.3. of the Swiss Take-Over Code, and the Swedish Recommendation, II.2. See also Article 10(1)(e) of the Draft Takeover Directive.

The obligation to disclose holdings of stock ought to include convertible securities, options and warrants giving the holder the right, on a unilateral basis, to acquire or subscribe to target-shares. Also, shares owned by others, but with respect to which the acquiror has the right to exercise the voting rights, ought to be included. The Draft Takeover Directive provides some useful inspiration in this regard.

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See Article 10(1)(e) of the Draft Takeover Directive, which defines in which situations shares are regarded as being “held” by the acquiror (or any of the other persons or entities referred to in points (bb) - (dd) of Article 10(1)(e)). This is the case as to the following:

- (a) securities in which the acquiror has the life interest;
- (b) securities which the acquiror is entitled to acquire, on his own initiative alone, under a formal agreement;
- (c) securities deposited with the acquiror to which voting rights are attached which the acquiror can exercise at his discretion in the absence of specific instructions from the security holders.

Article 10(1)(ee) addresses the situation where the acquiror (or any of the other persons or entities referred to above) hold shares that are lodged as security. Such shares must be indicated in the offer document, unless the person or entity holding the security controls the voting rights and declares his intention of exercising these, in which case such shares are to be regarded as belonging to the latter.

It is perhaps less obvious why previous dealings in target-shares by the acquiror must be indicated in the offer document. Foreign jurisdictions sometimes impose requirements of this nature on acquirors.

If, for example, a person whose shareholdings are required to be disclosed pursuant to the City Code has dealt for value in the shares in question during a period beginning twelve months prior to the offer period and ending with the latest practicable date prior to the posting of the offer document, the details must be stated, Rule 24.3(c) of the City Code.

Following a similar pattern, the Dutch takeover regulation provides that the offer document must state if the acquiror has acquired shares of the target-company within the last 3 years prior to the announcement of the acquiror's plan to make an offer, see Article 6(1) of the Merger Rules.

Also, the Swiss rules stipulate that the acquiror must set forth in the offer document the number of shares acquired and disposed of within the preceding year, see Article 4.3. of the Swiss Take-Over Code.

See also the Draft Takeover Directive, Article 10(1)(e), which stipulates that dealings in target-securities by any of the persons or entities referred to in Article 10(1)(e) points (bb) - (dd) within the last 12 months preceding the announcement must be indicated.

Typically, target-shareholders and the market will be concerned with the future, i.e. what is to be expected, and not the past. It may, nevertheless, make sense to impose on acquirors a duty to indicate major dealings within, for example, a 12 month period prior to the announcement of the

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public offer provided, however, that information is included about the price paid in connection with such previous dealings. A duty on the part of an acquiror to disclose the price paid per share in earlier transactions may help to provide a picture of whether the price offered in the public offer is reasonable.

Of material importance for target-shareholders and the market is information on persons or legal entities acting on behalf of (but in their own name) or in concert with the acquiror.

In this connection the concept of “acting in concert” known from the British City Code provides a helpful tool.⁷² It is thus important that not only parties acting in concert pursuant to formal agreements (including voting agreements) or arrangements but also concerted action based on understandings aimed at obtaining or consolidating control should be disclosed. Disclosure should be of such a kind as to give target-shareholders a true picture of the collective holdings and voting power of the acquiror and his “fan-club”.

In Article 2 of the Draft Takeover Directive, persons acting in concert are defined as persons “who, through concerted practices or pursuant to an agreement, cooperate with one another in connection with a bid.” The words “in connection with” makes this definition very broad, probably too broad. While the kinds of practices that need to be focused on are those where parties act jointly for the purpose of obtaining or consolidating control, the definition in the draft includes situations where no such joint activity exists. In other words, this definition goes beyond what is needed and thus complicates the system unnecessarily, see also the discussion under 4.2.1.2.

In addition to the names of persons/entities belonging to the above-mentioned categories and, if applicable, the size of their holdings, the obligation to disclose should include the nature of the agreement, arrangement or understanding.

See Rule 24.3 and 24.5 of the British City Code.

Article 10(1)(e), points (bb) and (dd), of the Draft Takeover Directive provide that the offer document must state the target-securities held by persons or entities acting in their own name but on behalf of the acquiror or by any person acting in concert with the acquiror. Such persons or entities will have to be identified, cf. Article 10(2).

The Draft Takeover Directive also prescribes that the offer document must state all agreements to which the acquiror is a party or of which he is aware con-

⁷² See about this notion under 4.2.1.2.

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cerning the offer or the exercising of the voting rights attached to the securities of the target-company, cf. Article 10(1)(n).

The disclosure by an acquiror ought also to include information on holdings of target-shares held by companies controlled by the acquiror, or belonging to the same group of companies, as well as by persons who are members of the board or managers of the acquiror and close family members of such persons. Although neither the mentioned legal entities nor the persons indicated necessarily cooperate with the acquiror, it may be fair to presume that such cooperation frequently exists. In any event it is of importance for the target-shareholders and the market to know the size of the stake in the target-company held by the said entities and persons who, at least, should be expected to sympathize with the acquiror. To avoid unnecessary duties to disclose, the duty referred to here ought to be limited to holdings of a certain size (e.g. 2 percent of the aggregate share capital/votes).

Most of what is recommended here may be found in Rule 24.3(a)(ii) and (iii) of the British City Code and the definition of "acting in concert" in the Code.

The Draft Takeover Directive, Article 10(1)(e), point (cc), would oblige acquirors to state target-securities held by undertakings controlled by the acquiror. As to the definition of "controlled undertakings", the draft refers to Article 8 of the Disclosure Directive, discussed under 4.2.1.2.

The duty mentioned above to disclose previous dealings in target-shares should include persons or entities who act on behalf of or in concert with the acquiror or companies controlled by or belonging to the same group of companies as the acquiror as well as board members and managers and their close family members.

See also Rule 24.3(c) of the British City Code, Article 6(1) of the Dutch Merger Rules, and Article 10(1)(e) of the Draft Takeover Directive.

For the purpose of creating a complete picture of the strength of the acquiror and his likelihood of success, it ought to be a requirement that the offer document contain an indication if, or to what extent, target-shareholders have, at the time of the announcement of the public offer, (irrevocably) committed themselves to tender their shares to the acquiror or to persons or entities acting on his behalf or in concert with him.

For an illustration of this, see Rule 24.3(a)(iv) of the British City Code and Article 6(1) of the Dutch Merger Rules. See also II.2. of the Swedish Recommendation.

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In order to give target-shareholders an impression of the nature of the transaction, it is desirable to impose on acquirors a duty to disclose stockholdings of the acquiror held by the target-company ("cross-holdings").

The German Guidelines, Clause C.7, provides for such a duty to disclose cross-holdings. Similarly, the Draft Takeover Directive provides that if the acquiror is a company, the offer document must contain a statement about the securities of the acquiror held by the target-company or by other persons on behalf of the target-company. This statement must include the votes attached to such securities, where this is known to the acquiror, cf. Article 10(1)(f).

4.3.4.6. Information regarding the acquiror's plans and expected effects of acquisition. No requirements exist under Danish law imposing on an acquiror a duty to disclose his plans and the expected effects of his acquisition in connection with the making of a public offer.

In order to allow target-shareholders to make an informed decision whether or not to sell their shares, information regarding the plans and intentions of the acquiror as well as the impact of his possible acquisition of the company is material. Also, this kind of information is important for the market to ensure that the pricing of the target-shares reflects current, relevant information about the company.

To the extent that the acquiror has developed specific plans regarding the future of the company, they should be stated. Plans for removing incumbent management, making restructurings, mergers, sell-offs of assets or subsidiaries etc. are important pieces of information.

Likewise, information about planned lay-offs of employees or closing down of the target-company's business or part thereof is crucial for target-shareholders as well as the market.

Not only particular steps planned by the acquiror are important, but also business plans regarding the long-term development of the target-company, including, for example, the expected impact of such plans on the level of leverage and on the dividend policy, are relevant and ought to be included in the offer document to the extent that such plans have been developed.

Along these lines, the Swedish Recommendation requires that the prospectus to be prepared by the acquiror indicates the reasons for the offer, the deliberations behind the same as well as the impact that the offer is expected to have on the target-company, see the Exhibit to the Recommendation, item 3. Also, the prospectus must include the acquiror's views on the short-term and long-term

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prospects of the acquisition. As a basis for the discussion of the future of the target-company the acquiror must present his financial targets, item 10 of the Exhibit.

Likewise, it follows from the British City Code that an acquiror will have to disclose his intentions regarding the continuation of the business of the target-company as well as his intentions regarding major changes to be introduced in the business. Moreover, he will normally be expected to disclose the long-term commercial justification of the proposed offer and his intentions with respect to the continued employment of the employees of the target-company and of its subsidiaries, see Rule 24.1 of the City Code.

While the American Williams Act (see 2.2.) and the French rules (see Article 7 of the COB-rules) provide quite detailed regulation, the German regulation merely requires the acquiror to state his goals, see Clause C.4 of the German Guidelines.

Pursuant to Article 10(1)(l) of the Draft Takeover Directive an acquiror must set forth in the offer document his objectives in making the bid and his intentions if the bid succeeds. The acquiror specifically would have to address issues pertaining to the use of target-assets, continuation of its business, the intended location of the registered office of the target-company, restructurings of the target-company and of companies controlled by it, continuation in office of incumbent board, and employment policy in the target-company and companies controlled by it. Moreover, any "special arrangements" concerning employees' rights of participation which the acquiror intends to maintain or introduce, any amendments to the statutes or instrument of incorporation⁷³ of the target-company, any measures concerning the listing of target-securities and any policy on return on capital must be stated.

We should probably not aim at a high degree of detail in connection with statements regarding the acquiror's plans and expected effects of acquisition. The basic plans/expected effects are material for the target-shareholders and the market, whereas the additional trouble and costs attached to providing details can hardly be justified.

Obviously, there will be various degrees of uncertainty attached to information of the above nature. The acquiror's plans may change, e.g. because the business environment changes, or it may turn out that the acquisition has effects that differ from those expected and perhaps entirely change the picture of the impact of the acquiror's stock purchase.

⁷³ The English version of the Draft Takeover Directive uses Anglo-Saxon corporate law terminology. The provisions found in the statutes and instrument of incorporation, respectively, are found in one document under Danish law, known as the "vedtægter".

However, for the reasons mentioned before, it makes sense to impose on acquirors a duty to provide the information irrespective of the uncertainties referred to above to the extent possible and based on their best knowledge and good faith.

4.3.4.7. Other kinds of information. Under Dutch takeover regulation it must be stated in the offer document whether there have been negotiations between the acquiror and the target-board and, if so, the outcome of such negotiations must be stated.⁷⁴ A somewhat similar principle is found in the German Guidelines which entails that the position of the target-company, if known to the acquiror, must be indicated.⁷⁵

It is probably useful, in order to enable target-shareholders to make their decisions on a fully informed basis, to impose on acquirors a duty to indicate whether the offer should be considered a “friendly” one, if the position of target-management is unknown, or if the offer is or is likely to be contested by target-management.

Similarly, and as proposed in the Draft Takeover Directive, Article 10(1)(m), it is appropriate to have a mandatory disclosure of any special advantages which the acquiror grants or intends to grant to the target-board. Information of this kind is material since it may give target-shareholders and the stock market as such a full impression of the motivating factors that affect the target-board’s attitude towards the offer.

The American Williams Act stands for the proposition that acquirors should provide information on the source of financing in connection with stock purchases, cf. 2.2. The Draft Takeover Directive also deals with the issue of financing, however, focusing on the impact of debt. It would thus be a requirement pursuant to Article 10(1)(ga) that the offer document stipulate future indebtedness of the acquiror and, if relevant, of the target-company, to finance the bid.

While there seems to be a limited demand for requiring that any source of financing be set forth in the offer document, it is material for target-shareholders to know if the debt-equity ratio will be affected by an acquisition. Therefore, it is desirable to have acquirors indicate if, or to what extent, the debt of the target-company will increase as a consequence of the acquisition. In this connection it should be noted that the prohibition in § 115, Subsection 2, of the Companies Act against target-financed

⁷⁴ See Article 6 (1) c of the Merger Rules.

⁷⁵ See Clause C.8. of the Guidelines.

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acquisitions puts a “cap” on the degree of leverage that a target-company may be exposed to, see further under IX.2.

The Swedish Recommendation prescribes that the offer document must include information regarding tax issues which may arise for the tendering shareholders.⁷⁶ Although information of this nature is very helpful for the target-shareholders and may be included as a service to them, the mandatory regulation of public offers we are concerned with should not include issues which are not particular to the specific offer but connected to the stockholding of each single shareholder.

An issue which may not attract too much legal attention but may, nevertheless, be useful in offer documents is a comment about how shareholders who want to tender their shares should act in order to accept the offer. According to the Draft Takeover Directive, information to this end should be included in the offer document, cf. Article 10(1)(k).

The question whether public offers addressed to shareholders of a company must contain identical terms to all shareholders or to all shareholders belonging to the same class raises issues of minority shareholder protection and is, consequently, discussed further under VIII.

Another issue closely related to this is the impact and desirability of partial offers, i.e. offers for only part of the shares of a company or of a class of shares. A discussion of this also involves questions regarding the interests of minority shareholders, for which reason this issue is discussed further under VIII.

4.3.5. Role of advisors. Nothing in Danish law indicates a duty for acquirors to retain advisors in connection with the making of a public offer.

When considering the role independent advisors should play, we may want to approach the question with three issues in mind. The first issue is the protection of acquiror-shareholders (assuming the acquiror is a company). The second is the protection of target-shareholders, and the third is our interest in ensuring that the relevant regulation is complied with.

As regards the interests of the shareholders of the acquiror it is hard to point out any reasons why the board of the acquiror (which is the corporate body authorized to act on behalf of the acquiror in these matters) should have an obligation to retain independent advisors, except for situations where a conflict of interest exists. The British City Code provides some useful guidance regarding this latter point.

⁷⁶ See the Exhibit to the Recommendation, item 2.

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The British City Code provides that the board of an acquiror must obtain “competent independent advice” on any offer when, *inter alia*, the directors are faced with a conflict of interest. The substance of such advice must be made known to the shareholders of the acquiror, see Rule 3.2 of the City Code. Examples of conflicts of interest include situations where there are significant cross-shareholdings between an acquiror and the target-company, when there are a number of directors common to both companies or when a person is a substantial shareholder in both companies, see Note 3 on Rule 3.2 of the City Code.

If the consideration to be paid consists (in whole or in part) of new shares to be issued by the acquiror, it is – as is the case with any issue of shares – necessary to have the shareholders of that company approve a charter amendment providing for an increase of the share capital, cf. further under XI.2.1.2. and 8.2. There seem to be no compelling reasons why advisors should be involved in this connection to a wider degree than already provided for in the Companies Act, cf. Chapter 5 of the Act.

However, the scenario changes the moment the board of a company uses an authority previously granted by the shareholders to issue new shares for the purpose of acquiring the shares of another company as a defensive device. In such event the board’s use of its authority has an unforeseen impact on the shareholders’ opportunities to sell their shares, for which reason there is a need to limit the board’s right to issue shares in such situation, and the question is if in such cases the duties of the board are satisfied by merely retaining independent advisors.⁷⁷

From the viewpoint of target-shareholders the main problem is how to evaluate an offer that consists of non-listed securities. In such events the best approach would probably be to require that acquirors incorporate in their offer an opinion by one or more impartial expert valuers, cf. 4.3.4.2.

The question left is whether we should require that public offers be made through e.g. financial institutions to ensure compliance with takeover regulation (see the French concept discussed under 4.3.2.).

See also the Swiss Take-Over Code which provides that acquirors must obtain a report from a firm of accountants certifying that the offer complies with the Code, see Article 5.2 of the Code. The acquiror must require the firm of accountants to undertake any particular verification exercises which might be requested by the Commission for Regulation of the Association of Swiss Exchanges, Article 5.3.

⁷⁷ The board’s use of an authority to issue shares in this situation is discussed further under XI.8.2.

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The Draft Takeover Directive, Article 9, would prescribe that an acquiror shall be represented either by a qualified person authorized to deal in the EC financial markets or by a credit institution authorized within the EC.

However, the question is if compliance with the rules is not best achieved by establishing an adequate sanction system, rather than making it mandatory to involve advisors. Again, it should be borne in mind that additional restrictions on acquirors lead to additional transaction costs.⁷⁸

The impact of increased transaction costs is also the reason why it would not be advisable to impose on acquirors a duty to arrange for a financial institution to guarantee the fulfilments of the acquiror's obligations under the offer, cf. the French model.

4.3.6. Rights of withdrawal and revision of offer. The point of departure under Danish contract law is that once an offer has come to the knowledge of the offeree, it can only be withdrawn if one of the conditions set forth in the offer is not met. Moreover, in such event an offer cannot be changed or revised if such change or revision would be to the detriment of the offeree.

Likewise, the starting point as regards parties who tender their shares pursuant to an offer is that such parties are bound if they accept the offer, irrespective of whether or not the acquiror may be able to pull out with reference to conditions of the offer not being met.

We will first consider the rights of the acquiror and the target-shareholders, respectively, to withdraw. Then we will focus on the right of an acquiror to revise an offer once it has been made.

Most jurisdictions only allow acquirors to withdraw their offers in specific circumstances while providing for a broader right to withdraw as regards target-shareholders.

The Williams Act only allows acquirors to withdraw their offers if a stated condition is not met. The target-shareholders, on the other hand, have a right of withdrawal at any time during the offering period, see under 2.3.3. above.

While it is a principle under the British City Code that acquirors are bound by their offers and may only withdraw the same in case of non-fulfilment of a condition, target-shareholders may withdraw their acceptances from a date which is 21 days after the first closing date of the initial offer if the offer has not become or been declared unconditional as to acceptances by such date, see Rule 34 of the City Code.

The French takeover regulation allows acquirors to withdraw their offers not only if a condition set forth in the offer has not been met, but also if a competing

⁷⁸ As a practical matter, most acquirors would probably retain advisors.

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bid is made. Similarly, in the latter event, shareholders who have already tendered their shares pursuant to the offer are automatically released from their obligations to sell, see Article 5-2-17 of the General Rules. In addition, shareholders who have tendered their shares always have a right of withdrawal during the entire opening period of the offer, see Article 5-2-12 of the General Rules.

The Swiss Take-Over Code provides that an offer cannot be withdrawn unless pursuant to a condition stated or in the event that a competing offer is published or the target-company takes defensive measures. Target-shareholders, on their part, may withdraw their acceptances prior to the closing date of the offer in the event that a competing offer is published, see Article 3.5. of the Code.

While the Swedish rules do not address the right for an acquiror to withdraw his offer, they tie the right for tendering shareholders to withdraw their acceptance of an offer to the acquiror's right to make his offer conditional as outlined under 4.3.4.4. This means that until the acquiror announces that the conditions set forth in the offer have been met, the target-shareholders may withdraw their acceptances. If no conditions were made, acceptances may be withdrawn until the moment when the opening period lapses, see II.4. of the Swedish Recommendation.

Article 13 of the Draft Takeover Directive contains a detailed regulation of the right for acquirors to withdraw offers made or declare them null and void. To avoid abuses of the takeover process, Article 13 only allows this in certain circumstances.

A bid may thus be withdrawn if a competing bid is made, cf. Article 13(1)(a).

The Draft Takeover Directive also allows for withdrawal of offers based on consideration consisting of securities where it turns out that impediments exist for the issue or listing of such securities. Article 13(1)(b) thus states that if the shareholders of the acquiror do not approve the issue of new securities offered in exchange for the shares comprised by the bid, the acquiror may withdraw his offer. Likewise, the failure to obtain an official stock exchange listing of such securities to be exchanged for the target-company's shares triggers a right to withdrawal, cf. Article 13(1)(c).

An acquiror is also permitted to withdraw his offer if the necessary judicial or administrative authorization for the acquisition of target-securities is refused or is not obtained (this probably refers to events where no decision has been made by the body in question), cf. Article 13(1)(d). In (d) particular reference is made to events where the competition authorities have not approved the acquisition.

Of great practical importance is the rule that an offer may be withdrawn, or declared null and void, if a condition (approved by the supervisory authority) has not been met, cf. Article 13(1)(e).

The Draft Takeover Directive, Article 13(1)(f), contains a general provision according to which the supervisory authority may allow a bid to be withdrawn or declared null and void in "exceptional circumstances", where an offer cannot be put into effect for reasons beyond the control of the parties to the offer.

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The questions under what circumstances, if any, tendering shareholders ought to have a right of withdrawal and if such a right should exist for the acquiror at all, are conceptually two different issues. Irrespective of this, it may be appropriate to establish a “link” between the tendering shareholders’ and the acquiror’s right to withdrawal.

If one follows the line of reasoning behind the Swedish Recommendation discussed above, it could be argued that a balance between the acquiror and the target-shareholders would be achieved if the target-shareholders are not bound by their acceptance to tender until the offer becomes unconditional. An argument which supports this concept is that there is no compelling reason for the tendering shareholders to be bound by their acceptance until the other party to the contract, the acquiror, is also bound. This seems to be a stringent way of thinking, and it ought to be considered if the Swedish concept would not be useful as a model for the Danish regulation with respect to this issue.

As proposed under 4.3.4.4., conditions for public offers should not be allowed if they depend primarily on subjective judgments on the part of the acquiror or the fulfilment of which is in his hands.

The question is, however, if there are situations where acquirors ought to be allowed to withdraw their offers although the cause of the withdrawal is not to be found in the non-fulfilment of a condition made in the offer document.

It is desirable to limit the degree of uncertainty connected to the making of public offers. The interest in avoiding uncertainty to the extent possible suggests that acquirors’ rights of withdrawal outside the situations where conditions are not fulfilled should be limited as far as possible.

The rules under Article 13 of the Draft Takeover Directive allowing acquirors to withdraw an offer if shareholder approval for the issue of securities or admission to listing of securities to be paid as consideration under the offer is not obtained seem to leave the target-shareholders with too much uncertainty. It would be preferable if requirements of this nature be reflected in conditions set forth in the offer document. Similarly, if the acquisition of the shares comprised by the offer requires approval from judicial or administrative authorities, this ought to be reflected in the offer document and made a condition of the offer.

All of the above situations can, and should, be predicted by the acquiror and be reflected in conditions set forth in the offer document. There is no reason not to make this a requirement with the effect that failure to do so entails that the offer cannot be withdrawn.

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One may query whether the fact that a competing offer is made should lead to the acquiror having a right to withdraw his offer as is, *inter alia*, set forth in the Draft Takeover Directive. Once a competing bid is made, the prospective acquiror who already made an offer will, depending on the circumstances, face a situation where it is likely that a substantial part of the target-shares, if not all, will be acquired by his competitor since it should be expected that the competing bid frequently contains terms and conditions that are more favorable to target-shareholders than the original bid. One could argue that there is no particular reason to be concerned with this, since, if he has made it a condition that he acquires a certain minimum number of shares and this condition is not met, his offer will be null and void. On the other hand, there is hardly any reason to impose on such an acquiror an obligation to leave the offer in place now that it is subject to much doubt whether he will receive the number of acceptances required. In other words, it seems appropriate to allow acquirors to withdraw their offers once a competing bid is made for the target-shares.

Should an acquiror facing a competing bid decide not to withdraw his own bid, we want to ensure that target-shareholders have a reasonable opportunity to compare both bids. To achieve this, it should be a requirement that in such event the period of acceptance set forth in the bid must be extended until the date of expiry of the period of acceptance of the competing bid as proposed in Article 20(4) of the Draft Takeover Directive.

The correlate of the right to withdraw on the part of the acquiror ought to be that the shareholders who already tendered their shares should have a right to withdraw their acceptances, thus allowing them to accept the higher offer made by the competing bidder. By tying the target-shareholders' right to withdrawal to the right of acquirors to withdraw, a "mirror" is created between the position of the acquiror on the one hand and the target-shareholders on the other.

There are situations where an acquiror suddenly faces a situation where his offer cannot be put into effect for reasons beyond his control or can only be put into effect with serious difficulties which, in the circumstances, makes it fair to release him from his offer. However, in such situations withdrawal should be made subject to the approval of the supervisory authority (i.e. the Copenhagen Stock Exchange), which would then evaluate the facts of the matter and determine if withdrawal is acceptable in the circumstances.

Some of our concerns with respect to withdrawals of offers by acquirors we also have as regards revisions of offers.

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It is thus not surprising that many jurisdictions impose restrictions on the right for acquirors to revise their offers.

The British City Code allows for revision of an offer, provided, however, that the offer is kept open for at least 14 days following the date on which the revised offer document was posted, cf. Rule 32.1. Consequently, an offer may normally not be revised within the last 14 days of the opening period. Viewed in conjunction with the rule stating that offers may ordinarily not be declared unconditional on the 60th day after the day the initial offer document was posted, this means that offers may not be changed after the 46th day following the date of posting of the initial offer document.

The City Code provides for an automatic revision in certain instances: if an acquiror purchases shares of the class of shares for which he has made an offer that is still open for acceptance, and assuming that he pays a price for the shares that is above the offer price, he must increase his offer to not less than the highest price paid for the shares so acquired, see Rule 6.2 of the City Code.

The French regulation provides that until 10 days before the last day of the opening period of an offer an acquiror may submit a revised offer to the Stock Exchange Council for approval. To obtain approval it is a prerequisite that the terms of the revised offer are more favorable than those of the initial offer, cf. Articles 5-2-24 and 5-2-27 of the General Rules. Also, an automatic revision mechanism is provided for, see Article 5-2-25 of the General Rules.

According to the Swiss Take-Over Code, an offer can, with few exceptions, only be revised if the effect of such revision is that the consideration is increased or the opening period extended, see Article 3.5. of the Code.

The Swedish rules contain an automatic revision system following the models touched upon above, see II.8. of the Swedish Recommendation.

According to Article 15(1) of the Draft Takeover Directive, an acquiror may revise the terms of a bid at any time before the last week of the period of acceptance. Article 15, viewed in conjunction with Article 13 concerning withdrawals of bids, probably entails that bids may not be revised to the detriment of the target-shareholders. Revisions of a bid must be publicly announced pursuant to Article 7(1) and (3) of the Draft Takeover Directive, cf. Article 15(1). In the event that a bid is revised, the period for acceptance is automatically extended by one week, cf. Article 15(2). Also, the acquiror must draw up a document setting forth the amendments to the offer document, such "new" document to be made public by the means indicated in Article 11(1), cf. Article 15(3). This must be done in "good time" before the expiry of the acceptance period. Shareholders who have already tendered their shares on the basis of the original bid must have the option to accept the revised bid, cf. Article 15(4).

The supervisory authority would be authorized to modify the time limits stated above on an ad hoc basis, stating its reasons to do so, cf. Article 15(5). Also, member states are granted a certain degree of flexibility in that they may

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further regulate revisions of a bid to avoid that such revisions “improperly impede” the operations of the target-company or the market, cf. Article 15(2)a.

There is nothing in the Draft Takeover Directive preventing an acquiror from purchasing target-shares during the acceptance period at a higher price than the price offered in the public bid, but according to Article 16 of the Draft Takeover Directive such a purchase is considered a revision of the public bid already made. Consequently, the consideration offered to those shareholders who have already tendered their shares pursuant to the previous offer must be increased accordingly. It is noteworthy that the right to receive a higher price in this situation applies not only if the acquiror purchases shares of the target-company at a higher price but also if such purchase is made by others for his account or by persons controlled by him or acting in concert with the acquiror, cf. Article 16 of the Draft Takeover Directive.

Revisions of public offers ought only to be allowed if they contain terms and conditions that, when viewed in their entirety, constitute an improvement compared to the original offer. If this requirement is not made, acquirors may be encouraged or tempted to subsequently change their offers in situations where they feel that they may still be able to acquire the number of shares desired even though the price is lowered (this could, in other words, lead to the conduct of so-called “Dutch auctions”).

Moreover, it should probably be a condition to revisions of bids that the period of acceptance is extended to allow target-shareholders to consider what is, in effect, a “new” offer. The proposed automatic extension by one week stipulated in the Draft Takeover Directive presents a satisfactory model in this regard.

There is probably no need to prohibit acquisition of shares “outside” a public offer at a higher price, provided, however, that such higher price is also offered to the shareholders who already tendered their shares on the basis of the offer. In this connection the automatic revision mechanism provided for in Article 16 of the Draft Directive and the disclosure system set forth in Article 17 provide useful means by which to ensure that all shareholders who tender their shares pursuant to an offer receive equal consideration.

Article 17(1) of the Draft Takeover Directive imposes on all “parties to a bid”⁷⁹ a duty throughout the period of acceptance of a bid to provide the supervisory authority, at any time and at its request, with all information in their possession

⁷⁹ The term “parties to the bid” is defined in Article 2 as the offeror, the representative of the offeror (as stipulated in Article 9), the directors (i.e. the board members), the addressees of the bid and the directors (board) of the target-company.

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concerning the bid. In addition, Article 17(2) of the Draft Takeover Directive provides that once a bid is publicly announced and during the acceptance period, the acquiror as well as holders of five percent or more of the votes of the target-company or of the acquiror must notify the supervisory authority immediately of all acquisitions of securities of the companies concerned. Also, acquisitions made by other persons or entities controlled by, on behalf of or in concert with the above mentioned persons or entities must be disclosed. The disclosure obligation includes the price paid for such securities and the votes already held. Similarly, any person who acquires 0.5 percent of the votes of the target-company (or the acquiror) must disclose this as well as subsequent acquisitions of target-securities by him, persons or entities controlled by, or acting on behalf of or in concert with him. This quite rigorous disclosure system creates the basis for the automatic revision mechanism provided for in Article 16 of the Draft Takeover Directive.

See also Article 5-2-21 of the French General Rules.

Both withdrawals and revisions of offers are acts which are material for the decision-making of target-shareholders and the stock market. Consequently, such acts should be announced as early as possible. As regards revisions of offers it is probably advisable to have acquirors follow the same procedure that would apply to offers made in the first place.

4.3.7. After the expiry of the offer period. Under Danish law nothing has been said or assumed as regards the position of the acquiror in the time after the expiry of an offer period.

To avoid uncertainty in the stock market, it is advisable to have acquirors state, immediately upon the expiry of the offering period, whether the terms and conditions of the offer have been met so that the offer will materialize. If this is not the case, an announcement should be made to the effect that the offer will not go forward and the shares tendered will not be acquired.

Many jurisdictions provide for an obligation on the part of acquirors to announce the outcome of their offer upon the expiry of the acceptance period, see e.g. Article 5-2-14 of the French General Rules, Article 11(3)(b) of the Dutch Merger Rules, Article 3.6. of the Swiss Take-Over Code, and II.13. of the Swedish Recommendation.

The Draft Takeover Directive, Article 18, would require the result of a bid to be made public immediately the period for acceptance has expired. Such publication must be made by the means set forth in Article 11(1).

Another question that arises is if there ought to be restrictions on the right for an acquiror to acquire shares of the target-company if his offer proves not to be successful.

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The British City Code provides that where an offer has been announced or posted but has not become or been declared wholly unconditional and has been withdrawn or has lapsed, the acquiror may not within 12 months from the date on which withdrawal took place or the offer lapsed make an offer for the target-company or acquire any shares of the target-company that would trigger the obligation for the acquiror to make a mandatory offer pursuant to Rule 9 of the City Code. The same restrictions apply to persons who act in concert with the acquiror or who have subsequently acted in concert with any of the persons mentioned, Rule 35.1 of the City Code. However, The Take-over Panel may consent to an exemption from this “quarantine” period. According to the official comments on Rule 35.1, the Panel’s consent may normally be expected, *inter alia*, when the new offer is recommended by the target-board or the new offer follows the announcement of an offer for the target-shares by a third party.

In addition to the 12 month quarantine period, the City Code provides that if an acquiror, together with any person acting in concert with him, holds shares carrying more than 50 percent of the voting rights of a company, neither the acquiror nor such other person may, within a 6 month period after the closure of any previous offer, which became or was declared wholly unconditional, make a second offer to, or purchase shares of the target-company from, shareholders at a higher price than that made available under the previous offer, Rule 35.3 of the City Code.

Other jurisdictions have rules that to a certain extent resemble the British concept.

The Swiss Take-Over Code thus provides that an acquiror may not publish a new offer for the target-shares for one year counted from the closing date of the offer, except if such new offer is made as a competing offer, see Article 3.9 of the Code.

There are no provisions in the German Guidelines restricting acquirors after the expiry of the offer period, except that if within 18 months after the offer period has lapsed the acquiror makes a public offer at a higher price, then the shareholders who tendered their shares pursuant to the former offer must be compensated for the difference between the two offers, see Clause C.20. of the Guidelines.

The Dutch Merger Rules provide that if an offer leads to the acquiror acquiring shares of the target-company, the acquiror will be restricted in his right to acquire shares of the same class of stock of the target-company in a 3 year period after the publication of the offer document. In the said period, the acquiror may not acquire shares at a price higher than the price offered in the public offer, unless the share purchases take place as ordinary transactions on the Amsterdam Stock Exchange or the Merger Commission grants its exemption from the above restriction, Article 12 of the Merger Rules.

According to the Swedish Recommendation an acquiror may not, for a nine month period after he started to make payments pursuant to a public offer, acquire shares of the target-company on terms that are more favorable than those

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set forth in the offer. This restriction does not apply if the acquiror increases the payments to those shareholders who already sold their shares so that they receive the same price as is offered subsequently, see the Recommendation, II.9.

The Draft Takeover Directive does not speak about any “quarantine” or restricted period for acquirors.

It is hard to see why there should be a need to restrict acquirors from acquiring shares or making new bids even though they have made a public offer for the same shares before. Obviously, e.g. public bids typically have an impact on the market price for the target-shares. But why should this lead to the imposition of restrictions on acquirors? Acquirors buy shares or make public offers if they have an interest in this and there seems to be no compelling reasons for depriving them of the right to do so. If acquirors abuse their “freedom” to manipulate or disturb the market, Rule 7.1 of the Copenhagen Stock Exchange Rules of Ethics may be invoked.⁸⁰

Rule 7.1 provides that any attempt to influence stock prices by “dishonest means” is a violation of the Rules of Ethics. According to the official comment on this rule, dishonest means may, for instance, be “the publication or spreading of incorrect, misleading, exaggerated or biased information on the company, its management or its relations to competitors, markets or authorities”. Attempts on the part of an acquiror to bring a target-company into “play” by indicating to the market that he plans to acquire the company, thereby boosting the price of the company’s shares with the purpose of selling his shares subsequently at a high price, would probably constitute a violation of Rule 7.1.

Finally, one may ask if after making an offer that did not result in him becoming the owner of all the shares, an acquiror ought to compensate the shareholders who tendered their shares if he subsequently makes a new offer at a higher price. However, it is difficult to see why such a requirement should be made. The price of a company’s stock changes from time to time. There are many reasons for this, e.g. the release of new financial information, the announcement of new policies or plans, or the occurrence of other potential acquirors. The acquiror, on his part, typically has no influence on such events and developments. The target-shareholders who disposed of their shares pursuant to the former offer do not expect additional consideration once they have sold their shares. Because of these fac-

⁸⁰ As discussed under VI.9.4., the problems connected to the existing regime, of which the Rules of Ethics are a part, include the lack of sanctions with respect to violations made by others than issuers or stockbroker companies. This obviously weakens the motivating effects of the Rules of Ethics.

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tors the desire to give all target-shareholders “equal” treatment hardly justifies a rule of the nature described here.

VIII Protection of minority shareholders in the takeover context

1. Introduction – The Companies Act

Frequently, public companies have a large number of shareholders, which is in particular true of companies having their shares listed at a stock exchange.

If any shareholder of a company were able to veto any decision made at a shareholders' meeting, it would be impossible to have the company managed in a satisfactory way and in the interests of most of the shareholders. Unanimity may be feasible in connection with legal entities, e.g. partnerships, having a limited number of participants who work closely together and for whom it is crucial to be able to veto on decisions. The entire concept of having a public company presupposes that several shareholders join forces, invest their money in a business to be managed by a management, and accept that they share their right to influence with other shareholders. General veto rights would certainly paralyze the company.

Accordingly, the point of departure in Danish company law is that a majority of shareholders are entitled to govern the company and dispose of its capital and assets as they wish and within the framework of the Companies Act.¹

However, if no limitations applied, the majority of the shareholders of a company might govern the company and render decisions which would benefit themselves while causing harm to the interests of minority shareholders. To be sure, this does not mean that the majority may not exercise an influence to control the company. Certainly, it may. But when exercising control, the majority cannot act without considering the interest of minority shareholders. If decisions made at a shareholders' meeting give the majority shareholders disproportionate advantages by ensuring them a share of the company's benefit which is not shared by minority shareholders or of which only a comparatively small part inures to such shareholders, the decision may constitute an abuse on the part of majority shareholders.²

¹ See Gomard, *Aktieselskabsret* p. 324 and Paul Krüger Andersen, *Aktie- og anpartsselskabsret* p. 212 ff.

² See Gomard, *Aktieselskabsret* p. 324 ff.

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As these preliminary observations suggest, there are two assumptions that explain why we are concerned with protecting the interests of minority shareholders. The first assumption, which is indisputable, is that minority shareholders have little say in connection with the governance of a company. The second assumption is that, unless minority interests are protected, there is a likelihood that majority shareholders will take advantage of the voicelessness of minority shareholders. Although this is not always the case, experience shows that majority shareholders often feel tempted to take advantage of their stronger position, sometimes, but not always, in abusive ways, to reap some benefits for themselves.

1.1. Specific provisions protecting minority shareholders. The Companies Act contains a number of provisions, the purpose of which is to protect minority shareholders. While protecting shareholders in situations where an acquiror exercises his influence over the company, none of these provisions specifically address the sequence of events that constitute the process whereby a company is taken over.

The specific provisions of the Companies Act dealing with minority protection can be divided into two categories, one which comprises provisions that give each individual shareholder certain rights and one which comprises provisions that protect the interests of minorities of a certain size.

The first category includes provisions in § 79, Subsection 1, of the Companies Act, according to which resolutions regarding charter amendments whereby the shareholders' right to dividend or to distribution of the company's assets is reduced for the benefit of others than the shareholders of the company or the employees in the company or its subsidiary must be adopted on a unanimous basis. As provisions of this nature give shareholders the right to veto decisions, they are referred to as "negative".

However, the Companies Act also grants each shareholder a right to demand that the company take certain action. Any shareholder may thus demand that an item be included in the agenda for a shareholders' meeting, cf. § 71. Also, each shareholder has the right to attend shareholders' meetings (§ 65, Subsection 2) and cast his vote at such meetings (§ 67). Moreover, such "positive" rights include the right to require information about the company as well as the right to demand payment of dividends duly declared at a shareholders meeting. Individual rights that specifically seek to protect minority shareholders' economic interests in a company are set forth in § 20 d of the Act, pursuant to which a minority shareholder of a company of which nine-tenths of the shares are owned by a parent com-

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pany may demand to be cashed out, and in § 134 f, which states that shareholders in a company that is dissolved in connection with a merger may claim damages if the consideration they receive for their shares is not reasonable and grounded on facts.

Rights that only apply if shareholders represent a certain percentage of the share capital of a company are provided for in § 78, according to which charter amendments must be adopted by a majority of two-thirds of the votes cast and the voting share capital represented at the shareholders' meeting. In addition, § 79, Subsection 2, states that charter amendments which entail that the shareholders' right to dividends or to distribution of the company's assets is reduced but not in favor of any third party, are subject to a majority of three-quarters of the voting share capital represented at the shareholders' meeting. If charter amendments are made that improve the legal status of certain shareholders at the expense of other shareholders, the approval of the shareholders whose legal status is adversely affected is required, cf. § 79, Subsection 3. In the event that a company has more than one class of shares, these types of charter amendments may be adopted by shareholders owning at least two-thirds of the shares represented at the shareholders meeting belonging to the class of shares whose legal status is being impaired. "Negative" protective provisions are also found in § 116, dealing with liquidation of companies, § 134 e on mergers and § 172 regarding restrictions in the transfer of shares as well as "ceilings" pertaining to voting rights.

"Positive" rights of minorities include § 70, according to which shareholders representing one-tenth of the share capital of a company may demand that an extraordinary shareholders' meeting be convened. Also, according to § 95 of the Act, shareholders who represent at least 25 percent of the share capital have the right to have special inspectors appointed in certain circumstances. Subject to the same threshold requirement, minority shareholders may elect a co-liquidator in connection with the liquidation of a company, cf. § 120 of the Companies Act.³

Some of the provisions of the Companies Act dealt with here are described further under XI. in connection with the discussion of defensive techniques and strategies.

³ For a general discussion of these issues, see Gomard, *Aktieselskabsret* p. 324 ff., Gomard, *Aktieselskaber og anpartsselskaber* p. 167 ff. and Paul Krüger Andersen, *Aktie- og anpartsselskabsret* p. 212 ff.

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1.2. The general standard in § 80. In addition to the specific provisions aimed at protecting minority interests, a general standard was included in the Companies Act in connection with a revision of the Act in 1973. The general standard, set forth in § 80 of the Act, states that the shareholders' meeting of a company may not pass any resolution which is obviously likely to procure undue advantage to certain shareholders or others at the expense of other shareholders or the company.

While § 80 was adopted quite recently, it is generally acknowledged that the principle expressed in § 80 is chiefly a codification of principles that have been known and acknowledged by courts and legal authors for a long time⁴. The idea that the specific provisions of the Companies Act will have to be supplemented by some additional protective principles is thus not new.

Case law from before 1973 is still of importance in addition to the specific rules set forth in the Companies Act. Gomard divides the notion of minority protection into 3 fundamental rules: a rule of "equality", a prohibition against decisions and acts which are clearly contrary to the interests of the company, and a prohibition against decisions whereby a majority abuses its superior voting power to achieve an undue advantage at the expense of the minority shareholders, cf. Gomard, *Aktieselskabsret* p. 343.

The language of § 80, and in particular the words "obviously" and "undue", indicates that shareholders may, to a certain extent, pursue their own interests in connection with the exercise of their influence. Only events where influence has clearly been used to give some shareholders or others benefits which are not shared by the remaining shareholders, and where the circumstances show that this is "unfair", are covered by § 80.

§ 80 may be invoked by one or more single shareholders and thus belongs to the first group of protective devices mentioned above. Accordingly, § 80 may be especially important where the usual minimum requirements with respect to capital ownership or votes in the specific protective provisions of the Companies Act are not met.

Also, § 80 may be of particular interest in situations where the issue in question is not governed by any particular protective provision of the Act. The fact that § 80 is a general standard entails that the applicability of the provision depends on the specific fact pattern of each individual matter.

§ 80 does not give shareholders a tool whereby they can prevent resolutions which must be presumed to be in violation of § 80 being made. However, shareholders that consider a given resolution to be in violation

⁴ See Gomard, *Aktieselskabsret* p. 342 ff.

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of the Act may file a suit against the company in order to have the resolution invalidated or altered by a court.

Also, § 142 of the Companies Act provides that a shareholder may be held liable for damages caused to i.a. the company and other shareholders as a consequence of a violation of the Companies Act or the company's charter provided that such violation was either intentional or grossly negligent. Depending on the circumstances, a shareholder may be required to redeem the shares belonging to shareholders who suffered harm as a result of his acts.

Deliberate violations of the Companies Act, including § 80, or of the charter of a company, made by means of resolutions at a shareholders' meeting may, in extraordinary circumstances, lead to the Registrar of Companies dissolving the company if so requested by shareholders representing at least 10 percent of the share capital, cf. § 119 of the Act.

Legal steps that are initiated in order to have a decision invalidated or altered pursuant to § 81 must be taken against the company and not its management, see e.g. *Petersen v. Korsgaard* (U1925.511, E. Cir.) and Thomsen, *A/S-loven med kommentarer* p. 333.

For a general discussion of § 80 of the Companies Act, see Gomard, *Aktieselskaber og anpartsselskaber* p. 169 ff., Werlauff, *Generalforsamling og beslutning* p. 201 ff., Werlauff, *Revision & Regnskabsvæsen* 1983, p. 273, Thomsen, *A/S-loven med kommentarer* p. 328 ff. and Paul Krüger Andersen, *Aktie- og anpartsselskabsret* p. 219 ff. See also Report No. 362/1964 on a revision of the Companies Act, p. 162 f. and Report No. 540/1969 on a Joint Nordic Company Law, p. 118 f. The applicability of § 80 in connection with abuses on the part of minority shareholders is discussed by Werlauff in *Revision & Regnskabsvæsen* 1983, p. 276 f. and in *Generalforsamling og beslutning* p. 204 ff.

Rule 7.2. of the Copenhagen Stock Exchange Rules of Ethics provides that the management and shareholders of a company must abstain from any action "which may prove detrimental to the normal and honest trade in the company shares, and/or may prove detrimental to investors or is apt to give certain shareholders an undue benefit at the expense of other shareholders or of the company". There is probably an overlap between § 80 of the Companies Act (and § 63 of the Act which is the parallel provision pertaining to management) and Rule 7.2. of the Stock Exchange Rules of Ethics.

The problematic aspect of § 80 is that, for the purposes of our inquiry, it only provides us with limited help. § 80 is thus restricted to resolutions made at shareholders' meetings and fails to address situations where the issue is the minimum requirements applying to the treatment of minority shareholders where, outside shareholders' meetings, attempts are made to take over a company.

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Neither do any other provisions of the Companies Act give us much guidance in this respect. § 17 of the Act provides that all shares shall have “equal rights” in the company. However, § 17 further states that the charter of a company may provide for different classes of shares, thereby diluting the notion of “equal rights”, a term that may in itself cause some trouble to define. While stipulating a principle of “equality”, § 17 fails to define the contents of such principle and, therefore, provides little guidance in connection with our inquiry. The equal-rights notion of § 17 is further diluted by the provisions of the Companies Act which provide for a right to deviate from the equal treatment principle, for example, the right for a two-thirds majority to deviate from the shareholders’ preemptive right to subscribe to new issues of shares, cf. § 30, Subsection 3.

2. The Stock Exchange Act and the rules promulgated thereunder

The Stock Exchange Act, § 11, states that the Copenhagen Stock Exchange must aim at having the trade and the quotation at the Exchange conducted in a manner which ensures that the trading and the pricing at the Exchange take place in an honest and transparent fashion and ensures an equal treatment for all those involved within the framework of the law. As will be seen, the latter part of this general standard contains the requirement that investors, stockbroker companies, and issuers must be treated equally. What exactly is meant by “equal” in this context will have to be determined by the board of the Copenhagen Stock Exchange and the Finance Inspectorate.

In the Information Obligations for Issuers of Listed Securities adopted by the board of the Copenhagen Stock Exchange, the equal-treatment notion is reflected in § 3, which states that the board and managers of a company are responsible for ensuring that everybody has equal access to information regarding the shares of the company. The official comment on § 3 explains that the principle of equal treatment is essential in the Stock Exchange Act and is closely related to the general equal-rights tenet in § 17 of the Companies Act.

Similarly, the objectives clause (Rule 1) of the Stock Exchange Rules of Ethics issued by the board of the Copenhagen Stock Exchange, stipulates that the purpose of the rules is, in furtherance of § 11 of the Stock Exchange Act, to promote conduct which ensures that the trading and the pricing of listed securities take place in an honest and transparent fashion providing equal terms for all those involved.

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As a supplement to the general standards which express a demand for equal treatment without stipulating exactly what is meant by this and how this should be achieved, Rule 4 of the Copenhagen Stock Exchange Rules of Ethics pertains to transfers of controlling stockholdings. The official comment on Rule 4 states that shareholders are also entitled to equal treatment when a controlling stockholding is transferred or established. Since Rule 4 probably represents one of the rules of Danish takeover regulation having the greatest impact on contested takeover activity, we will in the following focus on this rule.

2.1. Rule 4 of the Stock Exchange Rules of Ethics

2.1.1. Introduction. Rule 4 of the Stock Exchange Rules of Ethics imposes on an acquiror an obligation to make an offer to all the shareholders of a target-company in the event that the acquiror has acquired control of such company. The offer to the shareholders must be made on terms equal to those pertaining to the acquisition of the controlling interest.⁵

According to the comments on the rule the general principle according to which shareholders must be treated equally also applies when a change of control occurs. Frequently, the comments go, “drastic changes in terms and prospects” for a company occur when change of control takes place.⁶

2.1.2. Triggering events. The obligation to make an offer is triggered when the acquiror, as a result of his acquisition, whether by privately negotiated transactions or a public offer, directly or indirectly, *de jure* or *de facto*, gains control of a target-company. To ensure that acquirors are familiar with their obligation under Rule 4, it is stipulated that sellers of shares that constitute a controlling interest must inform the acquiror of his obligations under the rule.⁷

As is explained in the official comments on Rule 4, a controlling interest need not be a majority of the company’s share capital or votes, defined as more than 50 percent. Many companies may be controlled by a shareholder owning less than 50 percent of the company’s shares or votes. According to the official comments on Rule 4, a typical manifestation of control is where a stockholder is in a position to elect the majority of the members of the board of directors. Based on this test, acquisition of 30 – 40 percent of a company’s votes would probably enable an acquiror to

⁵ Rule 4.1. of the Rules of Ethics.

⁶ For a criticism of this rationale, see 2.1.10.

⁷ Rule 4.2. of the Rules of Ethics.

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exercise control of most companies listed on the Copenhagen Stock Exchange.

Several companies listed on the Stock Exchange have included provisions in their charters that put a “cap” on the number of votes that a shareholder has, irrespective of the number of shares he owns. If, for example, no shareholder may cast more than 1 vote, the acquisition of 51 percent of the company’s shares is not sufficient to gain control. In such cases purchase of a majority of the company’s equity capital will not trigger an obligation to make a bid under Rule 4. An offer that does not lead to the acquiror gaining control is not comprised by Rule 4, and no other specific regulation applies to such offer.

The threshold for when acquisition of shares leads to de facto control varies from company to company. If a company’s shares are widely spread, the threshold may be relatively low, whereas it may be quite high if a company has several large stockholders. Using a control criterion without specifying what exactly constitutes control may be a means of achieving a reasonably flexible standard. On the other hand, a mere control criterion creates some uncertainty with respect to the point at which the acquisition of major stockholdings of a company triggers the obligation to make an offer to the remaining shareholders. This problem is underscored by the fact that Rule 4 applies even though an acquiror has purchased the shares of a company for passive investment purposes without intending to acquire or exercise control. Rule 4 fails to distinguish between passive and active investments.

This uncertainty will probably in most cases be resolved through informal discussions between the acquiror or his advisors and the Copenhagen Stock Exchange. However, the question remains if it would not have been more desirable for the obligation to make an offer for all a company’s shares to be tied to the acquisition of a certain minimum percentage of the total votes of the company.

If a specific percentage threshold is used, there is always the risk that some large shareholders, for instance by means of a shareholders’ agreement, may arrange that a holding of shares, which does not trigger an obligation to make an offer for the other shares, would nevertheless give the owner de facto control of the company. It may, therefore, be necessary to supplement a rule specifying a threshold with a rule protecting against such shareholder arrangements leading to de facto control, the purpose of which is to circumvent the threshold stipulated.

Rule 4 contains no distinction between single transactions where control is gained and situations where such control is a result of a number of suc-

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cessive share purchases. Even successive acquisitions may trigger the obligation to make a bid under Rule 4.

Rule 4 is not restricted to transactions directly resulting in a change of control. The reference in 4.1 to transactions that indirectly result in a change of control means that the obligation to make a compulsory offer for the minority shares of a company is triggered in the event that a controlling stockholding of such company is owned by a non-listed parent company, the shares of which are being acquired. The official comments on Rule 4 add that this “at any rate” applies if the holding of shares constitutes the “most important activity” of the parent company. Otherwise, the comments explain, these rules could easily be circumvented. Rule 4 and the comments on the rule leave some uncertainty as to the indirect transactions comprised by the rule. Assuming that the parent company’s ownership of the shares constitutes a substantial (but not necessarily the largest) part of the parent company’s assets, acquiring control of the parent company with the main purpose of controlling the subsidiary would probably trigger the obligation to make a compulsory bid.

Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 23 ff., suggests, on the basis of the practice developed in connection with the British City Code, that the obligation to make a bid for the remaining shares applies if either the holding of shares of the subsidiary constitutes a substantial part of the assets of the parent company or one of the main purposes of acquiring control of the parent company is to gain control of the subsidiary. It is hardly desirable to require a compulsory bid to be made unless it has been a prime purpose of the acquiror when acquiring the parent company to gain control of the subsidiary. It is frequently seen that a parent company owns a number of subsidiaries which each constitute a substantial part of the parent company’s assets, but where an acquisition of the parent company would not lead to “drastic changes in terms and prospects” for the subsidiary, which, according to the official comments on Rule 4, is the rationale for giving the minority shareholders the right to sell their shares on equal terms. It, therefore, seems appropriate to add to the “substantial test” a requirement that the prime purpose on the part of the acquiror must have been to acquire control of the subsidiary through the acquisition of control of the parent company.

If both the parent company and the subsidiary are listed on the Stock Exchange, the question is if a transfer of the shares of the parent company triggers an obligation for the acquiror to make a bid not only for the remaining shares of the parent company but also to the minority shareholders of the subsidiary. The official comment on Rule 4 states that such a transfer will “not necessarily” entail that an offer must be made to the minority shareholders of the subsidiary. The comment, however, does not

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provide any guidance as to the events in which an acquiror would have to make an offer to the shareholders of the subsidiary, but it is fair to assume that principles similar to those outlined above would apply.

The Stock Exchange Rules of Ethics are, by their nature, limited to listed companies. In other words, shareholders of a subsidiary are only entitled to have their shares purchased as a result of a change of control if the subsidiary is listed on the Stock Exchange. If this is not the case, no obligations exist for an acquiror to offer all the minority shareholders to buy their shares on equal terms.

2.1.3. The obligation to offer “equal terms”. The obligation to make an offer on “equal terms” ordinarily means that minority shareholders must receive the same consideration (per share) as is paid for the majority holding.⁸ It follows from the system laid down in Rule 4 that the fact that shares only represent minority interests in a company is disregarded for the purpose of fixing the price of shares under the rule.

Frequently, an acquiror acquires a controlling interest in a company through a series of stock purchases in the market. According to the comments on Rule 4, the offer to the minority shareholders must in such case be based on the highest price paid.

However, the obligation of an acquiror having acquired control by means of a series of transactions to offer the minority shareholders the highest price paid probably does not apply in all events. If one or more initial purchases are made at a point when no plans to acquire control exist, it is hardly fair to include such share purchases when determining the highest price. While the obligation to make a compulsory offer under Rule 4 is not contingent upon an acquiror having the intention to acquire control, subjective factors may play a role when determining which share purchases to include when calculating the highest price paid for a company's shares. Sometimes the circumstances help to show an acquiror's plans. It may, for example, transpire from the facts of the matter that purchases of shares at a high price would only make sense from a business point of view if the acquiror from the outset intended to acquire control, which supports an argument that early stock acquisitions are part of a plan to acquire control and, consequently, should be included when determining the highest price paid.

If a company has one class of shares only, the acquiror must offer to the minority shareholders a price which is, at least, as high as the one he paid

⁸ See the official comments on Rule 4.

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for the controlling holding. In this connection it is immaterial whether the latter is equal to or differs from the quoted price.⁹

The language “equal terms” gives rise to particular problems in connection with the use of dual or multiple class stock.¹⁰ Rule 4 entails that shareholders must be treated equally, which does not necessarily mean that all shareholders must receive the same price for their shares. However, shareholders owning shares of the same class of stock must be offered the same price for their shares.

If the rights attached to the different classes of stock lead to the stock market valuing the shares of the classes differently, the shareholders that own shares belonging to different classes cannot claim the same price for their shares. If all classes of shares are listed and the holding acquired by the acquiror includes shares of all classes, the price paid by the acquiror for the shares in the respective classes will ordinarily provide guidance as to the difference in value.

Such difference in treatment of classes of shares will normally be considered to be decisive, not only if the different prices paid correspond to the differences in quotation, but also if the prices paid exceed the quoted prices. However, if the price paid by the acquiror for the shares of one class differs from (e.g. exceeds) the quoted price for the shares of that class, then the minority shareholders of the other class or classes must also be offered a proportionate increase.¹¹ When determining the differences in value between various classes of shares, the acquiror may consider the quoted prices for a period of time prior to his acquisition of control.¹² Only in extraordinary situations will the Stock Exchange accept that the A-shareholders receive more than 100 percent on top of what is paid to the B-shareholders.¹³

⁹ See the official comments on Rule 4.

¹⁰ Many companies on the Copenhagen Stock Exchange have shares designated as class A-shares and class B-shares, respectively. Ordinarily, the shares of the A class are high-voting shares (10 votes a share), while the class B-shares have only limited voting rights (1 vote a share).

¹¹ The official comments provide an example: if the shares of one class, A, are quoted at a price of 300 while the shares of the other class, B, are quoted at 200, then if the A-shares are acquired at 600, the B-shareholders must receive not less than 400 so that the price of the A-shares remains 50 percent higher than the price of the B-shares.

¹² See the official comments on the rule.

¹³ See the official comments on the rule.

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If the acquiror has purchased shares of one of the classes only, similar rules apply. This means that if, for example, the acquiror acquired A-shares only and he paid a price exceeding the quoted price, then the B-shareholders must receive a proportionate premium on top of the price quoted for the B-shares.

Special problems arise when only one class of shares, e.g. the B-class, is listed.¹⁴ In order to meet the “equal terms” standard, shareholders owning B-class shares must then receive at least 50 percent of the price that is paid per share for the A-shares of a company.¹⁵ The rule that the price for the A-shares may not exceed the price paid for the B-shares by more than 100 percent applies no matter whether the acquiror has acquired shares of both classes or not. The percentage-rule appears somewhat randomly chosen, even though there are obviously administrative advantages connected to using a specific figure. However, it would have been preferable if Rule 4, or the comments on the rule, had contained some guidelines as to how to determine the price of the B-shares, e.g. by providing a more useful formula for the relative prices of A- and B-class shares or by means of an expert appraisal model providing for valuation based on acknowledged principles of stock valuation.

It has been argued¹⁶ that only differences between classes of stock that are related to economic rights should lead to a difference in the price to be paid. According to this view, the fact that class A-shares ordinarily have 10 votes a share while class B-shares have 1 vote a share should not in itself lead to a different treatment, pricewise. The stock market, as a matter of fact, ordinarily does appreciate a difference between shares carrying 10 votes and shares carrying 1 vote, and it is hard to see why one should disregard this fact. While the important thing is that the stock market values A-class shares and B-class shares differently, the reason for this different treatment should not be decisive. The minority shareholders of different classes of a company would argueable not be treated on “equal terms” if the market mechanism were disregarded with reference to the argument that little or no attention should be paid to the value of voting rights. Therefore, problems with respect to determining the price of A-class and

¹⁴ Frequently, it is only the low-vote class of shares that is listed. The reverse situation: that only high-vote shares are listed, is never seen in practice.

¹⁵ See the official comments on Rule 4.

¹⁶ See Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 23 ff. at 28.

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B-class shares ought to be solved pursuant to the principles outlined above and without regard to the cause of the price differentiation.¹⁷

The existing disclosure obligations under § 28 a and § 28 b of the Companies Act¹⁸ do not require that the notification contains information about the price which the acquiror has paid for the shares purchased. Consequently, it may prove impossible to control if shares acquired have been purchased on equal terms.

Article 17(2) of the Draft Takeover Directive would resolve this problem since it requires that an acquiror must declare to the competent supervisory authority all acquisitions of shares of the target-company that are made after a bid is publicly announced, such declaration to include the price paid for the shares and the number of votes already held by the acquiror.

Rule 4 of the Rules of Ethics does not indicate if an acquiror has the right to purchase shares in the market in the event that a compulsory offer has been made, which is still open for acceptance. However, there is probably nothing to prevent the acquiror from making such market purchases, provided that all purchases of shares of the target-company are made on equal terms. If the acquiror decides, after having made a public offer, e.g. through the daily newspapers, to increase the price offered for the company's shares, he will have to increase the payments already made to the shareholders that have tendered their shares pursuant to the original public offer.

Rule 4 only creates a floor for the price to be paid to the minority shareholders. Nothing prevents an acquiror from paying a higher price for minority shares than the price paid per share for the controlling holding.

In the event that the duty to make a mandatory offer is triggered, the acquiror cannot make his offer conditional on e.g. the receipt of a minimum percentage of the target-company's share capital, see also VII.1.3.

2.1.4. **Exceptions to Rule 4.** Danish insurance companies, The Danish Labor Market Supplementary Pension Fund¹⁹, The Employees Capital

¹⁷ The practice by the Copenhagen Stock Exchange is described by Poul-Erik Skaanning-Jørgensen, Erik Bruun Hansen & Lene Nielsen in *Revision & Regnskabsvæsen* No. 3/1988, p. 33 ff.

¹⁸ See also Rule 3.3 of the Stock Exchange Rules of Ethics and § 36 of the Information Obligations for Issuers of Listed Securities.

¹⁹ Arbejdsmarkedets Tillægspension (ATP).

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Pension Fund²⁰ and others are subject to statutory regulation limiting their right to hold shares.²¹ For this reason, those institutions will be prevented from making an offer pursuant to Rule 4. Therefore, as is the case in connection with other unintended acquisitions of controlling interests, such institutions will have to dispose of their shares to the extent necessary for their holding not to constitute a controlling interest any more, cf. the comments on the rule.

The comments on Rule 4 also carve out certain other exceptions to the rule. Persons acquiring controlling interests in listed companies by means of inheritance are not subject to Rule 4. Moreover, the acquisition of a controlling interest by the holder of an unsatisfied mortgage is not comprised by Rule 4.

In addition to inheritance and unsatisfied mortgages, the comments on Rule 4 refer to “similar” events as being outside the scope of Rule 4. It is likely that e.g. acquisition of a controlling shareholding in connection with an insolvency reorganization of a group of companies would be outside the scope of Rule 4. When evaluating what transactions should not trigger the obligation to make a compulsory bid, the Board of the Copenhagen Stock Exchange would probably consider if the transaction at focus is of an “accidental” nature similar to the acquisition by inheritance or on the basis of an unsatisfied mortgage. If, on the other hand, the transaction is merely an ordinary acquisition of a controlling interest in disguise, no exemption is likely to be granted.

Transactions within the same group of companies are also exempted from Rule 4.

²⁰ Lønmodtagernes Dyrtdsfond (LD).

²¹ Restrictions apply to the right for insurance companies to acquire a controlling interest in an undertaking, see the Act on insurance companies, Consolidation Act No. 127 of March 23, 1984 (as amended by Act No. 325 of May 24, 1989, and Act No. 305 of May 16, 1990), § 6, Subsections 1 and 2. The Act on The Employees Capital Pension Fund, see Consolidation Act No. 42 of January 21, 1988, § 6, Subsection 5, entails that The Employees Capital Pension Fund may not invest its funds in an undertaking to the extent that such investment will give the Fund or the Fund together with The Danish Labor Market Supplementary Pension Fund a controlling interest in the undertaking. A similar limitation applies to The Danish Labor Market Supplementary Pension Fund, see the Act on The Danish Labor Market Supplementary Pension Fund, Consolidation Act No. 3 of January 5, 1988 (as amended by Act No. 267 of May 2, 1990), § 26, Subsection 6. In connection with the limitation in the Act, shares owned by The Employees Capital Pension Fund are included when determining if The Danish Labor Market Supplementary Pension Fund has a controlling stockholding.

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Apart from the exemptions specified in the comments on Rule 4, Rule 4.3. stipulates that the Board of the Copenhagen Stock Exchange may grant an exemption from the obligations to make a compulsory bid if “special circumstances” apply. The comments on Rule 4, again, do not provide any guidance as to the situations in which exemption may be granted. The Stock Exchange Rules of Ethics came into force on January 1, 1988, and so far the Board seems to be very reluctant to grant exemptions.

There are certain kinds of transactions that are likely to lead to an exemption, however. For example, this probably applies to accidental acquisitions other than those explicitly mentioned in the comments on Rule 4. Another example might be events where a restructuring of a company necessitates such exemption. If an acquiror injects capital into a company in connection with the acquisition of the company and the injection would be impossible financially if the acquiror were to make a bid for all the outstanding shares of that company, it is possible that an exemption will be granted. However, exemption will probably not be granted even in this scenario, unless the restructuring would in some way benefit all shareholders and provided that the minority shareholders’ interests are protected. Due to the desire to protect the minority shareholders which is the rationale of Rule 4, it is likely that the Board of the Copenhagen Stock Exchange will continue to be very restrictive in its exemption policy.²²

Ordinarily, the purchase by an acquiror of the entire capital of a company would lead to a delisting of the company from the Copenhagen Stock Exchange.²³ A solution of this problem is provided for in the comments on Rule 4, which stipulate that no automatic delisting will take place in such event; rather, the acquiror will be required to arrange for the spread of his shares within certain time limits.

2.1.5. Cooperation. Rule 4 of the Rules of Ethics applies to any person – natural or legal – as well as to two or more persons who cooperate in order to acquire control of a company, cf. the comments to Rule 4. There is

²² See Poul Erik Skaanning-Jørgensen, Erik Bruun Hansen & Lene Nielsen in *Revision & Regnskabsvæsen* No. 3/1988, p. 33 ff. at 42 f. See also Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 23 ff. at 30, about possible situations where an exemption from Rule 4 is likely to be granted.

²³ See § 5 of the Order on Listing Requirements, the attached Form A, II, 4, and Chapter 7 of the Order.

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some uncertainty as to what kinds of cooperation that fall within the scope of Rule 4.

In order to qualify under the rule, the purpose of the cooperation must be to gain control and not merely, for example, to cooperate in order to improve the financial position of the company. Frequently there is a very fine distinction between cooperating to achieve a reasonable return on the shareholders' investment on the one hand, and exercising influence on a joint basis that constitutes "control" on the other hand. It is probably fair to construe the notion of "control" as requiring a desire on the part of the persons acting together to exercise an active influence over the management of the company, rather than just focusing on receiving a fair dividend and protecting the value of the equity interest in the company. The latter kind of cooperation would fall outside the scope of Rule 4.

If a cooperation is established at a point when the persons cooperating have already acquired stockholdings that in the aggregate constitute a controlling interest, this probably falls outside the scope of Rule 4. The language of the comments on Rule 4 suggests that only cooperation in order to acquire control qualifies under the rule.

Another difficult aspect of the cooperation issue is what acts or activities actually constitute cooperation. Obviously, cooperation need not be reflected in a shareholders' agreement or other kind of written agreement, an oral agreement will do. It is not certain whether an informal common understanding is sufficient. The term "cooperating", however, suggests that some kind of active interaction, e.g. concerted action, is required. A mere "meeting of the minds" without any joint activity does not fall within Rule 4.

Even though Rule 4 does not require any formal cooperation or structure between the parties involved, certain links between entities perhaps make it more likely that such entities will be considered to cooperate. Such a presumption may be fair in connection with, for example, companies belonging to the same group, for a further discussion of this, see VII.4.2.1.2.

2.1.6. Interrelation between Rule 4 and § 20 b of the Companies Act.

An acquiror who owns more than 90 percent of a company's share capital and votes may want to cash out shareholders that do not tender their shares pursuant to his offer in accordance with § 20 b of the Companies Act. If, in such event, the acquiror and the minority shareholders cannot reach an agreement with respect to the price applicable to the cash-out, experts will have to be appointed pursuant to § 19, Subsection 2, of the Companies Act. The task of the experts will be to determine the value of the shares to

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be cashed out. However, Rule 4 of the Stock Exchange Rules of Ethics provides that the acquiror must give the minority shareholders an opportunity to sell their shares on “equal terms”. To the extent that there is an overlap between the two provisions, the most appropriate thing to do would be to have the value of the shares determined with reference to the price paid for the controlling shareholding since this price presumably reflects the current market value of the shares of the company.

If the controlling stockholding was traded at a price that is significantly lower than the price quoted for the shares on the stock exchange, which will normally be the basis for determining the price pursuant to § 19, Subsection 2, of the Companies Act, it may be more appropriate to use the price quoted rather than the price paid for the controlling shareholding. The quoted price may, for example, be relevant where the controlling shareholding was not acquired on an arm’s-length basis, or if the acquisition otherwise was not made on usual market terms and conditions.²⁴

In addition to the references already mentioned, Rule 4 is briefly touched upon by Werlauff in *Selskabsret* p. 316 ff.

2.1.7. Preliminary observations. A fundamental question which we have not dealt with so far is whether it is at all desirable to have a system imposing on acquirors an obligation to make bids once they acquire control. The issue is, in other words, if there ought at all to be a mandatory bid system, whether the trigger-mechanism is based on a control criterion or the acquisition of a certain percentage of a company’s shares or votes. The argument that has been made in support of a mandatory bid system is that it protects minority shareholders and ensures them “equal” treatment. However, there is no doubt, on the other hand, that mandatory bids lead to increased costs on the part of acquirors and may thus affect efficiency adversely.

²⁴ Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 23 ff. at 32, suggests that it should be decisive if the majority stockholding is acquired from a large number of shareholders rather than a few. If the controlling holding was acquired from a large number of shareholders the cash-out price should be equivalent to the payment that was paid for the controlling holding, according to Krüger Andersen. On the other hand, if the controlling holding was acquired from one or a few shareholders only, the value of the shares to be cashed out should be fixed pursuant to § 20 b of the Companies Act if such valuation would lead to a higher price than the price paid for the majority holding.

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Before we analyze these questions further it may be useful to consider some other jurisdictions where the concept of mandatory bids is used.

2.1.8. Comparative aspects. Neither American nor German, Dutch or Swedish takeover regulation imposes on an acquiror an obligation to make a bid for the remaining shares of a company once he has acquired control or reached a specific percentage of the votes of the company.

The British City Code contains very elaborate provisions dealing with mandatory public offers.

Any person (natural or legal) who acquires, whether or not by a series of transactions over a period of time, shares which – taken together with shares held or acquired by persons acting in concert with him – carry 30 percent or more of the voting rights of a company must extend his offer to the holders of any class of shares of which he or persons acting in concert with him hold shares.

A similar obligation applies to any person who, together with persons acting in concert with him, holds not less than 30 percent, but not more than 50 percent of the voting rights, where such person, or any person acting in concert with him, acquires in any period of 12 months additional shares carrying more than 2 percent of the voting rights.²⁵

An acquiror who crosses either of the above mentioned thresholds will have to make an offer not only for the class of shares of which he has acquired shares but also for the shares of any other class, and irrespective of whether such shares are voting shares or not. Offers regarding different classes of shares must be comparable.²⁶ It is worth noting that – in addition to the acquiror – each of the principal members of a group or persons acting in concert with him may, according to the circumstances of the case, have the obligation to extend an offer.

Mandatory offers must be conditional upon the acquiror receiving acceptances in respect of shares which, together with shares acquired or agreed to be acquired before or during the offer, will result in the acquiror and any persons acting in concert with him holding shares carrying more than 50 percent of the voting rights of the company.²⁷ Where an offer comes within the statutory provisions for possible reference to the Mo-

²⁵ Rule 9.1 (a) and (b) of the City Code.

²⁶ Rule 9.1 of the City Code sets forth that The Take-over Panel should be consulted in advance in such cases. Comparable offers are further dealt with in Rule 14 of the City Code.

²⁷ See Rule 9.3 of the City Code.

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nopolies and Mergers Commission, it must be a term of the offer that it will lapse if there is a reference before the first closing date or the date when the offer becomes or is declared unconditional as to acceptances, whichever is the later.²⁸

A mandatory offer may be subject to no other conditions, unless The Take-over Panel gives its consent.²⁹ If an acquiror does not receive acceptances in respect of shares which, together with shares acquired or agreed to be acquired before or during the offer, will result in the acquiror, and any persons acting in concert with him, holding shares carrying more than 50 percent of the voting rights of the company, the offer will lapse automatically.

The consideration to be offered must be in cash or be accompanied by a cash alternative, and the price offered shall not be less than the highest price paid by the acquiror or any person acting in concert with him for shares of that class within the preceding 12 months. If an acquiror is of the opinion that the highest price should not apply in a particular case, he must consult The Take-over Panel, which has authority to agree to an adjustment of the price.³⁰

A similar, but yet somewhat different, mandatory system is found in the French regulation of takeovers.³¹

The duty to make a bid is triggered when an acquiror, acting alone or in concert with others, becomes the owner of more than one-third of the share capital or voting rights of a company.³² Similarly, the obligation to make a bid for the shares of a company is triggered if, directly or indirectly, more than one-third of the share capital or voting rights is acquired of a company that holds as an essential part ("part essentielle") of its assets shares of the aforementioned company.³³

A third scenario where a bid must be made is in the event that the acquiror holds between one-third and 50 percent of the share capital/voting

²⁸ Rules 9.4 and 12 of the City Code.

²⁹ See Rule 9.3 of the City Code. According to the notes on Rule 9.3, the panel will not normally consider a request for a dispensation under the rule other than in exceptional circumstances. As examples hereof are mentioned where the necessary cash is to be provided, wholly or in part, by a cash underwritten alternative which is conditional on the obtaining of a listing for new shares, or when some governmental, including EC, clearance is required before the offer document is posted.

³⁰ Rule 9.5 of the City Code.

³¹ See Article 5-3-1 ff. of the General Rules.

³² See Article 5-3-1 of the General Rules.

³³ See Article 5-3-3 of the General Rules.

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rights of a company and increases his holding of share capital/votes by more than 2 percent within less than one year. The same applies if the acquiror within the said period becomes the owner of more than 50 percent of the share capital/votes.³⁴

When calculating the thresholds of ownership, the acquiror's pre-bid holdings must be included.

A mandatory bid need not include all target-shares but may be limited to two-thirds of the aggregate share capital/ votes.³⁵ In other words, it is not a requirement that all shareholders must have the opportunity to sell their shares.

There is another interesting aspect of the French mandatory bid system: The price to be paid for the remaining shares is not tied to the price paid for the controlling block of shares. Instead, the price will have to be negotiated with and approved by the Stock Exchange Council.³⁶ This obviously gives the Council flexibility to consider the special facts of each case when determining the price to be paid.

Similar to what we saw with respect to the Danish and British rules, an acquiror who has a duty to make a bid cannot make such bid conditional upon receipt of a minimum number of acceptances.

The Stock Exchange Council may grant exemptions from the mandatory bid requirements discussed. However, contrary to what we saw as to Danish law, the right to grant exemptions is governed by special rules.³⁷

Exemption may be granted in situations where

- (a) the crossing of the threshold is the result of a gratuitous transfer, or a merger or partial merger, approved by the target-shareholders;
- (b) the acquisition of shares/voting rights in excess of the one-third threshold does not exceed 3 percent and the acquiror undertakes to resell the "excess shares" within 18 months;
- (c) the one-third threshold is crossed because of a reduction of the aggregate number of shares/votes;
- (d) the acquisition does not lead to control;
- (e) the acquisition will trigger the so-called "block of control"-procedure.³⁸

³⁴ See Article 5-3-4 of the General Rules.

³⁵ See Article 5-3-1 of the General Rules.

³⁶ See Article 5-3-1 of the General Rules.

³⁷ See Article 5-3-6 of the General Rules.

³⁸ This procedure applies to the acquisition of a controlling block of shares from identified shareholders, cf. Article 5-4-1 ff. of the General Rules.

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The Swiss Take-Over Code applies a much simpler concept which provides that if, after the acceptance period of his (partial) offer has expired, an acquiror owns a total of more than 50 percent of the target-voting rights, he must buy all shares offered for sale, see Article 3.8 of the Code.

2.1.9. The Draft Takeover Directive. Article 4(1) and (2) of the Draft Takeover Directive applies to any natural person or entity who, as a result of his own acquisition or acquisition by others on his behalf or who act in concert with him, or by an undertaking which he controls³⁹, comes to hold⁴⁰ shares which, added to any existing holdings, give him a specified percentage of the voting rights of a company. Such an acquiror must make a bid for all of the remaining shares. Article 4 states that the threshold triggering the mandatory bid may not be fixed at more than one-third of the existing voting rights.

According to the official comments regarding Article 4, member states may provide in their legislation that the duty to make a bid arises when an acquiror intends to exceed the threshold stipulated. This would shift the trigger-mechanism from being tied to the votes actually held by the acquiror to being linked to the votes he may come to hold if his bid proves successful.

Article 4 does not stipulate the price at which mandatory offers must be made, so in this respect the Draft Takeover Directive differs from the Danish regime. The notion of equal treatment – whatever that means, specifically speaking – would apply, however, to mandatory bids under the directive, cf. Article 6a (stating the principles applicable to the discharge of the functions of the supervisory authority). Article 6a(a) thus states that all holders of target-securities “who are in the same position” shall be treated “equally”. This is probably meant to mean that all shareholders (of the same class) must receive the same price per share, cf. the discussion under 2.1.10 below, however.

³⁹ As to the Directive’s definition of “acting in concert” and “control”, see VII.4.3.4.5. and 4.2.1.2. (Article 4 in this regard is identical to Article 10(1)(e)).

⁴⁰ For a definition of shares considered to be “held” by a person, see VII.4.3.4.5. (Article 4 in this respect is a mirror of Article 10(1)(e)). As to voting rights attached to shares owned by the acquiror but which are lodged as security, Article 4 follows the system found in Article 10(1)(ee), see VII.4.3.4.5. Voting rights which cannot be exercised pursuant to Article 22 of Directive 77/91/EEC shall not be taken into account when calculating the threshold referred to in the text, cf. Article 4(2)b.

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Under Article 4(2)c, member states would have powers to enact legislation which would exempt acquirors from making a bid, although they have crossed the applicable triggering point. The categories of exemptions mentioned in Article 4 are:

Transfer of shares without consideration, acquisition in connection with a planned merger (which the acquiror has undertaken to carry out), acquisition resulting from a division of a company, events where the acquiror has crossed the triggering point but not by more than 3 percent of the voting rights and undertakes to dispose of the “excessive shares” within one year, in cases where the target-company is already controlled by the acquiror or undertakings controlling him or controlled by him, in events where a shareholder or a number of shareholders have given their formal undertaking not to transfer their securities to the acquiror, and in events where the securities have been acquired following an increase in the subscribed capital of the company and the acquiror has exercised his preemptive rights. In addition to this list of possible exemptions, Article 4(3) provides that the supervisory authority may grant exemption in other cases, giving its reasons for doing so.

2.1.10. Evaluation of the mandatory bid requirement. In some instances acquirors want to acquire the entire share capital of the target-company. The reasons for this may be a desire to avoid possible conflicts with smaller shareholders or to obtain a basis for having the target-company and the acquiror taxed on a consolidated basis.⁴¹

Other acquirors may prefer to acquire only the majority of the shares of a company. Because of Rule 4 of the Copenhagen Stock Exchange Rules of Ethics, acquirors who come to own a controlling stockholding do not have a choice: they must make a bid for the remaining shares on terms equal to the terms applying to the acquisition of the controlling interest. Obviously, the obligation to make such a mandatory bid makes it more expensive for acquirors to gain control. They cannot limit themselves to acquiring e.g. 35 or 45 percent of the votes of a company if this means control, but must offer to buy the shares of the minority shareholders as well.

There is probably no doubt that the increased costs connected to the mandatory bid system are counter-efficient. The question is if Rule 4 is, nevertheless, justified because of its attempt to achieve “equality”.

⁴¹ See IX.3.2. regarding the requirements for taxation of companies on a consolidated basis.

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According to the comments on Rule 4, “drastic changes in terms and prospects” frequently occur when the control changes. Owners of minority shareholdings, the comments state, must therefore be ensured the opportunity to dispose of their shares at a price equivalent to the price that was paid for the controlling holding. As stated in the comments on the rule, the rule seeks to provide for equal treatment of shareholders in connection with transfer of controlling stockholdings.

There are two elements of Rule 4: the duty to make a bid, and the obligation to offer in such bid terms equal to those pertaining to the acquisition of the controlling holding.

The comments on Rule 4 do not explain further why minority shareholders should have the opportunity to sell their shares once a change of control occurs. Some guidance as to the rationale behind the imposition on acquirors of a duty to make mandatory bids may be found in legal expositions dealing with the purpose of mandatory bids in other jurisdictions. In Weinberg & Blank’s *On Take-overs and Mergers* the following comments are made with respect to mandatory bids under the British City Code:

“The reason often given for the disfavour in financial and business circles of partial bids and private deals conferring voting control but not full equity ownership, is that the remaining shareholders are left as a powerless minority (or even, where the bidder acquires only effective control, an effectively powerless majority). By a successful partial bid or private deal, the new controller places itself in a position to exercise control over net assets considerably exceeding in value the financial stake of the controller in those assets; the new controller is in a position where it may well abuse control and will be able to take advantage of the “neutral” or management uses of control.”⁴²

The question one may ask here is if it necessarily makes any difference for minority shareholders who hold the controlling stockholding. Is the fact of the matter not that minority shareholders have a limited say at the shareholders’ meetings, or are perhaps virtually voiceless, and that this will just remain unchanged even after a change of control? Also, is it at all certain that the acquiror (the new controller) is in any way more abusive than the old one was? Moreover, Weinberg & Blank fail to take into account that the change of control may lead to improved management of the company and thus lead to an increase in the value of minority-shares. In short, it is not at all obvious that there are any particular rights of the

⁴² See M.A. Weinberg, M.V. Blank & A.L. Greystoke, *On Take-overs and Mergers* p. 116.

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minority shareholders that are exposed and need to be protected in connection with the transfer of control.

Weinberg & Blank concede that the former controlling shareholders were in a position similar to that of the new one but they emphasize that “the fact that the new controller has seen fit to make the bid or purchase at all, and in particular has seen fit to operate by way of a partial bid or private deal, gives rise to suspicions as to its intentions regarding the use to which control is to be put.”⁴³ However, there is hardly any reason to believe that acquirors who do not wish to acquire all the shares of a company have less laudable motives than other acquirors. A desire not to make a bid for the shares may be motivated by nothing else than an interest in avoiding excessive costs.

Another argument made by Weinberg & Blank⁴⁴ is that the acquiror will usually be a company while the former controllers would generally have been individuals. As a consequence hereof this would, according to Weinberg & Blank, lead to a danger that the interests of the target-company will be subjugated to the interests of the group. This assumption made by Weinberg & Blank may be right or may be wrong. In the case of many companies it is definitely wrong. Anyway, it is not very meaningful to guess about the consequences of a transfer of control from the hands of individuals to a company.

Since the minority shareholders’ legal or factual position does not necessarily change as a result of the change of control, it is, at least, questionable if giving the minority shareholders the right to have their shares acquired on terms equal to those that pertain to the controlling shareholding is really what we wanted to achieve when we stated that shareholders should be treated equally. Surely, we cannot claim that Rule 4 violates the notion of “equality” provided that the rule is applied correctly, cf. I.2.3.4., but we might want to consider if the criteria for who should be treated equally are adequate or if Rule 4 fails to acknowledge that majority and minority shareholders are not in the same “boat”.

The stock market will ordinarily consider a controlling holding of shares worth more than a minority holding. Rule 4 puts this pricing mechanism out of force and, in effect, provides an unexpected opportunity for minority shareholders, who may suddenly elect to dispose of their shares at a

⁴³ See M.A. Weinberg, M.V. Blank & A.L. Greystoke, *On Take-overs and Mergers* p. 116.

⁴⁴ See M.A. Weinberg, M.V. Blank & A.L. Greystoke, *On Take-overs and Mergers* p. 116.

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premium price because an acquiror presents himself. Rather than protecting the interests of minority shareholders, Rule 4 helps to give them unexpected benefits.

We have, so far, discussed the issue of mandatory bids focusing on the impact of change of control. An alternative approach would be to consider the nature of the notion of “control”. Adolf Berle has contended that control is an asset which “belongs” to the company.⁴⁵ Consequently, if a controlling shareholder sells his shares and thus his control, the premium he receives as consideration for the control could be viewed as belonging to the company or (perhaps) to all shareholders ratably.⁴⁶

Berle compares the shareholders’ position with that of a common law trustee:

“After all, if the trustee of a common law trust realizes a side profit in connection with his transactions with the trust estate, even though it does not damage that estate, he is liable to account for such profits on the theory that everything growing out of the trust estate belongs to it and to the cestuis que trustent”⁴⁷.

Although Berle agrees that “the case is not quite so clear in the corporate situation” where “the stockholder’s vote is given to him for his own benefit”⁴⁸, he maintains that “aggregate voting power is a part of the corporate mechanism, intended for the benefit of the entire corporation....”⁴⁹.

It is difficult to see, at all, the grounds for drawing parallels between trustees of a trust and shareholders of a company, as is done by Berle. The former are merely managing the funds and assets of the trust and are not supposed to realize “side profits” when making transactions with the trust. This is not what they have been hired to do. Shareholders, on the other hand, after all own the company, and exercising their voting power is one of the very features of corporate ownership upon which the entire concept of companies rests.

⁴⁵ See Adolf A. Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 at 1221 (1958), and in Berle & Means, *The Modern Corporation and Private Property* p. 244.

⁴⁶ See Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 at 1220 (1958).

⁴⁷ Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 at 1221 (1958).

⁴⁸ See Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 at 1221-1222 (1958).

⁴⁹ See Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 at 1222 (1958).

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Considering control as a corporate asset is also very hard to reconcile with the general perception of the notion “control”. There are various ways of defining control, but many commentators would probably agree that one adequate definition would be the power to elect and influence the board of a company.⁵⁰ If this definition is our point of departure, control is not embodied in the company, rather, it comes from “outside” and, typically, can only be acquired if the “would-be” controlling shareholder pays the premium required by those selling. Neither the company nor the other shareholders participate in the payment of such premium and it is, therefore, difficult to see why they should have a share of the benefit that inures upon a subsequent sale of control. It is, altogether, difficult to see how Berle’s viewpoint could justify the existence of a duty to make a bid for the remaining shares whenever control is acquired.

For a discussion of the position taken by Berle, see, for example, Alfred Hill, *The Sale of Controlling Shares*, 70 Harvard Law Review 986 (1957) and Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 Journal of Political Economy 110 (1965). In support of his point of view, Berle has referred to the decision in *Perlman v. Feldmann*, 219 F.2d 173 (2nd Cir. 1955). This is probably a very far-reaching understanding of the decision, see also Alfred Hill, *The Sale of Controlling Shares*, 70 Harvard Law Review 986 at 990 (1957).

Because mandatory bid requirements, such as Rule 4, make it comparatively expensive to carry out corporate acquisitions, they are likely to have an inhibiting effect on this kind of activity. The more costly it is to acquire control, the fewer acquisitions, including “hostile” ones, will be consummated. Due to the benefits attached to such takeovers it is fair to say that Rule 4 defeats the interests of society in creating an environment where takeovers may be consummated smoothly. In sum, there appears to be little justification for maintaining the mandatory bid requirement under Rule 4.

In an earlier version of the Draft Takeover Directive, prepared by the Permanent Representatives Committee, (10854/89, EF 105 DRS 67, Brussels, December 15, 1989), Article 4 would oblige an acquiror to make a bid, not for all remaining shares, but only so that he becomes the owner of at least 50 percent of the shares of a target-company once he has acquired a specified percentage of the votes of the company. Likewise, the French takeover regulation allows acquirors to limit mandatory bids to two-thirds of the share capital/voting rights, cf. 2.1.8. Rules of this kind are, of course, less costly for an acquiror and consequently

⁵⁰ See also Berle, “Control” in *Corporate Law*, 58 Columbia Law Review 1212 (1958).

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less inefficient. On the other hand, it is difficult to see the true need for imposing partial mandatory offers, considering the position and expectation of the minority shareholders as discussed above. If, as concluded, there are no grounds for giving minority shareholders the right to tender all their shares upon a change of control, there are hardly any good reasons either for allowing them to tender a part of their shares in such a situation.

For a criticism of Article 4 of the Draft Takeover Directive, see also Hans-Joachim Mertens, *Förderung von, Schutz vor, Zwang zu Übernahmeangeboten?*, Die Aktiengesellschaft 6/1990, p. 252 ff. at 256 ff.

For a discussion of the desirability of introducing mandatory bid requirements to Norwegian law, see Lucy Smith, *Kampen på aksjemarkedet, en rettslig studie av selskapsovertak og forsvarstiltak* p. 124 ff. The question of which authority would be required under Norwegian law to introduce mandatory bids is discussed by Morten Holmboe in *Lov og Rett*, 1989, p. 73 ff.

3. Alternative means by which to protect minority shareholders

3.1. Introduction. In other jurisdictions, not least in the United States, the issue of protecting minority interests in the event of contested takeovers has attracted much attention, and many efforts have been made to provide a system which protects such minorities, on the one hand, while maintaining a high degree of efficiency, on the other. Although the corporate scenario differs from country to country, it may be useful to have a look at the various methods of protecting minority interests developed in other jurisdictions.

3.2. Target-shareholder approval as a condition for public offer. One way of ensuring that minority shareholders' interests are protected would be to make it a requirement that public offers should be subject to approval by a certain minimum number or percentage of target-shareholders, excluding the acquiror and persons or entities controlled by him or acting in concert with him.

This concept is followed in the British City Code, which states that any offer that could result in the acquiror holding shares carrying 30 percent or more of the voting rights of the target-company must be conditional, not only on the specified number of acceptances being received, but also on approval of the offer being given by shareholders holding over 50 percent of the voting rights of the target-company not held by the acquiror or per-

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sons acting in concert with him.⁵¹ This approval requirement may occasionally be waived by The Take-over Panel if more than 50 percent of the voting rights of the target-company are held by one shareholder.

By making it a requirement that 50 percent of the remaining shareholders must approve offers for large numbers of shares, corporate acquisitions are delayed and a substantial impediment is created for change of corporate control. It is likely that requirements of this nature make changes of control much more expensive than if no such requirement existed. In addition, it is not obvious that such an approval mechanism benefits target-shareholders.

3.3. Eliminating or limiting the voting rights of the acquiror. A number of the American states have enacted state corporate statutes which eliminate or severely restrict the voting rights of an acquiror.

Indiana is among the states which have chosen to regulate the voting rights of the acquiror after an acquisition of a company.⁵² Any person who acquires 20 percent or more of the voting stock of an Indiana corporation cannot vote on his shares unless he first obtains the approval of the target-company's other shareholders. The acquiror may demand that a special shareholders' meeting be held with 50 days' notice. At such meeting the shareholders must decide whether to "reinstate" the voting rights of the acquiror. If the acquiror subsequently acquires additional shares of the company, he will have to obtain new approvals from the shareholders when crossing 1/3 or 1/2 of the target-company's aggregate voting stock in order to be able to vote on such additional shares. If the acquiror does not demand a special meeting within a certain time limit, the company has the option to repurchase the shares belonging to the acquiror for a reasonable price, provided that such right for the company has been stipulated in the company's charter. On the other hand, if the acquiror demands and obtains the right to vote on his shares, the shareholders who voted against such right for the acquiror may require that the acquiror buy their shares for a price equivalent to the highest price which the acquiror paid when he acquired his holding of stock in the target-company.

This type of takeover regulation protects the minority shareholders against abusive steps on the part of an acquiror. However, it is obvious that any acquiror, not only those that have "bad" motives, is virtually paralyzed, not only with respect to transactions which may harm the other

⁵¹ See Rule 36.5 of the City Code.

⁵² See Indiana Business Corporation Law § 23-1-42-1 ff.

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shareholders but also as regards any other exercise of influence over the management of the company. Also, the prospects of acquiring a major block of shares and then finding oneself without any voting rights is likely to deter many acquirors from attempting to acquire companies. This effect is hardly in the interests of shareholders or society, see V.2.7 and 3.

3.4. Business combination moratorium provisions. Many American states have adopted statutes which prohibit or restrict business combinations involving the acquiror, or a company controlled by the acquiror, and the target-company for a certain period of time after a takeover.

The change in Delaware's General Corporation Law adopted in 1988 constitutes an example of state regulation falling within the above mentioned category.⁵³ The new Delaware statute provides that an acquiror who becomes the owner of 15 percent or more of the outstanding voting stock of the target-company may not engage in any business combination involving the target-company for a period of 3 years following the date the acquiror crosses the 15 percent threshold.⁵⁴ According to the Delaware

⁵³ Under American law, the regulation of a company's management to dispose on its own without shareholder approval varies from state to state. Delaware is known to have a legislation which leaves great flexibility with the management to dispose on its own. As it is management who decides in which state to incorporate, a number of the largest companies in the United States have incorporated in Delaware (whereas corporate headquarters are often located in other states). This concentration of large companies in Delaware has led to the Delaware courts gaining a considerable experience within the area of corporate law. Consequently, the development in the corporate practice of the Delaware courts is followed by legislatures as well as courts in other states. New York State does not give corporate managements the same degree of leniency as is the case in Delaware. Still, New York is considered one of the key states with respect to the development of corporate law, among other things because of the considerable number of large companies having their headquarters in New York.

⁵⁴ See Delaware General Corporation Law § 203. In addition to mergers and consolidations, the term "business combination" includes any sale, lease, exchange, mortgage, pledge, transfer or other disposition of assets of the target-company to or with the acquiror, provided such assets have an aggregate market value equal to 10 percent or more of either the aggregate market value of all the assets of the target-company or the aggregate market value of all the outstanding stock of that company. The mentioned transactions do not constitute a business combination if the acquiror is merely involved proportionately as a stockholder of the target-company. Also, any Delaware company may elect not to be governed by the Delaware Takeover Statute.

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statute, there cannot be a merger of the target-company into the acquiror for a 3-year period, unless the board of directors of the target-company approves either the business combination or the stock transaction which resulted in the acquiror becoming a 15 percent stockholder. Another exemption from the 3-year limitation applies if the business combination is approved by the board of directors as well as by the affirmative vote of at least 66 2/3 percent of the outstanding shares, excluding the shares belonging to the acquiror. In addition, the 3-year delay of business combinations does not apply if the acquiror owns 85 percent or more of the outstanding voting stock of the target-company.

The Delaware Takeover Statute has been designed to protect the shareholders of the target-company against abusive tactics on the part of the acquiror, including use of two-tier tender offers, where shareholders who decide not to tender their shares to the acquiror in the first place are “squeezed out” at a much lower price than that offered to the shareholders in the first step when the acquiror effects a second-step merger of the target-company into the acquiror after having acquired control.

However, the Delaware statute can be criticized because it imposes restrictions on an acquiror in a 3-year period, irrespective of whether there are valid business reasons for effecting business combinations involving the target-company and the acquiror. In its attempt to protect the minority shareholders against being squeezed out at an unfair price, the statute seeks to “kill” the “cause” of the problem by hampering business combinations. By doing so, the statute not only creates impediments to business combinations of which some are likely to benefit most shareholders but probably also eliminates a large number of contested takeovers even though at least some of such takeovers may be beneficial for Delaware companies.⁵⁵

New York has adopted a takeover statute of the same type as the Delaware statute. If an acquiror acquires 20 percent or more of the outstanding stock of a New York corporation, the acquiror cannot effect a second-step merger for 5 years. However, an exemption applies if, prior to

⁵⁵ Among others, Indiana (Indiana Business Corporation Law 23-1-43-1 ff.), Kentucky (Kentucky Business Corporation Act 271 B. 12-210 ff.), Minnesota (Minnesota Business Corporation Act 302 A.673), New Jersey (New Jersey Business Corporation Act 14 A: 10 A – 1 ff.), New York (New York Business Corporation Law § 912), Washington (Washington Business Corporation Act chapter 23.A 50), and Wisconsin (Wisconsin Business Corporation Law 180.726) have adopted similar statutes.

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acquiring the 20 percent holding, the acquiror obtains an approval of the merger from the board of directors of the target-company.⁵⁶

3.5. “Fair price” provisions. Statutes which ensure that minority shareholders of a target-company receive a fair price for their shares have been adopted by a number of American states.

Maryland has thus enacted such a “fair-price” statute directly aimed at preventing possible abuses in connection with two-tier tender offers.⁵⁷ To prevent such abuses Maryland has required that an acquiror pay at a minimum as high a price to the minority shareholders in the second-step merger as he paid to acquire control. A business combination following an acquisition ordinarily requires 80 percent of all votes as well as a majority of two-thirds of the votes which the acquiror does not control.⁵⁸ An acquiror may avoid these special requirements with respect to business combinations by offering the remaining shareholders a price for their shares which is not less than the highest price paid for shares in the first step of the acquisition. This means that an acquiror will, in effect, be compelled to pay to the minority shareholders in the second-step merger a price which is often higher than the average price paid for shares acquired in the first instance.⁵⁹

The requirement that minority shareholders in the second-step merger must receive as high a price as the acquiror paid for the controlling block of shares disregards the fact that the minority shares are, ordinarily, worth less than majority shares. By “dismantling” this mechanism, the Maryland statute leads to the second-step merger becoming more expensive than necessary. Also, it is hard to see the rationale for treating shareholders who have securities of different values equally.

3.6. Disgorgement provisions. Recently, the legislature of Ohio adopted a new statute which contains the first American state law imposing on an

⁵⁶ See the New York Business Corporation Law § 912.

⁵⁷ See the Maryland General Corporation Law § 3-601 ff.

⁵⁸ In a number of American states, mergers may be approved by a majority of all shareholders.

⁵⁹ The Maryland-version has, inter alia, been adopted by Connecticut (Connecticut Stock Corporation Act 33 – 374 a ff.), Florida (Florida General Corporation Act 607.108), Illinois (Illinois Business Corporation Act 7.85), Louisiana (Louisiana Business Corporation Law 12: 132 ff.), and North Carolina (North Carolina Business Corporation Act 55 – 75 ff.).

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acquiror that obtains control a duty to disgorge profits.⁶⁰ An acquiror who obtains control must disgorge to the target-company any profit that he has received from the sale of shares acquired during a period beginning 18 months before and disposed of within 18 months after a proposal or public disclosure of acquisition of control of a target-company. However, the acquiror is released from this obligation to disgorge if he can prove to a court that when he disclosed his interest in the company he had reasonable grounds to believe that he would succeed in acquiring control. Another exemption applies if he can prove that his disclosure and other conduct were not effected with the purpose of influencing market trading and his acts did not materially affect the price or volume of trading in the market of target-shares.

The problems in connection with the Ohio approach is that it is difficult to state under what circumstances it is reasonable to impose on an acquiror an obligation to disgorge his profits. Courts are not very well suited for discussing, in hindsight, if acts by an acquiror were made not because the acquiror believed he could acquire control, but because he wanted to affect the trading in the market. If the purpose is to avoid manipulative acts, this kind of provision is hardly very suited. In addition, due to the discretion which is left with the courts by this type of provision, it is likely to deter acquirors from attempting to make corporate acquisitions even though such acquisitions are frequently desirable.

The principle found in the Ohio statute resembles what is known under Danish law as the “doctrine of enrichment” (“berigelsesgrundsætningen”), which is analyzed in detail by Anders Vinding Kruse in *Restitutioner, et bidrag til undersøgelsen af berigelsesgrundsætningen i dansk og fremmed ret*.

4. Conclusions

4.1. Introduction. When drawing conclusions with respect to how to strike the best possible balance between achieving maximum efficiency on the one hand and adequate protection of minority interests on the other, it is useful to consider the following three scenarios separately:

⁶⁰ See Section 1707.043 of the Ohio Revised Code. The new statute came into force on April 9, 1990.

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- (a) the scenario where the acquiror accumulates shares by purchasing in the market through privately negotiated transactions and without having initiated attempts to acquire control;
- (b) the scenario where the acquiror attempts to acquire control by means of privately negotiated transactions or a public offer; and
- (c) the scenario where the acquiror has obtained control and now exercises his influence.

4.2. The acquiror accumulates shares by purchasing in the market through privately negotiated transactions and without having initiated attempts to acquire control. A high degree of transparency with respect to share acquisitions is probably the best protection of the interests of shareholders of a company, including minority interests. Transparency is achieved by timely and adequate disclosure of relevant information regarding transactions in shares. Who should disclose, when disclosure should be made and what should be disclosed are issues that are discussed further under VII.4.2.

There is no reason for assuming that minority shareholders are exposed to risks of being treated unreasonably in the situation dealt with here, and there are thus no grounds for stating that further protection is needed.

4.3. The acquiror attempts to acquire control by means of privately negotiated transactions or a public offer. Once an acquiror decides to take over a company, an additional demand for protection of minority shareholders arises.

Typically, acquisition of shares from minority shareholders will not be based on privately negotiated transactions but rather on a public offer. Few acquirors would bother to negotiate with shareholders owning only small numbers of shares. Also, for the reasons discussed under VII.3.3., the greatest need for protection exists when minority shareholders face public offers. It is, therefore, important to ensure that such offers are made in a fashion and contain elements that meet the requirements for adequate protection. The requirements discussed and the conclusions drawn under VII.4.3. suggest how adequate protection could be ensured while, at the same time, aiming at achieving a high degree of efficiency. The protection recommended under VII.4.3. benefits all shareholders, including minority shareholders.

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However, there are certain issues which are so closely tied to questions of minority protection that they have not been dealt with under VII.

Under 2.1.10. it was suggested that the mandatory bid requirement in Rule 4 of the Rules of Ethics of the Copenhagen Stock Exchange ought to be abandoned.

Another question is whether partial public offers should be allowed and, if so, what requirements should apply to such offers. This discussion is not quite the same discussion which we had with respect to mandatory offers, although there are some resemblances. When analyzing the mandatory offer concept we were concerned with the desirability of imposing on share purchasers a duty, once they obtain control or reach a certain percentage of target-shares, to make a bid for the remaining shares. By contrast, here we are considering if public bids should be extended to include all shares once the concept of a public bid is elected by an acquiror and irrespective of the percentage of shares or voting power he already holds. At present, Danish law allows partial offers, provided that they do not lead to the acquiror owning a "controlling" interest.

The Dutch Merger Rules represent the only example among the jurisdictions covered by the survey made here of a takeover regulation which disallows partial public offers, see Article 6(1)d. A public offer for a Dutch company must include all the shares of a class of stock.

Supposing no mandatory offer requirement existed, if all public offers were to be made for all the shares of the target-company, it would be comparatively expensive for acquirors to use public offers rather than privately negotiated purchases in order to acquire control of a company. Encouraging acquirors to avoid public offers would be tantamount to slowing down the takeover process, which is likely to lead to increased inefficiency. If acquirors, nevertheless, decide to make public offers, the result is that they actually pay a higher price for the company than they would otherwise do, which is also a consequence that is hard to reconcile with the desire to achieve efficiency.

From the minority shareholders' point of view a rule that would compel acquirors to either buy 100 percent of the target-shares by means of a public offer or abstain from using this vehicle has the negative effect, still assuming that no mandatory bid requirement existed, that acquirors would feel tempted to purchase large blocks of shares in the market instead of focusing on minor shareholdings spread among a number of small shareholders. Acquirors who would otherwise have acquired a certain part of the minority shares may prefer only to buy large blocks and avoid

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public offers. The “all-or-nothing”-approach may, in other words, be contrary to the interests of minority shareholders.

Some may feel tempted to ask, then, why not make it a requirement that any attempt to acquire control of a company must be made by means of a public offer for 100 percent of the shares. By doing so, acquirors would be left with no choice but to make a public bid. However, such a requirement would get us back to the problems discussed under 2.1.10. regarding the mandatory bid requirement in Rule 4 of the Rules of Ethics. It would make takeovers very expensive and deter many potential acquirors from acquiring companies, a fact that would lead to inefficiency. Also, impediments to contested takeovers would, at least in the long run, harm the shareholders of a company, including minority shareholders, cf. V.2.7.

One could argue that the duty to make a bid for all shares whenever attempts are made to acquire control would treat all shareholders “equally” in the sense that any shareholder would have an opportunity to sell his shares. As stated above, however, the price for achieving this “equality” is very high, so high that minority shareholders may be better off having changes of control take place and, at least sometimes, enjoying the fruits of having the value of the company and their shares increase as a result of a takeover. Not only majority shareholders but also minority interests will benefit from increases in the value of the company. If it turns out that a majority shareholder abuses his influence to obtain undue advantages at the expense of the minority shareholders, § 80 of the Companies Act may be invoked, cf. under 4.4. below.

If one agrees to the notion that public offers made for only a part of a company’s shares should be allowed, the next question is what particular measures are needed for the purposes of protecting minority shareholders’ interests, in addition to the general requirements that should pertain to public offers.

It ought to be a requirement that all public offers are made to all the shareholders of the target-company, or all the shareholders holding shares of the same class of stock of that company. Also, all shareholders holding shares of the same class should receive identical offers. To the extent that the acquiror receives acceptances for a number of shares exceeding the number he wants to acquire, his acquisition should be made on a pro rata basis.

A public offer is addressed to a large number of shareholders with different holdings and different reasons for investing in the stock market, but all having a common interest in the opportunity of receiving an offer for their shares. Because of this nature of the public offer, it would seem diffi-

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cult to explain why acquirors should be allowed to e.g. purchase all the shares of some shareholders while not buying any shares from others. The concept of public offers here clearly supports the view that all shareholders of a class should have the opportunity to sell their shares on the same terms and that the acquiror should buy on a pro rata basis if there are more shares for sale than he wants to buy.

It could be argued that since the various shareholders own holdings of different sizes, and since the market frequently differentiates and attaches higher values to larger blocks of shares, it is not quite appropriate to offer all shareholders the same price per share. However, it would, as a practical matter, be impossible to take into account all the factors pertaining to the shares of each company that determine the price of a given stockholding. Also, the market's appraisal of the comparative value of different blocks of shares may change from time to time. Last, but not least, the regulation of public offers should be shaped in such a way that provisions which are excessively complicated are avoided, especially if such provisions do not serve any definite purpose.

As described under VII.2.3.3., the regulation found in The Williams Act and the rules issued thereunder provide for a system with the features proposed here. The British Companies Act also states that partial offers may not be selective, but must be made to all shareholders of the class. Moreover, the first of the general principles of the City Code stipulates that all shareholders of a class must be treated similarly. Likewise, a pro rata principle applies to shares tendered in excess of the percentage stipulated in the offer, cf. Rule 36.7 of the British City Code.

Similar principles are found in French law, see Article 15 of the 1989-Act and Article 5-2-15 of the General Rules, and in the German Guidelines (Clauses A.1. and D.7.).

Likewise, the Swiss Take-Over Code provides that an offer must "treat shareholders in a comparable situation equally" and adds that the pro rata principle applies to partial offers, cf. Articles 3.1 and 3.8 of the Code. The Swedish Recommendation follows the same line, see II.5. and II.10. providing for equal treatment of shareholders owning shares of the same class and making it a requirement that partial offers must be based on a pro rata principle, respectively.

4.4. The acquiror has obtained control and now exercises his influence. Acquirors who, after having acquired control, abuse their influence to achieve undue advantages at the expense of minority shareholders, or who try to eliminate such minorities by reducing dividend payments for the purpose of "starving" minorities, would, like any other majority share-

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holder who abuses his influence, violate § 80 of the Companies Act. The minority protection issue in this scenario is not different from any other (potential) conflict between majority and minority shareholders.

In addition to the general standard set forth in § 80, the specific provisions of the Companies Act providing minority protection, including in connection with mergers and liquidations, apply to the acquiror's acts, cf. 1.1.

We saw earlier how some of the American state statutes focus on protecting minority shareholders against two-tier tender offers where the acquiror pays a premium above the market price for shares leading to his control and then cashes out minority shareholders at a lower price in connection with a subsequent merger of the target-company into the acquiror.

However, even states which have not adopted business combination statutes or similar regulations have not left the minority shareholders without protection in the event where the acquiror treats the minority shareholders unfair, i.e. pays them an unreasonably low price for their shares. All of the American states grant dissenting minority shareholders, who have been cashed out in connection with a merger, the right to have their shares appraised by a court. Even states which have otherwise protected the shareholders of the target-company have granted such a right of appraisal, see, for example, Delaware General Corporation Law, § 262, and New York Business Corporation Law, § 623. In connection with an appraisal of shares, the court will ensure that the acquiror pays the difference between the amount already paid to the shareholders and the value of the shares according to the appraisal, if any.⁶¹

The concept of appraisal or valuation is also used in the merger chapter (Chapter 15) of the Danish Companies Act, although in a different way than by the American states. § 134 c thus states that each of the merging companies must appoint an impartial expert valuer who must prepare a

⁶¹ The method of valuation is illustrated in the decision by the Delaware Supreme Court in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). In this decision the Delaware Supreme Court abandoned the so-called "Delaware Block" or weighted average method of valuation as the exclusive method of valuation. According to the Delaware block method, the valuation was based on a weighting of the intrinsic value of the shares, the company's earnings potential and the market price of the shares. This concept was replaced by a more liberal approach, which would allow the courts to use "any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court". This change in valuation method has provided the Delaware courts with more flexibility than was formerly the case.

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written opinion including a statement as to whether the consideration for the shares in the company to be absorbed is reasonable and grounded on facts. Also, the valuation method or methods used must be indicated and accompanied by an evaluation of their suitability. Furthermore, the statement must reflect the values which each method will lead to and the importance that should be attached to the various methods, based on a comparison. Possible difficulties must be indicated.

Many American legal authors have argued that the right to appraisal under American law does not give the minority shareholders of a company sufficient protection. It has thus been emphasized that the acquiror controls the timing in connection with a squeeze-out merger and thereby also, at least to a large extent, the timing of the appraisal, which gives the acquiror the possibility of having the appraisal take place at a point in time advantageous for him. The time aspect is of particular significance since the acquiror can use his influence over the company to affect the price of the company's stock. Another alleged drawback in connection with the appraisal remedy is the fact that the initiative to obtain appraisal lies with the dissatisfied shareholders. The fact that the shareholders will have to initiate legal steps in order to exercise their right to appraisal probably means that the protection is not 100 percent efficient. Also, appraisal is a rather slow and sometimes costly remedy.⁶²

The Danish appraisal or valuation system laid down in the Companies Act escapes most of this criticism. While acquirors of Danish companies may use their control to "time" a merger for the purpose of achieving a valuation favorable for them, the fact that the expert opinion must be obtained "automatically" in all events significantly reduces the risk of abuses on the part of the acquiror. Moreover, minority shareholders will not have to pay for an appraisal. Rather, they may, upon receipt of the expert opinion, decide if they wish to challenge the consideration offered, in which case they have to make a reservation at the shareholders' meeting and file a suit for damages no later than 2 weeks after the passing of the resolution on the merger, cf. § 134 f. Against this background, there is reason to be-

⁶² For a criticism of the right to appraisal, see Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 *Harvard Law Review* 297 (1974) and Joel Seligman, *Reappraising the Appraisal Remedy*, *Corporate Practice Commentator*, p. 3 (1985-86), emphasizing, among other things, that the right to appraisal has only been used in relatively few instances in practice. A number of states, including New York, have made attempts to accommodate this criticism by stipulating rules that make the valuation proceeding more smooth and less costly, cf. New York Business Corporation Law § 623.

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lieve that minority shareholders are sufficiently protected under the present regime.

Another controversial aspect of the right to appraisal under American law is the fact that it is considered an exclusive remedy in a number of states. This means that the right to appraisal prevents the minority shareholders from, for example, halting a planned merger where the acquiror abuses his controlling influence over the company against the interest of the minority shareholders. In *Weinberger v. UOP, Inc.*⁶³ the court held that the right to appraisal is an adequate and exclusive remedy, unless fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved. By limiting the right to alternative remedies, the minority shareholders' right to participate in the company is converted into a purely economic interest, which the acquiror, if he so wishes, can eliminate by cashing out the minority shareholders at the price stipulated in connection with the appraisal. However, *Weinberger v. UOP, Inc.* made it clear that an acquiror has a duty to all the other shareholders to disclose all relevant information regarding the cash-out of the minority shareholders. Also, the case promotes the view that an acquiror should take the initiative to have an independent negotiating committee of the company's outside directors appointed so that an arm's length negotiation would be provided for. If such an independent committee had been established, the fairness of the transaction would probably not be challenged since the committee would negotiate on behalf of and protect the interests of the minority shareholders. The issue of an acquiror's right to effect a squeeze-out merger under Delaware law is now governed by the statute discussed under 3.4. However, the case contains a fairness test which is still of major importance in Delaware. Pursuant to the analysis used in this case, the notion of fairness can be divided into "fair dealing" and "fair price". While the former embraces the timing, structuring, negotiation, approval and disclosure of the transaction, the latter relates to the economic and financial considerations in connection with the cash-out of the minority shareholders. The case contains another interesting aspect: while it had for a long time been a requirement that a merger have a business purpose, this prerequisite, the definition of which has caused the courts a great deal of trouble, was abandoned by the Delaware Supreme Court. Instead, the court stressed the importance of the acquiror acting in a fair and loyal fashion vis-a-vis the minority shareholders. States which have not enacted business combination statutes like the statute enacted by Delaware in 1988 may still be influenced by the rationale of *Weinberger v. UOP, Inc.* when determining the effects of a right to appraisal.

⁶³ 457 A.2d 701 (Del. 1983).

IX Financial and tax aspects

1. Introduction

Although the principal focus of this book is on corporate law aspects, it is hardly possible to have a meaningful description and discussion of contested takeovers – or any other corporate acquisition for that sake – without considering the impact of financial and tax issues.

2. The prohibition in § 115, Subsection 2, of the Companies Act against target-financed acquisitions

2.1. Background. Danish public companies must have a minimum capital of DKK 300,000, cf. § 1, Subsection 3, of the Companies Act. However, as regards companies listed on the Copenhagen Stock Exchange a minimum share capital of DKK 15,000,000 is required.¹ The minimum capital requirement has as its purpose to provide that companies, at least from the outset, have sufficient capital to operate and thereby creates a certain protection of the creditors of the company.

Much too often it has been proven that minimum capital requirements do not create sufficient protection of a company's creditors. Once a company starts to operate with losses, such minimum requirements may leave little or virtually no protection of creditors. As a matter of fact, the use of a minimum capital requirement sometimes gives creditors a false feeling of comfort. American law does not provide for any minimum capital requirements, instead the American courts sometimes "pierce the corporate veil" by disregarding the corporate fiction. This may be done, for example, if a subsidiary is a mere instrument of its parent company, or if a company has been grossly undercapitalized, see the discussion in *Weisser v. Mursam Shoe Corp.*, 127 F. 2d 344 (2nd Cir. 1942). For a general description and discussion of piercing the corporate veil, see Clark, *Corporate Law* p. 71 ff. Piercing the corporate veil in the context of undercapitalization is discussed in Note, *Limited Limited Liability: A Definitive Judicial Standard for the Inadequate Capitalization Problem*, 47 Temple Law Quarterly 321 (1974). Piercing the corporate veil is known in Denmark as "hæftelsesgennembrud" or "ansvarsgennembrud" but has gained comparatively limited practical

¹ See Order on Listing Requirements, § 4, Subsection 1. Companies on stock market III, however, must only have a minimum capital of DKK 2,000,000, cf. the Stock Market III Order, § 1, Subsection 1.

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importance. For a discussion of this concept under Danish law, see Gomard, *Aktieselskaber og anpartsselskaber* p. 42-46 (inter alia discussing case law in this field) and p. 326, Gomard, *Hovedpunkter af Selskabsretten* p. 80-81, Lennart Lyng Andersen & Erik Werlauff, *Juristen* 1989, p. 190 ff. (discussing a Swedish proposal), Erik Werlauff, *Ugeskrift for Retsvæsen* 1986.B 393 ff., Werlauff, *Selskabsret* p. 165-166, and H.V. Godsk Pedersen, *Ugeskrift for Retsvæsen* 1985.B 352 ff. at 355-356.

As a supplement to the general minimum capital requirements, § 115, Subsection 2, of the Companies Act provides that a company may not furnish loans for financing the acquisition of its shares or shares of its parent company. Nor may a company make funds available or provide security in connection with such acquisition. § 115, Subsection 2, thus aims at protecting target-companies against having their financial position deteriorated as a consequence of an acquisition.

The Companies Act, § 115, Subsection 1, first sentence, prohibits loans from companies to, inter alia, their shareholders, irrespective of the purpose for which a loan is granted. Notwithstanding this provision, § 115 a, Subsection 1, allows a subsidiary to make loans or furnish security for the obligations of the parent company. § 115 a, Subsection 1, only allows transactions which would otherwise be prohibited by § 115, Subsection 1, first sentence, and not situations where a company grants a loan or provides security for the financing of the acquisition of its shares, cf. § 115, Subsection 2. Accordingly, it must be assumed that § 115 a, Subsection 1, only exempts from the general prohibition loans to shareholders made by subsidiaries to parent companies for purposes other than those set forth in § 115, Subsection 2.

In a report prepared by a committee established by the Ministry of Commerce, the following comments were made in connection with the provision in the previous Companies Act that had a content similar to § 115, Subsection 2:²

“The provision in § 115, Subsection 4, that prohibits a company from furnishing loans (or establishing security) for the financing of acquisition of shares of the company or its parent company, is a special Danish provision, which is found in § 47 of the 1964-draft, compare § 48. As a rationale for the provision it is stated on p. 132 of report 362/1964: “The provision supplements the rules about granting of loans to shareholders as well as the rules about acquisition of (a company’s) own shares, and, thereby, particularly aims at events that have occurred in practice where a purchaser – possibly a holding company established for the same purpose – acquires all shares of a company on credit and simultaneously herewith obtains a loan in the company in question for the financing of

² See Report No. 540/1969 On A Joint Nordic Company Law, p. 159.

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the acquisition subject to the express or implied agreement that after the acquisition of the company the loan must be repaid by means of the assets of the company acquired.” The proposed rule has gained increased actuality and importance as regards Danish law as a consequence of the events that took place in the “Boss”-case.”

The “Boss”-case³, or rather series of cases, has undoubtedly had an impact on the desire by the legislature to provide a ban against target-assets based acquisitions. One of the prime issues in the Boss-case was the fact that the target-company was made to contribute to the financing of the acquisition with its assets.

2.2. Scope of § 115, Subsection 2. § 115, Subsection 2, inter alia, prohibits “loans” from the target-company to the acquiror. Loans include various payments and credits that have the common denominator that the lender (here: the target-company) must receive its money back at a certain point.

A similar precondition does not apply with respect to the ban against making funds available or providing security (“stille midler til rådighed eller sikkerhed”) for the acquiror. In other words, the language of the provision suggests that any participation by the target-company in the financing of the acquisition of its shares is prohibited. Not only mortgage-arrangements or guarantees are banned, but also the provision by the target-company of assets to assist in the acquisition of the target-company’s shares.

The exact meaning of the prohibition in § 115, Subsection 2, has given rise to much uncertainty.

2.3. Granting of loans and credits. A loan or credit may be comprised by § 115, Subsection 2, irrespective of whether the loan was granted prior to or after the acquisition. The decisive fact is whether the loan was made for the purpose of financing the stock purchase. If an acquisition was debt-financed but the acquiror uses his influence on the target-company to

³ See *Suder v. A/S De Danske Bomuldsspinderier* (U1970.96, Sup.Ct.), *Scandinavian Clothing Industries v. Haderslev Konfektionsfabrik A/S* (U1970.795, Sup.Ct.), *Haderslev Konfektionsfabrik A/S v. Pantex Manufacturing (Holland) A/S* (U1970.803, Sup.Ct.) and *Alexander Schoeller & Co. AG v. A/S B. Muus & Co.* (U1973.417, Sup.Ct.). The Boss-case is described in Ministerial Report No. 690/1973 on the Joint Venture of Boss of Scandinavia. The issue relating to § 115, Subsection 2, is discussed on p. 129 ff.

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make it grant a loan in favor of the acquiror, such a transaction would be prohibited if the purpose of the loan is to finance the acquisition.

2.4. Making funds available and providing security. Obviously, cash contributions by the target-company to the acquiror for the purpose of financing the acquisition of the former are comprised by § 115, Subsection 2. Also, non-cash contributions by means of asset transfers in connection with an acquisition are prohibited.

Similarly, assets transferred or assigned after an acquisition for the purpose of paying the acquiror's debt incurred in connection with the acquisition would probably be comprised by § 115, Subsection 2.

If the selling shareholders, for the purpose of financing the sale of a company, take out assets belonging to that company having a total value equivalent to (a part of) the price for the company, and the company, as consideration for such asset transfer obtains a claim against the acquiror, the arrangement would, in effect, entail that the company's assets are used as payment. Consequently, such a transaction would probably be prohibited pursuant to § 115, Subsection 2.

The ban in § 115, Subsection 2, against provision of security probably applies no matter whether the security consists of target-assets or it takes the form of a banker's guarantee established on the part and at the expense of the acquiror.

2.5. Determining the purpose of a transaction. The restrictions provided for in § 115, Subsection 2, do not apply unless the purpose of the loan, the provision of funds or the establishing of security has been to finance the acquisition of the target-shares. It is sometimes difficult to determine the purpose of a transaction. Any transfer of assets or granting of a loan will have to be considered in the specific context and on the basis of the facts of each case.

Elements of importance when determining the purpose of a transaction include the size or value of the loan or asset transfer compared to the consideration to be paid for the target-company's shares, the time between the loan/asset transfer and the acquisition, and the financial structuring of the acquisition.

The size of a loan or the value of assets taken out of the target-company may indicate that such transactions in effect are made for the purpose of financing the purchase of target-shares. However, it is often difficult to find, at least a direct, relationship between the purchase price of the shares acquired and the values involved in the subsequent transactions. In this

connection the timing becomes an important issue. Although the fact that a loan is made at a point in time close to the acquisition of the target-company is not decisive in itself, it may, nevertheless, suggest a link between the two events. On the other hand, the fact that a loan is made several months after an acquisition is not sufficient to create a “safe harbor”. The structuring of the financing of a deal may show that e.g. a loan of a certain size constituted a necessary part of the financing. In short, the threshold question must be whether the transactions following an acquisition were a part of the acquiror’s plan to finance his purchase of target-shares.

2.6. Subsequent merger of acquiror and target-company. In the event that an acquiror has incurred debt, e.g. in the form of a loan from a bank, in connection with the acquisition of shares of a target-company and the acquiror and the target-company subsequently merge, the question is if or under what circumstances, § 115, Subsection 2, applies.

If the target-company is the surviving entity, the merger will result in the target-company being liable for the debt incurred as a part of the acquisition. The language in § 115, Subsection 2, does not deal directly with this question. However, such a transaction would have the same effect as if the target-company had incurred the debt directly. It is, therefore, likely that the Danish courts would consider the merger a violation of § 115, Subsection 2, at least if it is clear that the merger was a part of the acquiror’s plan from the outset. If it is established, for example, that the acquiror or his acquisition vehicle is an undercapitalized company that would not be able to, or would have difficulties in, financing the acquisition without additional funds, it may be assumed that the merger is a planned step in connection with the line of transactions. If the acquisition vehicle, on the other hand, is a financially very strong entity that would have no difficulties in financing the acquisition even without a merger, an improved basis exists for arguing that the merger is not tied to the financing of the acquisition.

In the reverse case, i.e. if the target-company and the acquiror merge with the latter as the surviving company, no § 115, Subsection 2-question ordinarily arises. The acquiror was and remains liable for the debt incurred in connection with the acquisition while the target-company ceases to exist.

§ 134 c, Subsection 4, imposes on merging companies a duty to retain impartial expert valuers who must prepare a statement showing if the merger may be presumed to lead to a reduced possibility of satisfying the

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creditors of each company. Perhaps one could expect that the courts would, as a practical matter, be reluctant to challenge transactions on the basis of § 115, Subsection 2, if the procedure set forth in § 134 c, Subsection 4, has been complied with, unless the statement submitted by the expert valuers is clearly erroneous.

2.7. Relationship between § 115, Subsection 2, and other provisions of the Companies Act. The Companies Act severely restricts the granting of loans or credits by the company as well as the right for the company to provide funds and security for the benefit of an acquiror. However, there are other means by which an acquiror may withdraw funds from the company that are not mentioned in § 115, Subsection 2. He may thus exercise his influence at the company's shareholders' meetings to pass resolutions that lead to higher dividend payments and/or reduction of the company's share capital for the purpose of repaying to the shareholders a part of their investment.

The Companies Act sets forth in detail the conditions for dividend payments as well as for reduction of share capital for the purpose of repaying to the shareholders some of their money, cf. §§ 109-112 and §§ 44, 44 a, and 46, respectively.

It has been argued that the mentioned provisions exhaust the conditions pertaining to the payments dealt with here and that § 115, Subsection 2, cannot be construed as resulting in further restrictions of this kind of payments.⁴ This does not seem to be a very convincing point of view, however.

The provisions dealing with dividend payments and other payments include requirements that serve to protect the capital of the company. Typically, these specific provisions create adequate protection of a company's capital. However, there is probably no basis for concluding the other way round and presume that it has been the intention of the legislature to allow e.g. large dividend payments to take place even though such payments, in effect, constitute repayment by the acquiror of loans obtained for the purpose of financing his acquisition of the company. In other words, if dividend payments or payments in connection with a reduction of the share capital of a company are used as means to avoid the restrictions in § 115, Subsection 2, such transactions probably cannot escape the ban by being labelled "dividends", for example. If this were possible, § 115, Subsection

⁴ See Jørn Ankjær Thomsen, *Revision & Regnskabsvæsen* No. 2/1990, p. 40 ff.

2, could easily be circumvented. The nature of a transaction is not changed merely because it appears in disguise.⁵

2.8. Economic impact of § 115, Subsection 2. § 115, Subsection 2, has a substantial impact on the costs to be paid by acquirors. The prohibition against target-asset financing frequently means that other, more expensive sources of finance will have to be exploited.

More expensive means of financing lead to reduced efficiency: higher barriers in terms of financing result in increased costs which, in turn, tend to inhibit corporate acquisitions otherwise desirable from an economic viewpoint, cf. I.2.2.

While there is obviously a desire to protect shareholders and creditors in the event that an economically weak acquiror wishes to acquire the target-company by using the target-company's own assets as a basis for the financing, § 115, Subsection 2, sometimes creates hurdles where it seems to make less sense. If a transaction in its entirety is sufficiently capitalized and thus financially safe, it is hard to see why the acquiror should be prevented from using target-assets as a means of financing.

The problem inherent in § 115, Subsection 2, of the Companies Act is that, because of the broad wording, the ban applies irrespective of whether or not the shareholders or the creditors are exposed to an increased risk.

Rather than having the very broad language that § 115, Subsection 2, contains, it would be preferable if the decisive test were whether the transaction could be presumed to involve a reduced possibility of satisfying the creditors of the company, cf. the model used in Subsection 4 of § 134 c of the Companies Act. Instead of prohibiting any use of target-assets this proposal would shift the focus so that the threshold question is not how a transaction is financed but what is the impact of the transaction on the company's ability to meet its financial obligations.

As the provision reads now, transactions that may be desirable from a financial point of view will frequently be banned because of the rigorous test in § 115, Subsection 2. Provided that creditors and shareholders of the target-company are sufficiently protected against an increased risk resulting from a higher level of debt, there are no persuasive arguments for eliminating transactions or restructurings of companies otherwise deemed desirable.

⁵ The problem in connection with the question discussed in the text is that it is frequently difficult to prove that e.g. a dividend payment is part of a line of transactions that, when viewed together, violate § 115, Subsection 2.

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As to many of the points found in this chapter, cf. also Gomard, *Aktieselskaber og anpartsselskaber* p. 226 ff., Thomsen, *A/S-loven med kommentarer* p. 357 ff., Paul Krüger Andersen, *Aktie- og Anpartsselskabsret* p. 133 ff. and Johan Giertsen, Lov og Rett, 1988, p. 421 ff. (on Norwegian law).

3. Tax issues of relevance for contested takeovers

3.1. Introduction – economic impact of tax laws. Although tax motives are rarely the sole rationale for a corporate acquisition, the tax implications of a transaction are of crucial importance for the decision whether or not to acquire and, in the affirmative case, how to structure the transaction.

Frequently, the chief focus in tax discussions is on how much tax is incurred in connection with a given transaction and how this burden can be avoided or reduced as much as possible. This angle, in other words, shows the impact of tax laws on the private economies of companies and shareholders. Assuming a rational behavior on the part of companies and shareholders⁶, it is right to presume that they will, within the borderlines of what is legal⁷, seek to avoid or reduce their taxes as much as possible.

From a fiscal point of view reductions of taxes lead to losses of revenues to society.

It could thus seem as if any step or transaction model by private parties which lead to the reduction of taxes payable is an evil. Loss of revenues in one field will have to be made up by increasing taxes in other fields.

However, not all kinds of tax planning are per se against the interests of society. This is illustrated by the fact that the tax system is also used by the legislature to create incentives for people to act in a certain way. For example, the right to depreciate for tax purposes and carry forward taxable losses (see below) are means by which the legislature seeks to stimulate business activities. Moreover, tax reduction may sometimes lead to companies employing funds saved for purposes that increase efficiency.⁸ In these events, the advantages from society's viewpoint of increased business activity and/or efficiency may, at the end of the day, exceed the value of the lost revenues.

⁶ See I.2.2.

⁷ In the following the term "tax planning" will be used when describing legal efforts to avoid or reduce taxes.

⁸ See also Alan J. Auerbach & David Reishus, *Taxes and the Merger Decision*, in *Knights, Raiders, and Targets* p. 300 ff.

It is probably impossible to state the “net” economic impact of tax planning as such on the economy of society, and due to the scope of this book we will in the following concentrate on whether the relevant tax provisions tend to induce or to inhibit takeovers. An answer to this question is important because it might give us an indication of the regulatory impediments to changes in the market for companies that the tax laws may constitute.

It should be noted that the following comments only serve to give an overview of the tax issues of relevance for takeovers. No attempt is made to give a detailed description of these aspects.

3.2. Taxation of the acquiror and the target-company on a consolidated basis (carry-overs). Provided that certain conditions are met, a Danish company and its wholly-owned subsidiaries have the right to elect to be taxed on a consolidated basis. This option may, in some circumstances, be crucial for the decision by the acquiror whether to initiate a takeover attempt.

The prime advantage connected to consolidated taxation is the possibility of deducting losses incurred by one company from the profits of another company within the same group of companies. According to the Tax Assessment Act (“Ligningsloven”)⁹, § 15, Subsection 1, a company may carry forward and deduct operating losses from income during a period of 5 consecutive years. As a result of the time limitation, many companies are not able to fully benefit from the right of deduction because they have no income within the 5 year period against which the losses can be offset. This problem may be solved by deducting the losses incurred by one company from the taxable income of another company on the basis of consolidated taxation (carry-over).

Even if taxation is made on a consolidated basis, the companies included in the group that is taxed remain separate entities that are independently liable for the tax each company must pay. However, consolidated taxation entails that the taxable income of each company will be added, thereby constituting the total taxable income subject to consolidated taxation.

The Act on Taxation of Companies (“Selskabsskatteloven”)¹⁰, § 31, contains the authority for the Tax Assessment Council (“Ligningsrådet”)

⁹ Consolidation Act No. 660 of October 19, 1989, as amended.

¹⁰ Consolidation Act No. 623 of August 31, 1990, as amended by Act No. 217 of April 10, 1991.

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to allow that two or more companies are taxed on a consolidated basis. § 31 states that the Tax Assessment Council may only give its permission to such consolidated taxation if the companies involved use the same fiscal year, and, as regards companies incorporated in Denmark, provided that all shares of a subsidiary are held by the parent company.¹¹ Under § 31 of the Act, the Tax Assessment Council is also authorised to issue additional conditions for the permission of taxation on a consolidated basis.

Pursuant to the authority granted in § 31 of the Act on Taxation of Companies, the Tax Assessment Council has adopted a number of conditions that must always be met in order to allow for consolidated taxation. Also, the Tax Assessment Council has adopted various terms pertaining to the granting of permission for consolidated taxation. The latter includes a term known as “term 2.4.2.”¹² Term 2.4.2. deals with so-called “thin capitalization”. The term sets forth that, in the event that one of the companies subject to the consolidated taxation has a negative taxable income, no deduction will be accepted for an amount equivalent to the net financing expenses from the profits from the other companies comprised by the consolidated taxation, provided that the company incurring losses directly or indirectly owns shares of the companies generating profits.

The net financing expenses are computed as the sum of interest, fiscal loss due to depreciation, exchange losses and recurring payments with a deduction for the sum of interest received, taxable gains due to appreciation and gains due to exchange fluctuations.

The purpose of term 2.4.2. is to ensure that a certain ratio is maintained between the acquiring company's debt and equity capital. Term 2.4.2. seeks to avoid that acquirors achieve benefits by having the transaction debt-financed rather than having shareholders of the acquiror inject equity capital into the acquiror.

¹¹ The 100 percent ownership requirement is made subject to § 7 A of the Tax Assessment Act. § 7 A of this Act allows for the issue of shares by a company to its employees. If a company has subsidiaries registered under the laws of a foreign country, permission for taxation on a consolidated basis may be granted if the Danish parent company on its own or together with The Industrialization Fund for Developing Countries (IFU) owns as much of the share capital of the foreign subsidiaries as is permitted under the local laws of the country where the subsidiary is incorporated.

¹² See SD-circular 1987-52, December 4, 1987. On April 9, 1991, the Council decided to amend this circular, including term 2.4.2., however, at the time of the completion of this book, the exact nature of the amendments is not known.

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An acquiring company that finances an acquisition by means of a loan made by a parent company will be able to deduct the interest payments from its taxable income. However, if the acquisition is financed by issue of stock by the acquiring company, no right to deduction would exist in the income of the acquiring company. In other words, the interest deductability may make it more attractive to have a transaction debt-financed than equity-financed, at least if we only focus on the acquiror. Term 2.4.2. seeks to eliminate this difference. It ought to be mentioned in this connection that the right for a parent company to receive dividends tax-free from its subsidiary under § 13, Subsection 1, item 2, of the Act on Taxation of Companies, may in some cases make equity financing a viable alternative after all.

As a consequence of term 2.4.2., there is a limit to the extent to which an acquiror may finance the acquisition of the target-company by means of debt.

For a further discussion of term 2.4.2., see Søren Rasmussen in *Revision & Regnskabsvæsen* 1986, p. 65 ff. The particular questions that arise when a Danish company is owned by shareholders domiciled abroad are dealt with by Søren Bjerre-Nielsen in *Skattepolitisk Oversigt* No. 2, 1985, p. 59 ff.

From a purely economic viewpoint the tax law that should be preferred in the corporate acquisition context is the law that facilitates transactions and moves in the market as much as possible. The more expensive it is to make transactions and changes, the more inefficiently the market will work.

The right to carry over taxable losses clearly stimulates takeover activity. By allowing companies that are taxed on a consolidated basis to "pool" their incomes and losses, a system is created whereby losses incurred by one company can be transferred to an acquiror to whom they have a higher value (because he has a taxable income).

It is more difficult to determine the impact of term 2.4.2.

The right to deduct interest payments when computing the taxable income¹³ makes debt financing, within certain limits, an attractive source of funding. While excessive use of debt may lead companies into financial trouble, moderate leverage makes financing cheaper without impairing the company's financial structure.

Although there may be many and good reasons for attempting to put a "cap" on leveraged financing, it is not certain that the restrictions imposed by term 2.4.2. are always desirable when seen in the context.

¹³ See § 6 e of the Act on tax to the Danish state ("Statsskatteloven"), cf. Act No. 149 of April 10, 1922, as amended.

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On the other hand, a final answer to this question necessitates further studies into the negative aspects of a change in the prevailing debt-equity ratio, which fall outside the scope of this book.

The right to carry forward taxable losses is also known in other jurisdictions, see, for example, Section 172 of the U.S. Internal Revenue Code ("IRC"), which allows carry forwards for up to 15 years. Incidentally, Section 172 also allows for a carry back, i.e. a right to offset taxable income in earlier years (up to 3 years). The IRC contains a number of limitations regarding the right for an acquiror to use a loss generated by a target-company. The purpose of these limitations is, generally speaking, to avoid that companies with large losses are acquired by companies generating taxable incomes for the purpose of having the consolidated income of those companies reduced. Of particular interest in this regard is Section 269 of the IRC, which gives the U.S. Internal Revenue Service authority to disallow deductions in events where the Service finds that the principal purpose for an acquisition of a company by a person or another company has been the desire to evade or avoid tax. There is another provision of the IRC that makes it less interesting for an acquiror to buy a company with large losses. Section 382 thus seeks to ensure that an acquiror of a company with losses cannot use such losses faster than it would have been the case if ownership of the company had not changed. The issues touched upon here are described in further detail by Daniel Q. Posin, *Corporate Tax Planning, Takeovers, Leveraged Buy-outs, and Restructurings* p. 842 ff. See also Stanley Foster Reed & Lane and Edson, p.c. *The Art of M&A* p. 239-240, 266-271, and 289-291.

3.3. Taxation of target-shareholders. As a general rule, gains in connection with the sale of shares owned for more than 3 years are not subject to taxation, cf. § 4, Subsection 1, of the Act on Taxation of Stock Capital Gains ("Aktieavancebeskatningsloven").¹⁴ Gains resulting from the sale of shares owned for less than 3 years are subject to ordinary income tax, cf. § 2, Subsection 1, of the Act.

Notwithstanding the above, natural persons who have within the most recent 5 years owned at least 25 percent of a company's share capital or 50 percent of the votes of a company, are subject to special rules when they sell their shares. With respect to shares sold prior to 3 years of ownership, gains are taxed as ordinary income, cf. § 2, Subsection 1, of the Act. If such shares are sold more than 3 years after the acquisition, the gain is subject to various deductions and will be taxed as special income (i.e. a flat rate of 50 percent), cf §§ 4 and 6. Special rules apply to sale of shares as part of one's business, see § 3 of the Act.

¹⁴ Consolidation Act No. 698 of November 5, 1987, as amended.

The gain in connection with the sale of shares will be computed as the difference between the proceeds of the sale and the price paid when acquiring the shares, cf. § 5 of the Act on Taxation of Stock Capital Gains.

The Tax Assessment Act, § 16 B, Subsection 2, provides that the consideration received by a shareholder as payment for the sale of the shares of a subsidiary to a parent company is taxed as ordinary income. For the purposes of § 16 B, Subsection 2, a parent company is defined as a company that is or in the relevant fiscal year becomes the owner of 25 percent or more of the issuing company (i.e. the subsidiary).

The purpose of § 16 B, Subsection 2, is to avoid a circumvention of the rules on dividend taxation by the establishment of holding company constructions.

Prior to the adoption of § 16 B, Subsection 2, in 1984, a majority shareholder was able to transfer his shares of a company (A) to another company (B) controlled by him by receiving cash or debt instruments in return. This would enable a majority shareholder to take funds out of (A) through (B) without such funds being subject to taxation, except for the profits arising out of the share transfer which would be taxed on a quite favorable basis (after more than 7 years of ownership only 25 percent).

It is worth noting that § 16 B, Subsection 2, leads to taxation of the entire consideration received by the selling shareholder and not only the difference between the price he paid when he acquired the shares and the consideration he received when disposing of the shares. This very considerable taxation, however, is not imposed to the extent the selling shareholder receives shares of the parent company in exchange for his shares of the subsidiary rather than cash or other assets. As to the part of the consideration that consists of parent-shares the rules of the Act on Taxation of Stock Capital Gains apply to the effect that, if tax becomes payable, only a difference between the seller's acquisition price and the consideration received in connection with the sale will be taxed.

As regards natural persons, § 16 B, Subsection 2, applies if the selling shareholder or his spouse keeps or acquires shares of either the subsidiary or the parent company. Also, the provision applies if one or more of the persons referred to above at the time of the sale of the shares have a substantial influence on either the subsidiary or the parent company, irrespective of whether such influence is based on a holding of shares, an agreement, or anything else, cf. § 16 B, Subsection 3.

With respect to the sale of shares by companies, § 16 B, Subsection 5, stipulates that Subsection 2 of the rule applies only where a person or his

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spouse at the time of the sale of shares had a substantial influence on the company selling the shares as well as the parent company.¹⁵

It follows from the above that natural persons selling their shares may be taxed pursuant to the more favorable rules of the Act on Taxation of Stock Capital Gains, rather than § 16 B of the Tax Assessment Act by disposing of all their shares of the subsidiary so that they are left with no interest in either the parent company or the subsidiary. In a takeover context this means that these shareholders have an incentive to sell all their shares of the target-company and not to acquire shares of the acquiror.¹⁶ Another way of avoiding the massive taxation is by only accepting a sale of the shares if the consideration consists of shares of the acquiror. This latter possibility may frequently not seem very attractive to the acquiror.

Unless the acquiror decides to issue shares to the selling shareholders as consideration for his purchase of target-shares, he might – after having acquired the majority of the shares – expect that the remaining shareholders are not inclined to sell their shares, unless the acquiror accepts to purchase all their shares of the target-company or offers such a high price that tax considerations play only a subordinated role.

Due to Rule 4 of the Copenhagen Stock Exchange Rules of Ethics, an acquiror that has gained control has an obligation to make a bid for the remaining shares on equal terms. Frequently, it will probably be in the interest of the acquiror to acquire all the target-shares. However, some acquirors that have less financial strength and perhaps do not see any need to acquire all target-shares may prefer not to do so. Such acquirors may find that minority shareholders of the target-company, otherwise inclined to sell only a part of their shares, will have a tax incentive to dispose of their entire shareholding because of § 16 B, Subsection 2, of the Tax Assessment Act. In other words, acquirors having limited financial strength or other reasons not to acquire all shares of the target-company may feel § 16 B, Subsection 2, as an undue burden.

The issues in connection with § 16 B, Subsection 2, of the Tax Assessment Act, are described by Kirsten Høpner Petersen in *Revision & Regnskabsvæsen* No. 9/1989 p. 47 ff. Pursuant to § 16 B, Subsection 6, of the Tax Assessment Act, the Ministry of Taxation may grant exemption from the provisions discussed

¹⁵ The standard “substantial influence” is discussed in government circular No. 50/1985, items 4 b-c.

¹⁶ As mentioned previously, it is also a requirement for the more lenient taxation that the shareholders do not otherwise have a substantial influence on either of the companies, cf. § 16 B, Subsection 3.

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above with the effect that the rules of the Act on Taxation of Stock Capital Gains apply. Høpner Petersen deals with the tax authorities' exemption practice in *Revision & Regnskabsvæsen* No. 10/1989, p. 64 ff. See also Aage Brink in *Inspi* No. 4/1989, p. 3 ff. For a criticism of § 16 B, Subsection 2, see Lida Hulgaard & Søren Rasmussen, *Advokaten* No. 18/1989, p. 377 ff. An overview of the "mechanisms" of the rule is provided by Michael Kirkegaard Nielsen in *Tidsskrift for skatteret* 1989.677. For a general discussion of these issues, see Eivind Christiansen, *Beskatning af aktionærer* p. 21 ff. at 42 and 148 ff.

If a shareholder resells his shares to the issuing company, he will – along the same lines as we saw above – be taxed on the entire consideration, cf. § 16 B, Subsection 1, of the Tax Assessment Act.

According to the Tax Assessment Act, § 16 B, Subsection 6, an exemption may be granted from the provision under Subsection 1, so that the sale of the shares will be considered an "ordinary sale of shares". For guidance with respect to when an exemption may be expected, see Circular No. 50/1985, item 9. For a general discussion of the rule and of exemption practice, see Eivind Christiansen, *Beskatning af aktionærer* p. 141 ff.

Turning to the impact of the tax rules discussed here, the three year ownership rule under the Act on Taxation of Stock Capital Gains will have an inhibiting effect on sales of shares within the period because profits received will be taxed. However, since the rule is limited to three years and considering that only profits – and not the entire consideration – are taxed, the rule may not be that big an obstacle to takeovers.

§ 16 B, Subsection 2, of the Tax Assessment Act is problematic in that it leads to excessive costs for acquirors. Target-shareholders are motivated to sell all their shares once they receive an offer from the acquiror. Like Rule 4 of the Copenhagen Stock Exchange Rules of Ethics, § 16 B, Subsection 2, may very well have the effect that some acquisitions will not be made. Those that will be made will frequently result in increased costs for the acquiror. This, in turn, tends to lead to inhibited market activity.

The massive taxation in connection with share buy-backs under § 16 B, Subsection 1, of the Tax Assessment Act probably has limited importance for takeover activity. Taxation of buy-backs obviously has no impact on the purchase by an acquiror of shares, and buy-backs are not a necessary part of the financing of an acquisition either. As we shall see in XI., however, § 16 B, Subsection 1, has an impact on defensive repurchases of shares.

Under U.S. law, shareholders selling their shares are taxed on the gain, i.e. the difference between the amount received in consideration for the sale and the shareholders' tax basis for the shares they sell. However, if the sale of shares is

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shaped as a tax-free reorganization (see Section 368(a) of the IRC), the selling shareholders may recognize no taxable gain, see 3.4.3.

3.4. Tax treatment of mergers. A merger between the target-company and the acquiror or his acquisition vehicle may be part of a takeover strategy. Such merger may also be decided after the acquisition as an advantageous step for many reasons.

Mergers may be structured in different fashions. A commonly used method is the so-called “vertical” merger whereby the target-company upon the acquisition is merged into the acquiror or his acquisition vehicle. Target-shareholders receive cash and/or shares of the surviving company.

Another method commonly used is the so-called “reverse vertical merger” whereby the acquiror or the acquisition vehicle is merged into the target-company.

In addition to the methods mentioned in the text, a merger may be “horizontal”, whereby two companies are amalgamated and a new legal entity is created. A number of variations exist, based on these different models.

Under Danish law, mergers may be either “taxable” or “non- taxable”.

3.4.1. Taxable mergers. The parties to a merger may elect (subject to certain conditions, cf. below) that the merger be governed by the Act on Taxation of Corporate Mergers (“Lov om beskatning ved fusion af aktieselskaber m.v.”) discussed later.¹⁷

If the parties do not elect to have a merger governed by the said Act, the transaction is considered a taxable merger. In such case a company that is merged into another company will be viewed as being dissolved and its assets are considered to be transferred to the surviving company.¹⁸ Consequently, the dissolved company will be treated like any other company being liquidated, cf. § 5 of the Act on Taxation of Companies.

Pursuant to § 5, taxation of the company in connection with liquidation will include income that the company has received since the expiry of the preceding fiscal year and until the day of dissolution. This income will include deferred taxes in connection with gains obtained as a result of the

¹⁷ Consolidation Act No. 569 of August 7, 1990.

¹⁸ The term “surviving company” covers both situations where e.g. a subsidiary is merged into a parent company and the parent continues, and events where two companies merge with a new legal entity as the surviving company.

“sale” of the company’s assets. The sale of, for example, machinery, inventory, real estate or stockholdings may lead to the realisation of substantial gains and, consequently, payment of significant taxes.

In connection with a taxable merger it is not possible to carry over taxable losses incurred by the company that is dissolved to the surviving company. The notion that the merger is, in effect, a liquidation of one legal entity in connection with the transfer of its assets to another legal entity, accounts for this lack of transferability of taxable losses.

Profits received by the shareholders in connection with the dissolution of a company as a result of a merger are subject to taxation in accordance with the Act on Taxation of Stock Capital Gains discussed under 3.3. For most shareholders this means that gains received after 3 years of stock ownership are tax-free.

3.4.2. Non-taxable mergers. By allowing parties to elect the tax treatment provided for in the Act on Taxation of Corporate Mergers, a system is established whereby some of the disadvantages connected to taxable mergers are avoided.

It is, ordinarily, a condition for the right to elect treatment under the Act on Taxation of Corporate Mergers that a part of the consideration equivalent to at least 90 percent of the value of the shares of the company that is dissolved is paid through the exchange of shares of the surviving company, cf. § 2 of the Act.

See *Ligningsvejledning aktionærer og selskaber 1990*, SD 1.2.1., where further details may be found.

If a parent company and a subsidiary merge at a point when the parent has held the votes necessary to decide such merger for a period of less than 3 years, the merger must be approved by the Tax Assessment Council in order to be non-taxable pursuant to the Act on Taxation of Corporate Mergers, cf. § 3 of the Act.

The Tax Assessment Council may make its permission contingent upon special terms that ensure that the merger does not provide advantages to the parties which were not envisaged when the Act was adopted. In this connection it has been emphasized that it is of importance whether the parent company has acquired the shares of the subsidiary at the current market price. If there is reason to believe that the merger is motivated by a desire to circumvent the term 2.4.2. pertaining to taxation on a consolidated basis, the permission to have the merger treated as a non-taxable merger will typically not be granted. The position of the Tax Assessment Council as to these questions is described in *Ligningsvejledning aktionærer og selskaber 1990*, SD 1.2.2. Generally, the tax authorities are quite

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reluctant to give permission to tax-free treatment in the case of vertical mergers that do not meet the 3 year-threshold, see e.g. Tidsskrift for Skatteret 1989.535.

The approval of the Tax Assessment Council is also required if, within the last three years prior to the merger date, one or more of the companies that are parties to the merger have acquired assets from the shareholders or from a company controlled by one of the shareholders, provided that such acquisition has not been made in the normal course of business, cf. § 4 of the Act.

If a permission is required under § 3 or § 4 of the Act on Taxation of Corporate Mergers, it is unlikely to be granted if, within the last three years prior to the merger date, a shareholder has sold shares of one of the merging companies to another of such companies in a situation where the sale was comprised by § 16 B of the Tax Assessment Act and the company acquiring the shares does not have an income that leaves “room” for interest payments to the selling shareholder or financier in the absence of a merger. See *Ligningsvejledning aktionærer og selskaber 1990*, SD 1.2.4.

Non-taxable mergers are based on a principle of succession, cf. § 8 of the Act. All assets owned by the dissolved company are, for the purposes of determining the taxable income of the surviving company, treated as if they were acquired by the surviving company at the time when such assets were acquired by the dissolved company. Moreover, the surviving company succeeds with respect to the consideration that was paid by the dissolved company as well as the depreciations made by that company. The result of the succession is that no gains will be realized as a consequence of the merger, which is contrary to what is the case regarding taxable mergers. Succession also includes the liabilities of the dissolved company.

Even the shareholders of companies that participate in a non-taxable merger are subject to the principle of succession. To the extent that shareholders of the dissolved company receive shares of the surviving company in exchange for their shares, no tax incurs. In connection with a subsequent sale of the shares that were received in exchange, such shares will be deemed to be acquired at the time and for the consideration that would have applied to a sale of the shares previously held in the dissolved company. If the shareholders of the dissolved company receive payment in cash, their existing shareholding will be deemed to be sold at the date of the merger.¹⁹

¹⁹ See *Ligningsvejledning aktionærer og selskaber 1990*, SH 3.5.

3.4.3. Electing the tax treatment. At a first glance it may seem as if tax-free treatment, if the prerequisites are met, would be preferable in connection with most mergers.

Electing treatment of a merger as non-taxable is not always in the interest of the parties, however. Losses that have been incurred by any one of the companies that are parties to the merger prior to the date of such merger may not be deducted in connection with the computation of the taxable income of the surviving company, § 8, Subsection 6, of the Act on Taxation of Corporate Mergers.²⁰ If one of the merging companies has losses that may be carried forward, and it must be assumed that the combined business will have a taxable surplus in the years to come, treating the merger as taxable may be preferable with the company having the losses to carry forward as surviving.

As mentioned before, election of non-taxable treatment entails that the surviving company succeeds as to the time of acquisition, the price paid, etc. in connection with the assets and liabilities of the dissolved company. In the case of a taxable merger, the assets of that company will be entered in the surviving company's books at the market value (rather than the book value for tax purposes). Consequently, treating the merger as taxable will lead to a "step-up" in the basis of depreciation and thus to increased deductions from future cash-flows. This fact should be taken into consideration when deciding whether to elect non-taxable treatment.

By using a reverse vertical merger, deferred taxes may be avoided even though the transaction does not qualify for tax-free treatment. The reason for this is that the acquisition vehicle typically owns no assets that could lead to deferred taxes, and therefore no tax is incurred as a result of the merger between the target-company and the acquisition vehicle. However, recently the Danish tax authorities have taken the position that the "sale" of the shares by the acquisition vehicle to the target-company is comprised by § 16 B, Subsection 5 and Subsection 2, of the Tax Assessment Act. Consequently, the entire consideration received for such shares, rather than only the profits, will be taxed, cf. 3.3.²¹ This massive taxation obviously makes this possibility less attractive.

For an outline of, inter alia, the tax treatment of mergers, see e.g. Svend Vedde & Susanne Nørgaard, SR-Skat 7-89, p. 370 ff.

²⁰ An exemption from this rule applies if a parent company merges with a subsidiary with which it has been taxed on a consolidated basis as per the date of the merger and in the preceding five fiscal years.

²¹ See Tidsskrift for skatteret 1990.29.

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The fact that companies may elect to effect a merger on either a taxable or a non-taxable basis gives them a flexibility in terms of achieving the most suitable tax treatment for their economic features. Seen from an economic viewpoint the high degree of flexibility tends to increase efficiency because the players in the market may choose the tax treatment that has the highest value for them.

The concept of having taxable as well as tax-free mergers is also known from other jurisdictions. Under U.S. law, it follows from the IRC that a merger is taxable, unless it meets certain requirements set forth in the Code. Taxable treatment of a merger, *inter alia*, means that the shareholders who surrender their shares recognize a gain or loss with respect to the shares. As is the case under Danish law, the surviving company can “step-up” the value of the assets acquired as a result of the transaction and thus increase the basis for depreciations. Tax-free treatment, on the other hand, means that the selling shareholders’ gain will not be recognized as taxable in so far as they receive shares of the surviving company as consideration. Also, the basis for depreciations will remain unchanged, see Sections 354(a) and 361(a) of the Code. Loss carry-overs are permitted or restricted in connection with either model so here the law is less stringent than we saw as to Danish law.

In order to qualify for tax-free treatment, a merger must meet the requirements in Section 368(a) of the IRC. This section defines three reorganization models by which tax-free treatment can be achieved. The three models are designated types A, B and C. For our purposes the A-model, which pertains to the so-called “statutory” (traditional) mergers is of particular interest. Although the detailed requirements under Section 368(a) will not be described here, one of the requirements for having a statutory merger qualify as tax-free is that the selling shareholders must receive a significant (typically 50 percent or more) equity interest in the surviving company (this is known as the “continuity of interest”-doctrine). For details about these issues, see Herrick K. Lidstone, Jr., William N. Krems & Richard B. Robinson, *Federal Income Taxation of Corporations* p. 291 ff. and Daniel Q. Posin, *Corporate Tax Planning, Takeovers, Leveraged Buyouts, and Restructurings* p. 386 ff., p. 469 ff. and p. 842 ff.

X Standards for managerial behavior when responding to “hostile” takeover attempts or threats

1. Introduction

In countries where contested takeovers have been known for a long time, i.e. the United States and Great Britain, the prime focus when discussing takeover responses has been on target-management rather than the inter-relationship among target-shareholders.

The reason for this is probably the apparent conflict of interest that exists between management and shareholders once a change of control is imminent or a more distant takeover threat exists. Target-management obviously has no interest in being compelled to leave office thereby losing their jobs and salaries. Target-shareholders, on the other hand, are interested in being offered an opportunity to sell their shares at a premium price or having the opportunity to replace management by a new, more efficient management.¹

Although the powers of management under Anglo-Saxon law differ from what is the case under Danish law, the conflict of interest issue is the same under Danish law.

Under V.2.7. and 3. I reached the conclusion that, from an economic viewpoint, neither shareholders nor society at large has an interest in management being able to insulate itself from control. The point made was that it should be left to target-shareholders to decide whether to sell their shares or not. Target-management should not be allowed to deprive the shareholders of this opportunity.

One of the main questions which we want to pursue in the following is if this conclusion can be reconciled with the role of target-management according to the existing principles of Danish corporate law.

Another important question is the relationship among the target-shareholders when responding to a takeover attempt or threat. The question here

¹ See Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 Business Lawyer 1733 at 1745 ff. (1981) and Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 Hastings Law Journal 377 at 382 ff. (1985).

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is what duties shareholders owe one another in connection with the adoption of defensive strategies or devices.

The decision whether or not to sell the shares of a company is made by each individual shareholder, who can make his choice independently and without regard to the other shareholders.

However, if a shareholder violates the Companies Act or the company's charter, intentionally or grossly negligently, he may be held liable for damages caused to the company, the other shareholders or third parties as a consequence of such violation, cf. § 142 of the Companies Act. As a consequence of § 142, shareholders who abuse their influence of a company to make decisions that benefit them unduly at the expense of the company or the other shareholders may be subject to liability.

As discussed under 2., the liability of the board and the managers is not limited to intent or gross negligence but includes any degree of negligence. The purpose of establishing a different basis of liability for management and for shareholders has probably been to indicate that shareholders do not have the same duty of loyalty as well as duty to monitor and control the company's affairs as is the case with management, cf. Gomard, *Aktieselskaber og anpartsselskaber* p. 325.

In addition to § 142, the Companies Act contains a number of provisions protecting minority shareholders against unfair and discriminatory treatment by majority shareholders. These protective provisions include, inter alia, § 79 and the general standard set forth in § 80 of the Companies Act. Since the issues of minority protection in this context are similar to those discussed in VIII., they will not be dealt with further here but will be commented on in connection with the discussion of specific defensive devices and strategies under XI.

It should be noted that if an acquiror is a minority shareholder at the point in time when the shareholders of the target-company adopt defensive devices or strategies, he will have the same remedies at his disposal against a resolution made by the other shareholders as any other minority shareholder.

2. Duties of board and managers under Danish law

2.1. Generally. There are no provisions in the Companies Act, or elsewhere, setting forth the obligations owed by the management of a company to the company's shareholders in connection with contested takeovers. The absence of regulation is obviously a drawback of the regime. However, some guidance with respect to the board's and the

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managers' duties may be derived from the general principles of liability and responsibility found in the Companies Act.

The provisions of the Act dealing with managerial liability are based on the general standard in Danish tort law, known as the "culpa"-rule. According to this rule, a person is liable for damages caused by him as a consequence of an act or omission that is based on his intent or negligence. When determining whether a person is liable, an assessment must be made if the person acted as a prudent and reasonable man ("bonus pater") would do in the circumstances.²

According to the culpa-standard, the Companies Act provides that the board and the managers are liable to the company for any damages caused by them in the performance of their duties intentionally or due to negligence, cf. § 140. Similarly, board and managers are liable vis-a-vis the company's shareholders, creditors or any third parties, provided, however, that they have violated the Companies Act or the company's charter. § 140 should be read in conjunction with § 54, Subsection 1, of the Act, which stipulates that it is the responsibility of the board to see to it that the company's business is properly organized. The Act also specifies that the board must ensure that the book-keeping and administration of the company's assets are controlled in a satisfactory way, cf. § 54, Subsection 3. Moreover, failure to monitor and control the managers may lead to liability for the board.

The managers may be held liable if they breach their duty to manage the company on a day-to-day basis in accordance with the Companies Act and the guidelines and instructions issued by the board. The Act specifically states that managers must see to it that the book-keeping of the company takes place pursuant to the relevant laws and regulations and that the company's assets are administered in a satisfactory fashion, cf. § 54, Subsection 3.

Apart from creating a standard of care, the culpa-rule, as reflected in the Companies Act, also imposes on management a duty to act loyally towards all shareholders. § 63 of the Act thus prohibits board and managers from acting in a fashion that is clearly likely to provide certain shareholders or others with an undue advantage at the expense of the other shareholders or the company.

² For a general discussion of the culpa-rule, see Anders Vinding Kruse, *Erstatningsretten* p. 29 ff., Henry Ussing, *Erstatningsret* p. 8 ff., and Stig Jørgensen, *Erstatningsret* p. 62 ff.

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In addition to containing a few specific provisions pertaining to managerial behavior, the culpa-standard as set forth in the Companies Act only gives general guidance as to how to determine whether or not management may be held liable, but leaves it up to the courts to decide the borderlines with respect to managerial liability.

When applying the culpa-rule, the fact-pattern of each case is thus crucial. However, although perhaps being too simplistic, it seems possible to divide the scenarios where management may be held liable pursuant to the culpa-rule into the following categories.

The first category encompasses situations where management is found to have breached a duty specifically imposed on it by the Companies Act or by provisions found elsewhere in the relevant legislation. Assuming that the breach of the duties can be clearly ascertained, e.g. in case the board has granted a loan to a shareholder of the company in violation of § 115, Subsection 1, of the Companies Act, the culpa-rule will be applied on a quite strict basis, meaning that management will normally be considered to be liable for any damages caused by their acts or omissions.³

Another category where management will typically be considered liable for damages incurred comprises situations where they have acted in disloyal pursuit of their own interests at the expense of the interests of the company, see, e.g., *Jul Jørgensen v. A/S Jydsk Handelskompagni* (U1932.488, Sup. Ct.) and *Andreasen v. Jensen* (U1921.156, Sup. Ct.)⁴ The likelihood of management being held liable is particularly great in events where they have been involved in self-dealing, i.e. have used their position and influence on the company to enter into contracts or arrangements for the benefit of themselves rather than the company. In this connection it ought to be noted that § 58 of the Companies Act provides that a member of a board or a manager may not take part in discussions regarding agreements between the company and the member if he has a material interest that “may conflict” with the interests of the company.

The third category includes the remaining situations, not covered by the above mentioned categories, where management has failed to perform its duties.

Questions of liability in this third category are the ones which give rise to most doubt and uncertainty.

The greater part of Danish court cases dealing with managerial liability have been concerned with situations where the company has faced finan-

³ See Gomard, *Aktieselskaber og anpartsselskaber* p. 323 f.

⁴ See Gomard, *Aktieselskabsret* p. 401-402.

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cial difficulties, but the board has attempted to overcome such difficulties and accepted transactions whereby third parties incurred losses or has simply failed to take any action at all.⁵

A number of court decisions have thus held the board liable for failure to monitor and control the financial development of the company's business, see e.g. *Oluf Svendsen Auto-Leasing A/S v. Jespersen* (U1977.246, M&C Ct.) and *Firma A. Matthison-Hansen & Co. v. Schou* (U1940.563, E. Cir.). If, on the other hand, the board is aware of the financial difficulties and makes serious efforts to solve these, courts are reluctant to impose liability on the board even if the efforts turn out to be in vain, see, for example, *Alg v. Havemann* (U1977.274, Sup. Ct.) and *Bjergaard Andersen v. Internal Revenue Service* (U1985.377, Sup. Ct.). In addition to ensuring that the annual accounts are prepared and filed with the Commerce and Companies Agency ("Erhvervs- og Selskabsstyrelsen") on a timely basis, the board must take the necessary action to protect the interests of the company and its shareholders as well as its creditors.⁶

Although it is difficult to draw a clear picture of these cases, a distinction should be made between losses incurred as a result of the board's omission to take action due to sheer passiveness or ignorance, or actions taken on an uninformed basis, on the one hand, and losses caused by erroneous judgments made in good faith and on an informed basis, on the other.

While omissions or acts resulting from passiveness, ignorance or lack of information will normally not free the board from liability, it will ordinarily not be held liable for erring in its informed judgment, made in good faith if it subsequently turns out that the decisions lead to losses for the company and its shareholders. It follows from this that failure to maximize the shareholders' investment will give rise to no liability for a board which acted in good faith and properly informed.

⁵ See Gomard, *Aktieselskaber og anpartsselskaber* p. 320 ff. and the cases cited there.

⁶ Cf. § 54, § 69 a and § 140 of the Companies Act. According to § 69 a of the Companies Act the board must arrange for a shareholders' meeting to be held not later than 6 months after the company has lost half of its share capital. At such shareholders' meeting the board will have to give an explanation of the company's financial position and, if necessary, make proposals for steps to be taken. See also Gomard, *Aktieselskaber og anpartsselskaber* p. 173 ff. and 319 ff., Gomard, *Aktieselskabsret* p. 411 f., Sten Langebæk, *Bestyrelsens idegrundlag og funktion* p. 33 ff. and Thomsen, *A/S-loven med kommentarer* p. 304 f. and 427 ff.

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Compared to what has been seen in other European countries as well as the United States, the practice by the Danish courts with respect to managerial liability is generally considered to be comparatively lenient although there is perhaps a trend towards judging managerial behavior according to more rigid standards.

For a discussion of managerial liability, see Gomard, *Aktieselskabsret* p. 397 ff., Gomard, *Aktieselskaber og anpartsselskaber* p. 319 ff., the same author, at the 29th Nordic Jurist Meeting 1981, Part I, p. 365 ff. and 385 f., and in *Ugeskrift for Retsvæsen* 1971.B 117 ff. See also Werlauff, *Selskabsret* p. 293 ff., Paul Krüger Andersen, *Aktie- og Anpartsselskabsret* p. 236 ff., Thomsen, *A/S-loven med kommentarer* p. 427 ff., Jørgen Boe, *Ugeskrift for Retsvæsen* 1984.B 385 ff., O.A. Borum, *Juristen* 1963 p. 249 ff., Jan Kobbernagel, *Direktøren* p. 162 ff., Jan Kobbernagel, *Ledelse og Ansvar* p. 182 ff., and Niels Alkil, *Juristen* 1945, p. 129 ff. Issues of managerial liability in a comparative context are discussed by Rolf Dotevall, *Skadeståndsansvar för styrelsesledamot och verkställande direktör – en aktiebolagsrättslig studie i komparativ belysning*.

2.2. The takeover context. Due to the powers and role of the board pursuant to the Companies Act, it is the board that attracts the chief interest in a takeover context. Consequently, our prime focus in this chapter and in chapter XI is on the board and only to a lesser degree on managers.

There is very sparse case law in Denmark dealing with the role of the management when facing a takeover offer or attempt by an acquiror with whom they do not sympathize.

However, the issue was raised in *Lorentzen v. A/S Schweitzers Bogtrykkeri* (U1934.1081, W. Cir.).

This case involved a company which had a share capital of DKK 73,500. The plaintiff had initiated purchases of shares and came to a point where he held approximately DKK 33,000 of the company's shares. According to the charter, the board was entitled to issue new shares and increase the total share capital up to DKK 90,000. Moreover, the charter stipulated that the existing shareholders would have no preemptive rights to subscribe to new shares. The board exercised its authority and issued shares for DKK 16,500, which were purchased by an employee of the company.

The plaintiff filed a suit against the company, claiming that the issue of the DKK 16,500 shares had been illegal as the purpose of the issue had not been to expand the company's business or provide further funds in connection with the operations of the company. Rather, the plaintiff argued, the new shares had been issued to perpetuate the board's control over the company. The plaintiff also argued that the issue constituted a violation of the principle of equal treatment of

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shareholders, which, he stressed, was a condition upon which the authority to the board rested.

The plurality of the judges conceded that the prime purpose of the board's use of its authority had been to prevent a change of control. In a rather vague statement the plurality added that the increase of the share capital should also be viewed in conjunction with the fact that the company had considered purchasing real estate and a rotation press.

Based on these facts and after having noted that no conditions were attached to the authority granted to the board in the charter, the plurality of the judges held that the board had not exceeded the limits of its authority by the issue of shares which, according to the plurality, had only led to a moderate increase of the total share capital.⁷

A dissenting judge noted that there was no proof that the increase of the share capital had been made with the purchase of real estate or a rotation press in mind. The sole purpose of the stock issue had been to prevent the plaintiff from acquiring a majority stockholding. The dissenting judge held that in his opinion it is a precondition for the right of the board (as well as for the shareholders for that sake) to increase the share capital that the increase is made for the purpose of obtaining capital for the company's operations. Since this condition had not been fulfilled, the dissenting opinion concluded that the issue of shares was illegal.

The opinion of the plurality in this case reflects the view that the board should be granted considerable flexibility even in the takeover context. Although the decision dates back approximately 45 years, a recent court decision suggests that the courts may have maintained this view on the board's role.

On January 28, 1991, the Supreme Court handed down its decision in *Arnth-Jensen v. A/S Ringkjøbing Bank* (U1991.180, Sup.Ct.), affirming the decision in the matter by the High Court of the Western Circuit. In the case two minority shareholders had challenged a shareholder decision to authorize the board of a bank to increase the share capital of the company.⁸ According to the authority,

⁷ Another issue of the case was the subsequent approval at two extraordinary shareholders' meetings of the increase of the share capital made by the board. The company's charter contained a provision stipulating that no shareholder would be entitled to vote on his shares if he had been a registered owner of such shares for a period of less than 3 months prior to the shareholders' meeting. The plaintiff did not meet this requirement and for this reason was prevented from voting on his shares. However, the issue dealt with in the text and the question of the plaintiff's right to vote are two separate issues. The use of record dates as a defensive means is further discussed under XI.2.2.2.

⁸ The main issue in the case relates to the use of record dates and is not dealt with here but discussed further under XI.2.3.2.

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the board would be entitled to increase the share capital by DKK 48 million to DKK 80 million. Out of the DKK 48 million the existing shareholders would have a preemptive right to subscribe for DKK 28 million, whereas no such preemptive rights existed with respect to DKK 19 million. The remaining DKK 1 million would be issued to employees of the bank.

At the time of the decision by the courts, the board had not exercised its authority to increase the share capital. It transpires from the facts of the case that the reason why the proposal to authorize the board had been made was a desire to avoid a major shareholder having a decisive influence on the terms and conditions of the issue of shares in connection with an increase of the share capital. Moreover, the reason why a part of the increase should be effected without the existing shareholders having preemptive rights was to avoid a major shareholder being in a position to obtain and maintain a dominating influence of the bank.

The plaintiffs argued that the shareholders' decision to authorize the board constituted a violation of § 63 and § 80 of the Companies Act.⁹ The point made by the plaintiffs was that the authority to the board was a response to attempts by the plaintiffs to acquire shares of the company, which was a small, Danish local bank. Prior to any increase of the share capital of the bank, the plaintiffs held more than 25 percent of the share capital. The increase of the share capital led to a "dilution" of the plaintiffs' interest. Stressing that the purpose of the increase had not been to obtain new capital for the company but rather to ensure the maximum spread of the shares, the plaintiffs stated that the attempt to deprive them of influence of the bank violated the general standards set forth in § 63 and § 80.

The defendant, on the other hand, stated that a local bank with ties to a specific region of the country has a legitimate interest in having a large number of small shareholders. The bank had been familiar with plans of the plaintiffs which, according to the defendant, could not be reconciled with the interest in having the share capital widely spread.

The High Court accepted the point made by the defendant and held that a company which operates as a local bank may have an interest in having its share capital spread among many shareholders. In view of this, the court did not find that the authority to the board had been motivated by desires to create undue benefits for others at the expense of the plaintiffs. The Supreme Court, affirming the result reached by the High Court, briefly stated that it found no grounds for invalidating the shareholders' decision (which had been adopted by a qualified majority) on the basis of § 80.

⁹ § 63 is mentioned under 2.1. of this chapter, while § 80 of the Companies Act is discussed under chapter VIII.1.2. § 63 deals with acts by the board and the managers and since the board had not, at the time of the decision, exercised its powers under the authority granted, it is hard to argue that the board had violated § 63.

At first glance it could seem as if the case focuses on the relationship among the shareholders only. It ought to be noted, however, that the decision, in effect, allows the board the right to exercise its authority for the purpose of preventing a change of control.

The case was concerned with a company that for historical and other reasons had close ties to a geographically limited part of Denmark. Perhaps boards of companies that do not have such features cannot expect the same degree of flexibility. Nevertheless, the case still stands for the proposition that the board presumably always acts in the best interests of the company and its shareholders and thus needs a high degree of freedom. The decision thus fails to recognize any conflict of interests between the management on the one hand and shareholders on the other.

Smith v. A/S Handels- og Landbrugsbanken i Thisted (U1966.465, W. Cir.), discussed further under XI. 2.3.2., deals with a different subject matter, but also indicates that the courts seem to presume that corporate managements always act in the best interests of the company and its shareholders.

The dissenting opinion in *Lorentzen v. A/S Schweitzers Bogtrykkeri* (U1934.1081, W. Cir.) is interesting in that it applies a test that focuses on whether the board has exercised its authority in accordance with the purposes for which such authority was given to management. According to this approach it is decisive if the board pursued a proper purpose when it exercised its authority.¹⁰

2.3. Preliminary observations. The culpa-rule is, by its nature, a very general standard that fails to address specifically some of the issues related to transfer of corporate control. As stated by Gomard, the culpa-rule is “as vague as it is common and as common as it is vague”.¹¹

The duties of management as expressed and implied in the Companies Act and the case law developed thereunder thus gives us an indication but not a clear answer as to what role target-board and managers should play when facing a takeover attempt.

We may, against this background, want to consider if the culpa-rule ought to be supplemented by an additional standard or standards that provide more guidance with respect to the role of management in this context.

Since the case law in Denmark in connection with these issues is so scarce and so little has been said about these things in Danish legal theory

¹⁰ As described under 3.2.1., the proper purpose test is an approach which the British courts use when evaluating management's defensive tactics.

¹¹ Gomard, *Aktieselskabsret* p. 400.

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we continue our study by focusing on two foreign jurisdictions where a considerable amount of case law as well as legal scholarship has dealt with the issues discussed here. The purpose of looking at these two jurisdictions is thus to obtain some guidance when we approach the issues further and perhaps become acquainted with possible solutions to the problems at focus.

3. American and British law

3.1. American law

3.1.1. Introduction. Under American law, the management of a company plays a key role in the event of a takeover attempt regarding the company or if a more distant threat exists that the company may be taken over. Most state corporate laws grant the board a considerable flexibility to act without the consent of the shareholders. As a consequence of this right for the board, a major part of the case law and the discussion among legal authors in connection with target responses to takeover attempts or threats have focused on the role of management vis-a-vis the shareholders of the target company.¹²

American companies are managed under the direction of a board of directors elected by the company's shareholders. The board of directors resembles what is known under Danish law as a "bestyrelse". However, ordinarily, the board of directors will have a closer contact to the day-to-day management of the company than is the case with a "bestyrelse". The day-to-day management of the company is carried out by a number of executive officers appointed by the board and spearheaded by the Chief Executive Officer (CEO). While the authority and duties of the board are defined in the relevant state corporate laws, the authority and duties of the officers appointed by the board are determined in the company's by-laws or provided by the board. Many American state corporate laws include provisions according to which the shareholders can only make decisions of a material nature if such decisions are initiated or approved by the

¹² Although less attention has been paid in the takeover context to the duties of shareholders owed to other shareholders, such duties do exist, see e.g. *Sinclair Oil Corporation v. Levien*, 280 A.2d 717 (Del. 1971) where the Delaware Supreme Court held that the business judgment rule discussed under 3.1.2. should apply, unless a shareholder exercises his influence to obtain benefits which are not shared with and which harm the other shareholders. In the latter event, the court would apply an "intrinsic fairness" test. Other courts have applied a test according to which the threshold question is if an act made by a majority shareholder or a group of shareholders was made in good faith or for a reasonable purpose, cf. *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

board of directors. As the text will show, the board of directors has a much wider right to act on its own, i.e. without shareholder approval, than is the case with a Danish “bestyrelse”.

3.1.2. The business judgment rule. The sources of the duties of management when facing a takeover attempt or when establishing a strategy for defending against possible future takeover attempts are chiefly found in state law.

Under American law the view is that the management of companies is entrusted to the board of directors. This has led to the notion that the board members are fiduciaries that have an obligation to act in the best interest of the company and its shareholders.¹³ The fiduciary duties of a board are composed of the so-called “duty of loyalty” and the “duty of care”.¹⁴

It is a general principle that business decisions made by the board or the executive officers of a company in connection with the management of the company, will not be challenged by the courts, provided that management has acted on an informed basis and in good faith with respect to the effect of the decision on the company and its shareholders. This has led to the use of the so-called “business judgment rule”, which by the Delaware Supreme Court has been described as “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company”, cf. *Aronson v. Lewis*.¹⁵ In other words, the point of departure is that decisions made by target-management in connection with takeovers are considered business decisions which will not be second-guessed by the courts.

In order for a decision to be a business decision, it is a condition that it was made in the best interests of the company and its shareholders. The determination of whether this condition is met has given rise to a great deal of trouble in the practice of the American courts.¹⁶

¹³ One of the most well-known discussions of the relation of management to the company's shareholders is found in Berle & Means, *The Modern Corporation and Private Property*.

¹⁴ For a further explanation of these notions, see below.

¹⁵ 473 A.2d 805 at 812 (Del. 1984).

¹⁶ A large number of the contested takeovers seen in recent years have involved Delaware companies, and the Supreme Court of Delaware has, therefore, rendered a number of landmark decisions, which, among other things due to the ex-

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When facing a takeover bid, target-management will have to consider “the inadequacy of the bid, the nature and timing of the offer, questions of illegality, the impact on constituencies other than shareholders, the risk of nonconsummation, and the basic stockholder interests at stake, including the past actions of the bidder and its affiliates in other takeover contests”.¹⁷

No general duty exists for management of a company to cooperate for the sale of the company, even if an acquiror offers a premium price compared to the pre-bid market price for the shares, cf., for example, *Ivanhoe Partners v. Newmont Mining Corp.*¹⁸

If target-management deems that the price offered is inadequate, it is free to encourage other prospective buyers to make competing bids for the company’s shares. Management may also, in order to increase the price of the company’s shares, take steps in order to restructure the business of the company, sell parts of the company’s assets or divisions of the company, or increase the dividend payments to the shareholders. However, provided that the bid made by the acquiror is not unfair to shareholders, target-management may not take any steps which will prevent the shareholders from choosing between the offer made by the acquiror and, for example, a proposal made by management for restructuring of the company’s business, cf. *City Capital Associates Limited Partnership v. Interco Inc.*¹⁹ Target-management is free to procure alternatives to the “hostile” bid whereas it may not defeat offers which are merely deemed to be too low.

These limitations of target-management’s right to fend off a takeover bid do not apply if the conditions for the acquiror’s bid or the methods used by the acquiror are unfair to the shareholders or to some of these.²⁰ In such events, or in case the acquiror’s offer is illegal, target-management may take steps to delay or prevent the takeover attempt to the extent nec-

pertise which the Delaware courts have gained in this area, have influenced the courts of other states, cf. below.

¹⁷ *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 at 1341-1342 (Del. 1987). See also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 at 955-56 (Del. 1985).

¹⁸ 535 A.2d 1334 (Del. 1987). See also *Desert Partners, L.P. v. USG Corp.*, 686 F. Supp. 1289 (N.D. Ill. 1988). In both these cases the court emphasized that the target-board reasonably had perceived the offer as a coercive offer, i.e. an offer unfair to some of the shareholders.

¹⁹ 551 A.2d 787 (Del. Ch. 1988).

²⁰ See *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016 (S.D.N.Y. 1985).

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essary in order to protect the interests of the shareholders. When protecting the shareholder interests, it is a requirement that the response by management is reasonable in relation to the threat posed, *Unocal Corp. v. Mesa Petroleum Co.*²¹ According to this test, which has proven to be one of the fundamental standards applied by Delaware courts in this context, the right of the management to delay or prevent a takeover increases proportionately with the risk of unfairness or abuses on behalf of the acquiror. It is, for example, easier for management to convince a court that it was in the best interest of the shareholders to thwart a two-tiered ("front end loaded") tender offer, where the acquiror paid a high price for acquiring control (the first tier) while only paying a low price for the remaining shares (the second tier), than a tender offer which would benefit all shareholders on equal terms. If an acquiror is known to use coercive means as a part of his modus operandi, this is a fact which may be taken into consideration when management responds to his bid.²²

In recent years the American courts have shown a trend towards limiting the right for target-managements to challenge or defeat takeover bids. This development is illustrated by the landmark case, *Unocal Corp. v. Mesa Petroleum Co.*²³ In this case the Delaware Supreme Court held that it is a condition for applying the business judgment rule that target-management is able to demonstrate that it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership".²⁴ Management will have to show that it did not act with the sole or prime purpose to perpetuate itself in office but was motivated by "a good faith concern for the welfare of the corporation and its stockholders".²⁵ A mere lack of sympathy for the acquiror is not sufficient basis for fending off his takeover bid.

²¹ 493 A.2d 946 at 955 (Del. 1985). See also *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985). This principle was also applied in *Paramount Communications, Inc. v. Time, Inc.* (1989-1990 transfer binder) Fed. Sec. L. Rep. (CCH) 94,938 (Del., July 24, 1989).

²² See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (Del. 1987). In this case the court (at 1342) emphasized that the acquiror, Ivanhoe Partners, was a general partnership controlled by T. Boone Pickens, Jr., who was known by the court for his secret acquisition of shares, "bear hug" letters (see II.2.), coercive partial tender offers and inadequate bids.

²³ 493 A.2d 946 (Del. 1985).

²⁴ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 at 955 (Del. 1985).

²⁵ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 at 955 (Del. 1985).

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However, some of the most recent decisions rendered by the Delaware Supreme Court seem to afford the target-board a wider discretion than prior case law suggested, which has given rise to a discussion of whether the board has a right to “just say no” when facing a contested bid. There is probably no doubt that the notion of “just saying no” is a misleading way of describing the role that target-management should play. The most recent case law thus still imposes a duty on the board of directors to act in the best interest of the shareholders. But it also allows the board some discretion when determining what is in the shareholders’ best interest. Not only short-term benefits to shareholders but also long-term interests may be included in the board’s deliberations. As stated by the Delaware Supreme Court in *Paramount Communications Inc. v. Time, Inc.*, directors “are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy”.²⁶ It follows from this that the board has no obligation to dismantle defenses previously adopted and consider the bid if the board reaches the conclusion that an offer is not in the long-term interest of the shareholders, see e.g. *Mills Acquisition Co. v. MacMillan, Inc.*²⁷

Although no additional federal statutory restrictions apply once it has become clear that a public offer is imminent, as is the case in a number of other jurisdictions, the courts have ordinarily found that the business judgment rule is a particularly proper standard if a defensive strategy is implemented prior to a “hostile” bid has occurred, since it is clear in these situations that the defense has not been established for the sole or prime purpose of eliminating a specific acquiror known by management.²⁸

The protection which the business judgment rule constitutes for target-management does not apply without exceptions. It is thus a requirement that management has fulfilled the duty of loyalty and duty of care owed to the shareholders.

The duty of loyalty is a result of the recognition that separation of ownership and management may lead to management and shareholders having conflicting interests. In such case management must give priority to the

²⁶ (1989-1990 transfer binder) Fed. Sec. L. Rep. (CCH) 94,938 at p. 95,211 (Del. July 24, 1989).

²⁷ 559 A.2d 1261 at 1285, footnote 35 (Del. 1988).

²⁸ See, for example, *Moran v. Household International, Inc.*, 500 A.2d 1346 at 1350 (Del. 1985) and *Warner Communications, Inc. v. Murdoch*, 581 F. Supp. 1482 at 1490-91 (D. Del. 1984).

interests of the company and of the shareholders over management's own interests.

Members of management must abstain from pursuing their own interests if this conflicts with the interests of the company and the shareholders. If a board member or an officer has a direct personal interest in the outcome of a matter, he must abstain from participating in any decisions regarding that subject matter. If he fails to observe this duty, he will not be protected by the "free harbor" constituted by the business judgment rule. Assuming, for example, that an acquiror promises target-management economic benefits if it cooperates with the acquiror in order to persuade the shareholders to tender their shares, the acts made by management in connection with the acquisition will not be governed by the business judgment rule.

The duty of care requirement establishes a standard for the basis on which managements must make their corporate decisions. It is crucial that such decisions should be made on a fully informed basis, cf. *Smith v. Van Gorkum*.²⁹ In this case the board of a company approved a merger agreement after a brief oral presentation of a length of less than half an hour at a meeting which had been called without any indications of the purpose of the meeting. Also, no steps were taken to examine possible alternatives or to obtain an independent appraisal of the proposed transaction. The court held that the board had breached its duty of care.

If management has made its decision on an informed basis, it is not decisive whether the decision is optimal. Even though the courts in recent years tend to impose more rigorous standards with respect to the acts of management, most cases where a breach of the duty of care has been found involves transactions where management had acted in a way which was close to if not pure gross negligence.³⁰

In Delaware, management, in order to be protected by the business judgment rule, has to show "good faith and reasonable investigation", cf. *Unocal v. Mesa Petroleum Co.*³¹ If management is not able to carry this burden of proof or if the other party – the shareholders who want to hold the management liable for its acts – can prove that the management has acted disloyally or negligently, the business judgment rule is not applicable.

In New York State the courts have held that shareholders who wish to hold management liable must prove that management breached its duties

²⁹ 488 A.2d 858 (Del. 1985).

³⁰ See *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

³¹ 493 A.2d 946 at 955 (Del. 1985).

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to the company and its shareholders and that the business judgment rule is thus not applicable, cf. *Hanson Trust PLC v. ML SCM Acquisition, Inc.*³²

In a landmark case the Delaware Supreme Court has made another important modification of the scope of the business judgment rule. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*³³ the court held that the role which the management of a company plays in connection with a contested takeover changes the moment it is inevitable that the company will be sold. While until such moment the management may within the scope of its duties defend the corporate bastion, it will be charged with achieving the best possible price for the stockholders at a sale of the company once it has become clear that the company is for sale.³⁴ As a consequence hereof, target-management will have little say in the future of the company once it is clear that a sale of the company's shares will take place under all circumstances. In such situation the defensive measures discussed under XI. are only applicable to the extent that they can facilitate the sale of the company on the best possible conditions.

In the event that control of the company has already been transferred to the acquiror, target-management does not enjoy the protection of the busi-

³² 781 F.2d 264 (2nd Cir. 1986). The proof may, for example, include doubtful motives on part of the management or conflicts of interest.

³³ 506 A.2d 173 at 184 (Del. 1986). The Revlon-decision has been followed in, inter alia, *Edelman v. Fruehauf Corp.*, 798 F.2d 882 at 886-87 (6th Cir. 1986).

³⁴ In *Paramount Communications, Inc. v. Time, Inc.*, (1989- 1990 transfer binder) Fed. Sec. L. Rep. (CCH) 94,938 (Del. July 24, 1989), the Delaware Supreme Court indicated that the duties introduced in the Revlon-case are only triggered if the company initiates an active bidding process in order to sell itself or takes steps whereby the company will be broken up. If the board does not aim at discontinuing the existence of the company, but simply tries to defend it, believing that this is in the best interest of the shareholders, no duty to start an auction will arise. If the management of the company wishes to acquire the shares of the company, it is not sufficient that a committee of disinterested board members is established. It is an additional requirement that the committee operates independently and actively so that the arrangement is not merely a "rubberstamp" procedure, cf. the principle expressed in *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 at 1285 (Del. 1988). If, during the "auction", two bids are made which are identical, the target-management is probably entitled to choose one of the bids without having to continue the auction in order to obtain one highest bid, cf. *In re RJR Nabisco, Inc. Shareholders Litigation*, Fed. Sec. L. Rep. (CCH) 94,194 (Del. Ch., January 31, 1989).

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ness judgment rule if it, nevertheless, tries to “undo” his bid, cf. *Frantz Manufacturing Co. v. EAC Industries, Inc.*³⁵

In the text above, the focus has been on the duties of management owed to the shareholders. However, in several cases courts have stated that management may also take into consideration the interests of other constituencies, cf. *Ivanhoe Partners v. Newmont Mining Corp.*³⁶ In *Revlon, Inc. v. MacAndrews & Forbes Holdings Inc.*³⁷ the Delaware Supreme Court made it clear that taking into consideration other interests than the shareholders’ presupposes that the shareholders still reap some benefits. This probably means that the management may not fend off a takeover attempt which is in the interest of the shareholders with reference to the interests of employees or others. On the other hand, interests of such other constituencies may be taken into consideration to the extent that they do not conflict with the interests of the shareholders. Once an “auction” among active bidders is in progress, and the object no longer is to protect or maintain the business, the board may probably not consider non-shareholder interests.³⁸

In order to allow managements to observe the interests of other constituencies, some of the American states have stipulated in their state corporate statutes that such other interests should be taken into consideration when managing the company.³⁹

For a discussion of the business judgment rule and the other issues touched upon in the text, see Robert Charles Clark, *Corporate Law* p. 581 ff., Steven G. Bradbury, *Corporate Actions and Directors’ Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 Michigan Law Review 276 (1988), Jennifer Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 University of Pennsylvania Law Review 315 (1987), Dennis J. Block & H. Adam Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?* 37 Business Lawyer 27 (1981), and Easterbrook & Fis-

³⁵ 501 A.2d 401 (Del. 1985).

³⁶ 535 A.2d 1334 at 1341-1342 (Del. 1987). See also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 at 955 (Del. 1985) where the company’s creditors, customers, employees and society at large are mentioned as having interests in the company.

³⁷ 506 A.2d 173 at 182 (Del. 1986).

³⁸ 506 A.2d 173 at 182 (Del. 1986).

³⁹ See, for example, the Ohio General Corporation Law § 1701.59, which refers to the interests of employees, suppliers, creditors and customers as well as society, state and nation. See also the Missouri General and Business Corporation Law § 351.347, which, in addition, states that the financial circumstances of an acquiror as well as his experience, competence and integrity may be considered.

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chel, *The Proper Role of Target's Management in Responding to a Tender Offer*, 94 Harvard Law Review 1161 (1981). Easterbrook & Fischel express the view in the mentioned article that the business judgment rule is not a suitable standard in these situations because of the conflict of interests between the management and the company.

3.1.3. Situations not covered by the business judgment rule. The fact that the conditions for applying the business judgment rule are not met is not tantamount to the decision or act of management being invalidated by the courts. Provided that management is able to prove that the decision or act is "fair" the courts will uphold the decision or act even though a conflict has existed between the interests of management and the company and its shareholders.⁴⁰

In this context the fairness-test focuses on whether, in the circumstances, it was in the shareholders' interest to thwart the takeover attempt. The question is if it was reasonable to prevent a change of control at all while no attempt is made to analyze if management has wasted the company's funds. This point is illustrated by a sceptical comment made by Gilson in connection with a defensive repurchase of an acquiror's shares:⁴¹

"Management's conflict of interest was not in the price paid, but in the decision to acquire the shares at all. Applying a fairness standard to this decision, however, requires a court to determine whether it was "fair" for control to remain with management rather than shift to the offeror. And this inquiry must necessarily focus on whether the shareholders would be better off with existing management or by selling their shares. But this is an investment decision, made continually by shareholders in deciding whether to sell their shares, and raises the same issue of judicial competence which justifies a restrictive judicial role with respect to the duty of care."

Especially because of the burden of proof it is, as a practical matter, often difficult for management to convince courts that a decision was fair to the company and its shareholders, if it is clear that management had interests which were not shared by the company and the shareholders. This problem

⁴⁰ See *Treadway Companies, Inc. v. Care Corp.*, 638.F 2d 357 at 382 (2nd Cir. 1980). See also Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 Hastings Law Journal 377 at 394 ff. (1985).

⁴¹ Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers*, 33 Stanford Law Review 819 at 827 (1981). See also Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 Hastings Law Journal 377 at 395 (1985).

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is magnified because legal proceedings against a company's management will frequently be initiated by shareholders after the management has successfully defeated a contested takeover attempt which, if it had succeeded, would have provided the shareholders with a substantial profit in connection with the tender of their shares.

3.2. British law

3.2.1. Introduction

British companies are managed by a board of directors, cf. Section 282 of the Companies Act 1985 and *Palmer's Company Law* by C.M. Schmitthoff, Vol. 1, p. 875 ff. Under British law, there is no division of management into what is known in Denmark as the "bestyrelse" and the "direktion", cf. V.2.2. However, in large companies, in practice, the board of a British company usually appoints one or more managing directors who are in charge of the day-to-day management of the company, cf. *Palmer's Company Law*, Vol. 1, p. 915 ff. See also R.R. Pennington, *Company Law* p. 657 ff., about managing directors.

Under British law, like American law, management owes a duty of care as well as a duty of loyalty to the company.⁴²

Although the fiduciary duties owed by management to the company resemble the fiduciary duties known in American law, the law in Great Britain has developed in quite a different direction than has been the case in the United States, as will be seen later.

Ordinarily, British courts will not challenge the board of directors' judgment on business matters if the board has exercised its discretion to serve the best interests of the company.

Where the board is granted a certain discretion and the board's decisions and acts are made within the boundaries set forth by the law and the company's charter, the so-called "proper purpose doctrine" means that the courts will not make any second-guesses with respect to such decisions or acts, provided that the board did not exercise its discretion for an improper purpose. In this context, improper purposes are purposes others than those

⁴² See *Palmer's Company Law* by C.M. Schmitthoff, Vol. 1, p. 934 ff. and L.C.B. Gower, *Principles of Modern Company Law* p. 572 ff. The 9th of the General Principles of the City Code states that not only the interests of shareholders but also the interests of employees and creditors should be considered when the directors are giving advice to shareholders regarding a takeover offer. Although this indicates that the board should not exclusively protect shareholder interests, it is also clear that the body of rules contained in the City Code primarily focus on shareholder welfare.

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which management must pursue according to statutory and case law, cf. 3.2.2.⁴³

Unlike American law, management of a company has only limited powers to prevent or frustrate “hostile” takeover attempts without shareholder approval. While this is generally the case even before a takeover attempt has been initiated, the powers of management are further reduced in the event that a public offer for the company’s shares has been made or is imminent.

3.2.2. Before a public offer becomes imminent. In the leading case, *Hogg v. Cramphorn, Limited*⁴⁴ the board of a target-company established a trust for the benefit of the company’s employees as a response to a “hostile” bid for all of the shares of the company. The board members appointed themselves trustees of the trust and used an authority previously granted by the shareholders at a shareholders’ meeting to issue a large number of preferred shares to the trust. These shares had 10 votes per share and as a consequence of the board’s transaction more than 50 percent of the votes were allocated to “friendly” shareholders. Subsequently, a shareholder commenced legal action challenging the board’s defensive steps.

The court held that the board had used its powers to retain its control and thereby interfered with the rights of a shareholder majority to decide on the offer made. According to the court, this constituted an improper purpose.⁴⁵ The purpose of the authorization given by the shareholders to the board in *Hogg v. Cramphorn, Limited* was not to ensure that the board could remain in control and thwart bids for the company’s shares but rather to enable the board to raise further funds to the company by issuing new shares.⁴⁶

⁴³ See *Palmer’s Company Law* by C.M. Schmitthoff, Vol. 1, p. 940 ff. and Deborah A. De Mott, *Comparative Dimensions of Takeover Regulation*, in *Knights, Raiders, and Targets* p. 398 ff. at 409-410.

⁴⁴ (1967) Ch. 254 (1966) 3 W.L.R. 995.

⁴⁵ The court did not question the board’s good faith or motivation. The motive of the board had been to maintain a management structure they believed to be better for the shareholders, employees and the company than the changes likely to follow if the takeover offer succeeded. Good faith on the part of the board does not create a “safe harbor” if the board has pursued improper purposes.

⁴⁶ The case is discussed in *Palmer’s Company Law*, by C.M. Schmitthoff, Vol. 1, p. 940-941 and by Deborah A. De Mott, *Comparative Dimensions of Takeover Regulation*, in *Knights, Raiders, and Targets* p. 398 ff. at 409-410.

After the adoption of the City Code the result reached in *Hogg v. Cramphorn, Limited* is not too interesting from a practical point of view as regards target-management's role when a public bid has been made or is imminent, cf. the discussion about Rule 21 of the City Code under 3.2.3. However, the principle that is expressed in the case still provides guidelines for the evaluation of acts made by target-management prior to such public offer. In a somewhat similar case, *Howard Smith Ltd. v. Ampol Petroleum Ltd.*⁴⁷, the court also held that the issuance of new shares for the purpose of diluting the stockholding of an acquiror falls outside the purposes that the board may pursue.

Although most cases in which the courts have deemed that directors of a target-company have exercised the powers conferred upon them for improper purposes have dealt with issue of shares to defend against an unwelcome takeover attempt or to promote a welcome bid, the improper purpose test also applies to other defensive steps initiated by target-management.

A British management may thus not use the powers vested in it for another purpose to frustrate a "hostile" takeover attempt, thereby ensuring that incumbent management remains in control. Even if management succeeds in proving that its attempt to defeat a takeover bid was motivated by a desire to protect the interests of the shareholders and a belief that incumbent management was best fit to do this, a defensive step must still – in order to pass muster – fall within the purposes that management must pursue.

3.2.3. Once a public offer becomes imminent. Even though substantial restrictions pertain to the ability of management to adopt defensive measures before a public offer becomes imminent, further severe restrictions apply the moment that the target-board has reason to believe that a bona-fide offer may be imminent, cf. Rule 21 of the City Code.

During the course of an offer, or when an offer may be imminent, the board will have to obtain shareholder approval in order to take a number of frustrating actions, unless the board acts pursuant to an agreement entered into earlier.

The restrictions on management as mentioned above apply to the issue of any authorized but unissued shares as well as the issue or granting of options in respect of any unissued shares. This means that issue and sale

⁴⁷ (1974) A.C. 821 (1974) 2 W.L.R. 689 (P.C.). This case is discussed in *Palmer's Company Law*, by C.M. Schmitthoff, Vol. 1, p. 941 ff.

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of shares to a “friendly” third party can only take place if the shareholders approve.

Moreover, target-management may not issue securities, or allow the issue of securities, that may be converted into shares or that carry the right to subscribe for shares.

Target-management may not sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of any material amount. For the purpose of determining whether a disposal or acquisition is of a “material amount” the Take-over Panel will consider the value of the assets involved compared with the assets of the target-company, the aggregate value of the consideration to be received or paid compared with the assets of the target-company, and the net profits attributable to the assets to be disposed of or acquired compared with those of the target-company.⁴⁸

Finally, the City Code contains a general clause according to which shareholder approval is required for entering into any contract otherwise than in the ordinary course of business. According to the practice of The Take-over Panel, target-litigation for the purpose of defeating a contested takeover would also be contingent upon shareholder approval.⁴⁹

Rule 21 is supplemented by Rule 37.3 of the City Code, according to which the target-board may not redeem or repurchase target-shares without shareholder approval under circumstances similar to those described in Rule 21. Lately, repurchase of shares has been used by a number of British companies, perhaps influenced by American investment banks.⁵⁰

The provisions of Rule 21 of the City Code should be viewed in conjunction with the seventh of the general principles of the City Code, according to which the target-board may not take any action on its own which could effectively result in any bona fide offer being frustrated or in the shareholders being denied an opportunity to decide on its merits once an offer becomes imminent. The principle reflects the underlying rationale behind Rule 21, namely that the target-shareholders – not target-management – must decide whether or not to accept the offer.

⁴⁸ See the Note on Rule 21 of the City Code.

⁴⁹ See the discussion of the litigation initiated by Minorco against Consolidated Goldfields by Robert Falkner, *Consgold: More questions than answers?*, International Financial Law Review, p. 13 ff. (July 1989).

⁵⁰ Within the last few years a number of American investment banks have established offices in London. These banks have brought with them know-how, including a variety of defensive techniques, see the description hereof by Claire Makin, *The Americanization of British M&A*, Institutional Investor, p. 41 ff. (October 1988).

The result of the restrictions imposed on target-management is that there is very little room for defensive steps once a public offer may be imminent. The board will have to submit defensive plans for shareholder approval and the City Code thereby ensures that it is the shareholders who decide whether to sell their shares.

However, the City Code does not entail that target-management must remain passive. It is frequently seen that target-management finds a friendly third party who then makes a competing bid for the target-shares. Also, management may make proposals to the shareholders, for example for the purpose of arranging for the merger of the company with such friendly third party.

The fact that only limited means are available for target-management has led to many “battles” being fought in British newspapers where target-management and the acquiror try to persuade the shareholders to follow their respective views. While statements made in such contexts are often quite hostile and explicit, Rule 20 of the City Code provides that no statement may be issued which, while not factually inaccurate, may mislead shareholders and the market, or may create uncertainty.

In addition to the restrictions that the City Code imposes on a target-management facing a public offer, the City Code contains provisions designed to ensure that target-shareholders receive sufficient information and advice to enable them to reach an informed decision.⁵¹ The Code specifically stipulates that the target-board must obtain competent, independent advice on any offer and further states that the substance of such advice must be communicated to the shareholders of the target-company.⁵²

Moreover, the target-board must circulate to the target-shareholders its views on the offer.⁵³ If relevant, the target-board should comment upon the statements in the offer document regarding the acquiror’s intentions with respect to the target-company and its employees.⁵⁴

4 Danish law – revisited

4.1. Introduction. The American and the British approach discussed above represent two different ways of handling the issues relating to the role of corporate management in the takeover context.

⁵¹ See the fourth of the general principles of the City Code.

⁵² See Rule 3.1 of the City Code.

⁵³ See Rule 25.1 of the City Code.

⁵⁴ See Rule 25.2 of the City Code.

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One of the principal features of American law in this area is the application of the business judgment rule to transfer of corporate control. Generally, a decision made by management facing a takeover attempt is viewed and treated as any other business decision. Another notable feature of the American system is the absence at the federal level of special provisions pertaining to situations where a takeover bid is made or is imminent.

By contrast, the British approach seems to presuppose that there is a potential conflict of interest between the company and its management. The “proper purpose test” seeks to motivate management not to use means at its disposal meant for other purposes to inhibit or thwart takeover attempts. Moreover, the rules of the City Code are based on the assumption that when a public offer is imminent, a conflict of interest is inevitable for which reason management may not frustrate the takeover attempt without obtaining shareholder approval.

With these two approaches as a starting point we will now revert to the similar issues under Danish law.

4.2. The business judgment rule and the proper purpose test. It is a weakness inherent in the business judgment rule that, as a point of departure, it assumes that no conflict of interest exists between target-management and the company. According to American case law the rule is only applicable where no conflict of interest exists. But is it not a fact that there always is a potential conflict of interest when management is exposed to the risk of losing its position, area of responsibility and compensation while target-shareholders may reap economic benefits in connection with a sale of their shares? How can management be expected to pursue shareholder interests when the temptation not to do so is so great?

Easterbrook and Fischel are among the most serious critics of the use of the business judgment rule in the takeover context. They argue that the presumption that management will make decisions which maximize shareholder welfare has never been applied where acute conflicts of interest arise, as in contested tender offer situations. Also, they state that the rationale underlying the rule, i.e. the inability of courts to make better decisions than managers, is inapplicable to the takeover context.⁵⁵

⁵⁵ See Easterbrook & Fischel, *Takeover Bids, Defensive Tactics and Shareholders' Welfare*, 36 *Business Lawyer* 1733 at 1745-1747 (1981) and Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 *Harvard Law Review* 1161 at 1194 ff. (1981).

The arguments made by Easterbrook and Fischel are persuasive and it is, at least, very doubtful whether the business judgment rule is a suitable standard to evaluate management's behavior in this context.

The proper purpose test known from British case law and from the dissenting opinion in *Lorentzen v. A/S Schweitzers Bogtrykkeri* (U1934.1081, W. Cir.) seems to be a more adequate standard by which to evaluate acts by management. However simplistic it may be, this rule is founded on the notion that authorities granted to management should only be exercised in accordance with the purposes for which they were granted. Powers to increase a company's share capital may only be exercised if this is done for the purpose of providing fresh capital while it may not be used as a defensive device. The proper purpose test is appealing because it recognizes the inherent conflict of interest which exists when management faces a potential change of control.

However, one may object that even though the circumstances will often show what the "proper" purpose is, it may sometimes be difficult to determine if management has pursued an improper purpose.

This leads us to a discussion of what interests should be promoted and protected by management.

4.3. What interests may be pursued by management?

4.3.1. **Introduction.** In the takeover context the question of what interests may be pursued by management is critical since the answer to the question determines if or to what extent target-management may defeat a "hostile" takeover attempt with reference to, for example, a desire to keep the shares of the company on Danish hands or the danger that jobs will be lost as a result of the takeover.

It is implied in the Companies Act that management must not only serve shareholder interests but also protect the interests of the company, see e.g. the reference in § 54, Subsection 1, to the affairs of the "company". See also § 63. While determining the shareholders' interests raises few conceptual problems, more uncertainty is attached to the reference to the interests of the company.

There is no doubt that some of the provisions of the Companies Act aim at protecting other interests than those of the shareholders. Members of the board or managers who cause damage to creditors of the company due to negligence or intent are thus liable pursuant to § 140 of the Act.

Also, in addition to the general culpa-rule, a large number of laws impose on management obligations to meet other standards or requirements to the effect that if such standards or requirements are not met, the com-

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pany and/or management may face criminal or civil sanctions. Environmental laws and laws on workers' protection could be mentioned as examples of this.

Leaving aside the situations where it is clearly stated or accepted that management owes a duty to others than the shareholders, the question is if management may use its discretion and powers to pursue other goals or take into account other factors than those which serve the shareholders' interests.

4.3.2. The role and responsibilities of companies – the Anglo-Saxon debate. Although sometimes referred to anthropomorphically⁵⁶, a company is nothing but a legal structure. It possesses no "mind" and pursues no interests of its own. All it can do is to represent and be the instrument of its stakeholders, whoever they are.⁵⁷

Determining the stakeholders is the very core of the problem, however. To whom owes management a duty? To the shareholders, to the employees or creditors, or perhaps society at large?

By attempting to answer these questions we, in effect, also propose the role companies should play in society.

Many conceptions have developed as regards the proper role of companies in society, especially among Anglo-Saxon scholars. Since the issue is the same as under Danish law, we will consider some of these theories before we turn to the Danish corporate stage.

In their article *Corporate Wealth Maximization, Takeovers and the Market for Corporate Control*, Nationaløkonomisk Tidsskrift No. 1/1990, p. 79 ff., Arthur Stonehill and Kåre B. Dullum assert that Anglo-American corporate markets pursue so-called "Stockholder Wealth Maximization" ("SWM"), while in non-Anglo-American markets the notion of "Corporate Wealth Maximization" ("CWM") prevails. The SWM model, as defined by Stonehill/Dullum, basically assumes that the single goal of a company is to maximize the shareholders' return for a given level of risk, whereas the CWM concept presupposes that a company – due to the existence of several constituencies – has several goals. The problem of the Stonehill-Dullum article is that it presents an overly simplified picture of the roles companies are viewed as having in Anglo-Saxon and non-Anglo-Saxon countries, respectively. Also, as we shall see below, the dif-

⁵⁶ See, for example, the terminology used by John Kenneth Galbraith in his book, *The New Industrial State* p. 75 ff.

⁵⁷ The nature and characteristics of legal entities are described by Gomard, *Hovedpunkter af selskabsretten* p. 10 ff.

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ferences in the present conception of companies in the two categories of countries may not be that great after all.

The traditional view of the goal of the modern company has been that it should pursue long-term profitability. In the words of probably the most prominent supporter of this view, professor Milton Friedman:

“...there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”⁵⁸

The profit maximization model does not suggest or imply that the interests of others than shareholders do not matter. The regulatory framework within which a company operates imposes on the company several restrictions in order to protect and promote the interests of others, e.g. employees and creditors.⁵⁹

One of the earliest court decisions addressing the issue of corporate social responsibility, the landmark-case *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919) is frequently referred to as representing the proposition that the only goal of companies is to pursue profit maximization. In the case Henry Ford, who owned 58 percent of the shares of Ford Motor Co. and controlled its board, exercised his control to have the company cease paying any special dividends on top of the regular dividend of USD 1.2 million. When Mr. Ford took this step, Ford Motor Co. had a surplus of USD 112 million, including USD 52.5 million in cash. Ford explained his step by stating: “My ambition is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes”. Among the minority shareholders of Ford Motor Co. were the two Dodge-brothers who filed a suit against the company to compel it to increase the dividend payments. The court accepted the point made by the Dodge-brothers and ordered Ford Motor Co. to increase the dividend payments to USD 19.3 million, which was approximately equal to its cash surplus at the time of Henry Ford’s announcement, adjusted by special dividend payments made between the announcement and the filing of the lawsuit. Although the case could be viewed as supporting the “pure” profit maximization model, it could also be construed as having as its prime focus the abusive behavior of one (controlling) shareholder against the others. One thing is to exercise one’s control in a way that makes the company conduct altruistic activities at a reasonable level, but it is something quite different if altruism leads to dividend payments at an extraordinarily low level. It is probably hard for most minority shareholders to accept that they will have to starve because the majority shareholder wishes to increase his philanthropic contributions.

⁵⁸ See Milton Friedman, *Capitalism and Freedom* p. 133.

⁵⁹ See Robert Charles Clark, *Corporate Law* p. 678.

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Many scholars have challenged the profit maximization model as a proper standard for determining the corporate goal. Professor Neil W. Chamberlain has thus made the following statement:

“The corporate responsibilities which most concern us as a society are not those running to shareholders but to other segments of the public and to society as a whole. One can, perhaps, subsume the latter under the former by invoking the magic but meaningless incantation of long-run profit maximization. That decision-principle, if indeed it can be dignified as such, can be made to justify almost any policy except liquidation of the corporation, depending on the picture one draws of what the long term will look like and the road leading to it.”⁶⁰

According to an alternative school of thought the primary goal of a company is the growth of its business. In the words of John Kenneth Galbraith:

“This is the goal that commends itself most strongly to the self-interest of the technostucture.

..... The paradox of modern economic motivation is that profit maximization as a goal requires that the individual member of the technostucture subordinate his personal pecuniary interest to that of the remote and unknown stockholder. By contrast, growth as a goal is wholly consistent with the personal and pecuniary interest of those who participate in decisions and direct the enterprise.”⁶¹

Profit maximization and corporate growth theories are well-known conceptions of what ought to be the goals of companies. However, the prevailing view in Anglo-Saxon countries seems to present a more varied picture. Perhaps this is best illustrated by the following statement by E. Merrick Dodd, made in 1932:

“...there are indications that even today corporation managers not infrequently use corporate funds in ways which suggest a social responsibility rather than an exclusively profit-making viewpoint The view that directors may within limits properly use corporate funds to support charities which are important to the welfare of the community in which the corporation does business probably comes much nearer representing the attitude of public opinion and the present corporate practice than does the traditional language of courts and lawyers. Nor are there wanting signs of the adoption of more liberal attitude by legislatures and judges.

... Such a view is difficult to justify if we insist on thinking of the business corporation as merely an aggregate of stockholders with directors and officers

⁶⁰ See statement by Neil W. Chamberlain in *The Greening of the Boardroom: Reflections on corporate responsibility*, (fourteenth annual Columbia law symposium), 10 Columbia Journal of Law and Social Problems 15 at 36 (1973).

⁶¹ See John Kenneth Galbraith, *The New Industrial State* p. 179-180.

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chosen by them as their trustees or agents. It is not for a trustee to be public-spirited with his beneficiary's property. But we are not bound to treat the corporation as a mere aggregate of stockholders. The traditional view of our law is that a corporation is a distinct legal entity."⁶²

Although Dodd recognizes that there are more stakeholders of a company than merely the shareholders, he still agrees that profitmaking for absentee-owners "must be the legal standard by which we measure (managers') conduct until some other legal standard has been evolved".⁶³

The point made here is further illustrated by the principles for corporate governance, proposed by the American Law Institute⁶⁴:

"§ 2.01 The Objective and Conduct of the Business Corporation.

A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business

- (a) is obliged, to the same extent as a natural person, to act within the boundaries set by law,
- (b) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business, and
- (c) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes."

The ALI-proposal suggests that profit maximization is the chief goal of a company, whereas some deviations from this goal are permissible.

Back in the mid-fifties, professor L.C.B. Gower in his article *Corporate Control: The Battle for the Berkeley*⁶⁵ indicated that the public opinion in England seems to support the view expressed by professor Dodd. It is thus widely accepted that management owes a duty to the shareholders but may, within certain limits, take into consideration the interests of others e.g. labor and society as well.

⁶² See Dodd, *For Whom are Corporate Managers Trustees?* 45 Harvard Law Review 1145 at 1158-1160 (1932).

⁶³ See Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 University of Chicago Law Review 194 at 206 (1934).

⁶⁴ See American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, Tentative Draft No. 2, 1984, § 2.01.

⁶⁵ 68 Harvard Law Review 1176 at 1190 (1955).

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It is probably fair to say that the picture drawn by the ALI-proposal represents a very, and perhaps the most, widely held view on corporate governance today, at least among Anglo-Saxon scholars.⁶⁶

4.3.3. Danish law – proposing a model. The question I want to address now is how the above widely held view on corporate responsibility in Anglo-Saxon countries fits into what we believe is the proper role of companies under Danish law.

In the following I will try to show that the views expressed by Dodd and the ALI (as stated above) provide very helpful guidance in connection with our attempt to find proper solutions to the similar issues under Danish law.

Under Danish law – as opposed to what is the case in Anglo-Saxon law – the role of management vis-a-vis the company's shareholders is not considered to be that of a fiduciary.

However, contrary to what some commentators believe, concluding that a fiduciary duty exists for management does not in itself give an answer to what exactly is management's responsibility. As stated by Justice Frankfurter, in *Securities and Exchange Commission v. Chenery Corporation*, 318 U.S. 80 at 85-86 (1943), "to say that a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations?"

Let us initiate our inquiry by considering the function of a company.

A company is, arguably, nothing but a function of the joint interests of all the shareholders. The choice of using a corporate structure rather than, for example, a partnership, does not change the fact that nobody has as strong an interest in the company as the shareholders. Narrowly stated, the collective interests of the shareholders of a company could be expressed as a reference to the objectives of the company.⁶⁷

Focusing on companies in general, as we saw under V.2.3., it is in the common interest of shareholders to maximize the value of their equity investment. This goal resembles the aim of long-term profit maximization referred to above, except that it specifically includes not only profits in a

⁶⁶ Not all commentators agree that the ALI-proposal reflects the reality of today, see e.g. Comment, *Corporate Ethics and Corporate Governance: A Critique of the ALI Statement on Corporate Governance Section 2.01(b)*, 71 California Law Review 994 (1983) dealing with an earlier draft ALI-proposal.

⁶⁷ See also Rolf Dotewall, *Skadeståndsansvar för styrelsesledamot och verkställande direktör – en aktiebolagsrättslig studie i komparativ belysning* p. 357-360.

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narrow sense but also gains in the value of the equity investment. For the sake of accuracy, we will use the term “shareholder wealth maximization” in the following when describing the shareholders’ interest.

If we use the above functional approach and assume that references to interests of “the company” are, in effect, references to the collective interests of shareholders (contrasted with each single shareholder’s interests), we reach the conclusion that the company should have as its goal to maximize its shareholders’ wealth. But what then about other constituencies that have an interest in the company? Should we rather determine the interests of “the company” as a reference to the interests of any stakeholder of the company and then attempt to define who is a stakeholder?

It is true that the shareholders are those who are the residual claimants to the company’s assets and thus will lose their investment if the company goes bankrupt and reap the profits if the company operates successfully. But it is equally true that the employees and to a certain degree the creditors of a company have an interest in its future. Although employees typically do not hold shares of the company, they probably feel that their employment with the company gives them a very tangible interest in the company and its future. Losing one’s job will be considered by most individuals as a very serious matter not only financially but also personally. Following the same line of thought it could, although perhaps less forcefully, be argued that the creditors of the company ought to have their interests promoted by the company’s management. If the company operates with losses, or perhaps even goes bankrupt, the losses incurred by the creditors may be just as big and just as tangible as those which the shareholders experience. The same could be said to apply to the interests of a local community which benefits from the jobs and revenues generated by the company.

Leaving corporate managements with very broad powers to consider other interests than those of the shareholders poses some serious problems, however.

One problem is that very broad powers would make it very difficult to hold management accountable for its acts. For example, how can we challenge a policy that has been adopted to benefit a local community but is bad for shareholders? What if the interests conflict, what interest should prevail? Would it be possible at all to create a framework within which management must manage the company?

Another aspect is that such a system would give rise to much uncertainty as regards the position of the shareholders. Shareholders would never know if management had made a “trade-off” in favor of some

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loosely defined public interest and to the disadvantage of the shareholders. To the extent that it becomes more uncertain to be a shareholder, it is likely that many investors would be reluctant to invest in the stock market. This would, in turn, make financing more expensive for companies, since money would become a scarcer commodity.

The concerns raised here suggest that granting management broad authority to consider multiple interests may not be the best means of pursuing such interests. Rather than leaving such broad powers with management, it may be preferable – as is done to a wide extent already – to have the legislature protect the interests of employees, creditors and society at large by means of regulation. Doing so would narrow down the field of uncertainty discussed here.

The point I want to make is not that management should forget about interests of other groups than the shareholders. But it is suggested that pursuing maximization of shareholder wealth ought to be the prime objective of management and that, by and large, management's acts should be made to achieve this end.

Maximizing shareholder wealth is a standard which carries with it sufficient flexibility to allow management to consider the well-being of employees as well as the interests of creditors and society. Even if management treats employees in a way which is not optimal from a short-term cost-benefit viewpoint, or, for example, contributes to the local community without assurance that the contribution will lead to benefits of any kind for the company and its shareholders, such acts can frequently be justified because they are likely to promote the long-term interests of the company and thus the shareholders. Employees who are satisfied because they are offered attractive terms of employment typically do a better job than people who have less attractive terms, and this difference may benefit both the company and its shareholders in the long run. Contributions to the local community may create goodwill which may benefit the company on a long-term basis. We should not make it a requirement that each single act by management must lead to some tangible benefits to shareholders. What is important is that, viewed in their context and as a whole, management's acts serve the interests of shareholders not only on a short-term basis but also in the long run.

In sum, the advantage of applying the shareholder wealth maximization standard proposed here is thus that it provides a comparatively clearly defined goal for management and, by the same token, establishes a useful standard for evaluating managerial acts. Although I recognize that it is difficult to identify the borderlines of managerial authority, I believe the

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standard proposed here puts a “cap” on the extent to which interests of other groups than shareholders may be pursued.⁶⁸

As we saw earlier, the Danish Companies Act creates a framework for the pursuit of shareholder interests. Consistently with the thoughts expressed here, it is generally accepted among Danish legal authors that management may take into consideration factors other than those that only relate to shareholders’ interests. Management may thus consider the impact of a decision on the employees and their jobs.⁶⁹ Moreover, management may take into account other interests which benefit the public good rather than the shareholders. Management may also, within reasonable limits, grant gifts on behalf of the company for the benefit of the public good although they may be unable to prove that the gifts create goodwill for the company or otherwise benefit shareholders.⁷⁰ There is probably no basis for shareholders to hold management liable for pursuing interests other than those strictly connected to the interests of the shareholders.

The question is, however, how far management may go if pursuit of other interests conflicts with the interests of the shareholders. There is no case law that provides a bright line between events where pursuit of other interests than the shareholders’ is acceptable and situations where pursuit of such other interests violates management’s duties owed to shareholders.

Gomard gives an example of how a conflict between profitability and other goals may arise.⁷¹ If a company receives a takeover offer from a foreign acquiror, Gomard suggests that the board may, at least to a certain extent, consider the interest in keeping the company on Danish hands without being subject to liability. This is, similarly, the case, according to Gomard, in events where the company is aware that it may be possible to procure more favorable purchase offers from foreign acquirors.

There is hardly any doubt that the prevailing view among Danish courts is that there is an area within which the board, when exercising its discretion, may consider national interests or other factors that benefit the public good. However, we still face the difficult problem of determining how far the board may go in this respect.

⁶⁸ See also the discussion by Eugene V. Rostow in his thoughtful article *To Whom and for what Ends is Corporate Management Responsible?* in *The Corporation in Modern Society* (Edward S. Mason, ed.) p. 46 ff.

⁶⁹ See Gomard, *Ugeskrift for Retsvæsen* 1971.B 117 at 132.

⁷⁰ See Gomard, *Ugeskrift for Retsvæsen* 1971.B 117 at 132, note 48, and § 114 of the Companies Act.

⁷¹ See Gomard, *Ugeskrift for Retsvæsen* 1971.B 117 at 132. See also the discussion by Gomard at the 29th Nordic Jurist Meeting, 1981, Part I, p. 367-368.

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As long as the board and the managers in all important matters protect and serve the interests of the shareholders (as determined above) in connection with the management of the company there is little need to impose further restrictions on them. Ordinarily, the shareholders should not interfere in the specific policies or decisions made by management but will have to accept that management exercises discretion as long as the focus is on managerial issues. After all, management is hired to run the business and this includes making business decisions. If the shareholders, nevertheless, deem that management exercises its discretion in an unsatisfactory way but still not in a fashion that would constitute a breach of management's duties, they may, at any time, remove the board and thereby indirectly also the managers.

However, the scenario is quite different in the event where management faces a change of control and gives priority to e.g. the desire to keep the company on Danish hands or to maintain jobs irrespective of the fact that this cannot always be reconciled with the interests of the shareholders in receiving a premium price for their shares.

While it makes sense from a legal and business point of view to grant the board and the managers flexibility in connection with managerial issues, there seems to be less reason to accept such flexibility in the event that a takeover attempt is being made or is imminent. The decision whether to sell the shares or not is first and foremost an investment decision and not a managerial issue.

On the basis of the observations made here it is submitted that it is relevant to distinguish between managerial issues, in a broad sense, and questions relating to changes of corporate control.

Ordinarily, national interests and the desire to protect jobs are laudable factors to consider, which frequently do not conflict with shareholder interests. However, the potential conflict between the interests of shareholders and these other interests is substantial and has farreaching ramifications for the shareholders in the takeover context.

The argument I want to make here is that the existing principles of the Companies Act support the view that in these instances the shareholders should have an opportunity to consider the bid.

§ 134 e, Subsection 1, of the Companies Act pertaining to mergers thus provides that as regards the dissolving company a merger resolution must be passed at a shareholders' meeting. Since, from the viewpoint of the shareholders of this company, the merger may constitute an important change in their investment, they should decide if the proposal to merge should be adopted or not. Similarly, § 116, Subsection 1, of the Compa-

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nies Act provides that, as a general rule, the shareholders and not management resolve whether or not to liquidate the company.

It should be noted that the board is granted no right to veto merger resolutions or resolutions to liquidate the company.

Perhaps it may be argued that the Companies Act grants the board powers in situations that are not strictly confined to managing the company, and that this suggests that no distinction is relevant as proposed here. For example, according to § 134 e, Subsection 2, it is the board of the surviving company – and not the shareholders – who decide on the merger of the company. This is not a very persuasive argument, however. It is correct that deciding whether or not a company should merge is not a managerial issue in the strict sense. But it ought to be noted that often a merger has a limited impact only on the shareholders of the surviving company, who, therefore, frequently view the transaction like any other managerial act. This is not always the case, however, and, in order to protect the shareholders' interests, shareholders who represent 5 percent of the share capital of the company have a right to demand that the resolution be passed at a shareholders' meeting, cf. § 134 e, Subsection 2, of the Act. The mechanism provided for in § 134 e, Subsection 2, actually supports the view that changes of corporate control is a matter that should be decided on by the shareholders and not by management.

The underlying principle behind the above quoted provisions of Chapters 14 and 15 of the Companies Act dealing with liquidation and mergers, respectively, is that decisions of material importance in connection with the shareholders' investment in the company must be made by the shareholders and no one else.

The decision whether to sell one's shares is not a collective shareholder decision like those made pursuant to Chapters 14 and 15 of the Companies Act. However, the fact that the sales decision is an individual decision rather than a collective one does not make the principles expressed in those two chapters less applicable. On the contrary, the chapters on liquidation and mergers clearly support the viewpoints presented here, and there seems to be even less reason to allow management to interfere in each shareholder's decision as to whether or not he should sell his shares.

From this conclusion it follows that in the takeover context the board of a target-company should only pursue interests of others than shareholders if this does not conflict with shareholder interests. It is always a condition, however, that the laws pertaining to the company's business and the provisions of the Companies Act protecting the interests of creditors and others have been duly observed.

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The target-board should not be allowed to defeat a takeover attempt on its own, even if it suspects that the acquiror may liquidate and close down the company's business after the acquisition. Similarly, the target-board should not be allowed to attempt to halt a takeover bid with or without a premium price even though the bid is made by a foreign acquiror with whom the board does not sympathize.

There may be situations where the target-board believes that the bid has been made to manipulate the market for the target-shares. Also, a bid may be of such a nature or be made in such circumstances that it should be expected to harm the shareholders or some of them.

The question is if we should allow the target-board to defeat a takeover attempt on its own in events where it deems that an offer cannot be characterized as bona fide. Although it may seem appealing to allow the target-board to create impediments to the takeover attempt in such situations, we should not forget the inherent conflict of interest discussed earlier. If we leave it up to the board to determine if a takeover attempt is bona fide or not, we must expect, as we have seen in the United States, that many takeovers will be followed by legal disputes on whether the board breached its duties when it defeated a takeover attempt. One of the prime reasons for this is probably that boards frequently have a different perception of what is bona fide than at least some of the shareholders. Therefore, rather than giving the target-board the right to veto takeovers in these instances, the preferable solution is to impose on the target-board a duty to inform the target-shareholders and the Copenhagen Stock Exchange immediately and, if necessary, have a shareholders' meeting convened.

The above comments do not suggest that management should be voiceless and should not express its views with respect to a takeover attempt. It may certainly recommend that when considering whether or not to accept the bid target-shareholders take into account the effects that the acquisition may have on jobs, Danish national interests, etc. But target-management's statements in this connection should be restricted to a guidance or recommendation to the shareholders and not an attempt to defeat the bid.

4.4. Target-management's specific rights and obligations. On the basis of the proposed standard for managerial behavior in the takeover context, the focus in the following will be on determining the borderlines for what management may do and must do.

Applying the general principles pertaining to management's duties to the takeover context, the target-board must establish a reasonable basis for the target-shareholders to decide whether or not to sell their shares.

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Typically, the decision to be made by the shareholders of the target-company as to whether or not to sell their shares will not only depend on the price and terms and conditions offered, but also on the expectations that the shareholders may have with respect to the future of the company. For this reason the target-board's views of an offer, including the price offered, and, not least, its expectations and plans regarding the company and the value of its shares, are material. Therefore, it seems reasonable to impose on target-board a duty not only to remain passive upon the occurrence of a contested offer, but to make a statement regarding the offer. This does not necessarily mean that the target-board must in all circumstances express itself in favor of or against an offer. If the target-board does not feel in a position to determine whether or not an offer should be accepted, it is probably its right and its obligation to communicate this to the shareholders of the target-company and explain the background of the board's position. Except for these particular cases, where the board does not feel in a position to make a decision with respect to the offer, it is not in the interest of shareholders that the board remains neutral. Shareholders should be advised as soon and as far as this is possible, and the board should not be allowed to free itself from such duty owed to the shareholders. In order to ensure that all shareholders benefit from the advice by the target-board, and receive it at a proper time, it ought to be communicated to them in writing and through the mass-media.

Any statements by management should be correct, relevant, and not misleading.

To provide the best possible basis for decision the target-board must have a duty to disclose to the shareholders any information known to it and material to the shareholders in deciding on the offer. Examples of this include voting arrangements agreed upon between the acquiror and the target-company, and the target-company's holdings of acquiror-shares.

The Draft Takeover Directive, Article 14, would impose on the board of a target-company to draw up a document containing its reasoned opinion on the bid. The document must specify if the target-board is in agreement with the acquiror (and further specify any agreements on the exercise of the voting rights attached to the target-shares to the extent such agreements are known to the board). To the extent members of the board of the target-company hold target-shares, they must indicate if they intend to accept the offer.

The requirements set forth in the Draft Takeover Directive fail to address questions regarding the obligation of target-management to act loyally to the shareholders, cf. the comments made below.

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The Draft Takeover Directive, Article 19, includes an obligation for the target-board to communicate to its employees' representatives, *inter alia*, the offer document and the document prepared by the target-board. It is not a requirement under Danish law that the employees of the target-company consent to a transfer of control and it is thus not clear what effect this provision would have in Denmark, if adopted.

The British City Code⁷² imposes on the board of a target-company a duty to obtain competent independent advice on any offer and further states that the substance of such advice must be made known to the target-shareholders. There is probably no need for making it an absolute requirement under Danish law that the target-board retain independent advisors, although boards may often, as a practical matter, elect to do so in order to be fully acquainted with e.g. the financial or legal aspects of a takeover attempt.

When analyzing the action that may be taken by the target-board pursuant to the standard developed above, the decisive test is if the acts by management are likely to bar an offer from being made or from being accepted by the target-shareholders or merely ensure for the shareholders a fair and reasonable basis for deciding, but perhaps lead to a delay of the offer.

The target-board must not interfere in the shareholders' decision of whether or not to sell their shares by, for example, creating impediments for the making of a contested offer or for the acceptance of such offer.

On the other hand, it is a right as well as an obligation for the target-board to obtain additional information or explanations from the acquiror regarding the offer if this is necessary to ensure that the shareholders' decision is made on an informed and legal basis. It is probably the duty of the target-board to clarify questions of doubt in connection with an offer made, including regarding the acquiror's motives or plans. If the acquiror does not provide the necessary information, the target-board may and should have a duty to inform the shareholders about this. In such event the target-board should be entitled to await the further information before making a statement about the offer, provided that the missing information is of a material nature in the context of the shareholders' decision.

If the target-board has reason to believe that an offer was made for the purpose of manipulating the market for the target-shares or for other abusive purposes, it should be the duty of the board to advise the target-share-

⁷² See Rule 3.1.

holders and the Copenhagen Stock Exchange about this immediately, as mentioned earlier.

The duty of a board to protect the interests of the shareholders can hardly be extended to include an obligation for a target-board to make efforts to find alternatives to a contested offer, even though it advises the target-shareholders not to accept the offer. On the other hand, however, the target-board is free to procure offers from other prospective buyers, provided that such step is made with due respect for the interests of the shareholders. The target-board may also propose to the shareholders restructurings of the target-company's business, for instance, in order to boost the price of the company's shares.

The board has a duty to act in the best interest of, and be loyal to, the company's shareholders. In case of conflicts of interest, the board must give priority to the company's and shareholders' interests. To the extent that the Companies Act allows the board to act on its own without shareholder approval, it must, upon the making of a takeover offer, exercise its discretion pursuant to the interests of the shareholders rather than its own interests.⁷³

According to § 58 of the Companies Act a board member or manager may not take part in discussions regarding agreements between the company and the member of the board/manager if he has a material interest that may conflict with the interests of the company.

If some board members have such a conflicting interest, the remaining members of the board must decide in the matter. If the entire board has this conflict of interest, it will be the duty of the board to take the steps necessary in order to avoid the conflict. Depending on the circumstances, this may lead the incumbent board to resign and arrange for a new board to be elected, or see to it that the issue be submitted to the shareholders for them to decide.

⁷³ In connection with the division of the powers between the shareholders and the board it is the general principle that only matters which according to the Companies Act or the company's charter are shareholder matters, must be dealt with by the shareholders at a shareholders' meeting. However, legal commentators have held that the board may be compelled to obtain the approval of the shareholders in certain other situations where, for example, a proposed action will change the entire nature of the business of the company (e.g. a sale of the company's activities) or otherwise have a crucial impact on the financial position of the company. See Gomard, *Aktieselskabsret* p. 312 f., Gomard, *Aktieselskaber og anpartsselskaber* p. 151 ff. and Werlauff, *Generalforsamling og beslutning* p. 97 ff.

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The question of whether or not target-shareholders should accept a contested offer does not involve target-management as a contractual party, and § 58, therefore, does not apply to the offer itself.

However, if a third party, e.g. a prospective acquiror, grants the target-board benefits or favors contingent upon the board's support of a takeover bid, such benefits or favors must be disclosed to the shareholders. Following the principle in § 58, which is to avoid conflicts of interest influencing the outcome of corporate decisions, it must be a duty of the board to inform the shareholders about any special circumstances that lead to or may lead to the board's decisions or approvals being motivated by its personal interests. The target-board must probably also disclose acts or statements made by the acquiror which show that, if successful, the acquiror plans to remove incumbent management. Information of this nature is likely to give the shareholders of the target-company an impression of the conflicting views that may exist between the acquiror and the target-board and which may influence the target-board's attitude towards a bid.

Typically, the decision of whether or not to sell the shares will be an investment decision based, in particular, on the price offered, while the target-board may have personal or other reasons for not merely focusing on the price offered. Only by imposing on the target-board the above disclosure obligations is a basis provided that ensures that the target-shareholders are fully familiar with the motives behind the board's position with respect to an offer.

If an acquiror communicates his bid for the target-company's shares to the target-board rather than the target-shareholders, e.g. because it is not clear that the target-board will consider the takeover attempt "hostile", the target-board may not delay the bid by failing to inform the shareholders about the bid. The Information Obligations for Issuers of Listed Securities contain in § 13 a duty for listed companies to disclose information immediately on "essential circumstances relating to the company which may be assumed to be significant to the pricing of the securities". In the official comments on § 13, public bids made for the shares of a company are not included among the examples given. However, the making of a bid for a company's shares will almost inevitably have an impact on the price of the company's shares and therefore be covered by § 13. It would have been useful if the making of a bid for the shares of a listed company had been

mentioned in the examples provided in the official comments on § 13, not least considering the practical importance of such bids.⁷⁴

The duty on the part of the board to act in a loyal manner must be exercised equally vis-a-vis all shareholders. The board may not act to the advantage of certain shareholders at the expense of others, cf. § 63 of the Companies Act.⁷⁵

We have seen how the British City Code imposes particular restrictions on the target-board once a public bid has been made or is imminent.

The Draft Takeover Directive, Article 8(1), contains restrictions of the powers of a target-board that are clearly inspired by the British City Code. It is thus stated that the target-board may not issue securities (as defined) without shareholder approval from the moment it is informed that an acquiror has decided to make an offer and until the result of the bid is made public. Moreover, the board may not without such approval engage in transactions which would have the effect of “altering significantly the assets or liabilities of the company or resulting in the company entering into commitments without consideration”, unless the supervisory authority authorizes such transactions, giving its reasons to do so. Also, the board may not on its own have the company acquire its own shares. Article 8(2) – probably chiefly as a matter of order – stipulates that the target-board may call for a shareholders’ meeting during the acceptance period. The board may elect to do so in order to obtain shareholder approval of specific takeover defenses.

The question here is if the rights and obligations of the target-board as outlined above create sufficient protection of the shareholders against the board’s possible acts in violation of shareholder interests. Due to the inherent conflict of interests, the target-board should not be allowed to prevent or inhibit future takeovers even though no concrete threat exists. Priority must be given to the shareholder interests, and it must thus always be the shareholders who decide whether they want defenses to be adopted or not.

However, there is still an issue to be considered. Shareholders often grant authority to the board the exercise of which may affect the shareholders’ position in case of a takeover. The best example of such authority is the authority to issue new shares in connection with an increase of the company’s share capital. If this type of authority has been granted, it may be tempting for the board to exercise the authority if a “hostile” acquiror presents himself in order to prevent him from gaining control. In such

⁷⁴ § 13 of the Information Obligations for Issuers of Listed Securities is identical to § 19, Subsection 1, of the Stock Exchange Act.

⁷⁵ Shareholders owe to each other a duty of loyalty similarly worded, cf. the general standard provided for in § 80 of the Companies Act.

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event it is important that the board is prevented from exercising its authority for the purposes of fending off the takeover attempt. Similarly, disposal or acquisition of material amounts of assets, repurchase of shares or any other defensive device falling within the province of managerial authority ought to be subject to shareholder approval in this situation. Altogether, the British City Code provides a useful model at this point for a solution to the similar issue under Danish law.

XI Specific defensive devices and strategies

1. Introduction

One of the conclusions reached in chapter V. was that contested takeovers constitute a means by which to “prune” the Danish business world and enable it to adapt to changes. With this in mind we attempted in chapter X. to determine the standards pertaining to managements facing takeover attempts or threats.

The purpose of this chapter is to provide a more detailed picture of management’s role and – equally important – of the duties which shareholders owe each other. Also, still with the above-mentioned conclusion in mind, I will attempt to evaluate the economic impact of defenses and consider if regulatory changes are needed.

There is no country in the world where the minds of corporate managers and their professional advisors have been so flourishing and innovative in connection with the attempts to “protect” companies against “unwelcome” acquirors as the United States.

Several European countries have experienced a spread of takeover and defensive techniques from the United States. The high degree of sophistication in the American takeover market and the aggressive role of American investment banks abroad, and in particular in Great Britain, are probably some of the key reasons why financial and legal advisors in the European countries have looked to the United States for inspiration when developing their own techniques.¹

Although it remains to be seen if Denmark will be among the countries that adopt the American concepts, I will in the following describe and discuss defenses by first looking at defenses developed in the United States and then trying to draw some parallels for the purpose of illustrating the extent to which the techniques may be applied in Denmark.² As we shall see, some of the most significant defensive techniques or corporate structures already existing in Denmark have been known for years and

¹ See II.1. for further details on this.

² For a description and discussion in Danish of U.S. takeover defenses, see Jan Schans Christensen, *Hostile Takeovers – “fjendtlige” virksomhedsovertagelser i USA* p. 46 ff.

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have been used independently of the development in e.g. the United States.

2. Shark repellents

2.1. Introduction. Frequently, U.S. companies adopt provisions in their charters or by-laws³ in order to delay or prevent contested takeovers. Such charter or by-law provisions are known as “shark repellents”.

2.1.1. American law. While amendments of a company’s charter require the approval of the shareholders, the board of directors is ordinarily entitled to alter the by-laws on its own. This right for the board is exercised to a very large extent in practice since it enables the board to make by-law amendments for the purpose of avoiding takeovers without having to obtain the approval from the shareholders, which may cause delays. Also, if the board were to obtain shareholder approval, a significant risk would exist that the approval would be denied by a majority of the shareholders.

The following description and discussion of shark repellents should be read against this background. In addition, it should be borne in mind that several of the American state corporate statutes – and in particular the General Corporation Law of Delaware – are very flexible as to what particular provisions may be inserted in a company’s by-laws. On the other hand, any decision which the management makes may subsequently be reviewed by the courts.⁴

2.1.1.1. Proxy contests. To the extent that management cannot act on its own but has to obtain the approval of the shareholders in a matter, e.g. in order to alter the charter of the company, management has access to means

³ The charter of a U.S. company, also known as the certificate of incorporation, includes the company’s name, its purpose, the nature of its business, the location of its headquarters, the number of board members, and its capital structure (i.e. the number of shares which the board is authorized to issue, different classes of stock, etc.). The by-laws include rules for general meetings and board meetings, duties of the officers, information about the number of shares issued within the maximum provided for in the charter, and other rules relating to the company, provided that such rules do not violate company law or the company’s charter.

⁴ For a general discussion of shark repellents, see Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 319 ff. and Barry G. Baysinger & Henry N. Butler, *Anti Takeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 Virginia Law Review 1257 (1985).

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which provide a significant advantage for management over the shareholders. This means is the so-called “proxy machinery”. When management seeks support among the shareholders for changing the charter, the usual procedure is to send proxies to all shareholders. The proxies contain a statement reflecting the viewpoints of management as well as an explanation thereof. In addition, the proxies, when signed, authorize management to vote on behalf of the shareholders at the shareholders’ meeting where the issue will be dealt with. Shareholders who do not agree with management may then initiate a so-called “proxy contest” or “proxy fight”, i.e. submit their proxies to their co-shareholders, explaining their points of view and soliciting the shareholders’ authority to vote on their behalf at the shareholders’ meeting. Proxy contests may also be used by an acquiror who has purchased shares of the company and who now wishes to put pressure on management in order to alter the company’s business policy, or who wishes to persuade the other shareholders to take action against incumbent management.⁵

As many companies have several thousands of shareholders⁶, the costs in connection with a proxy fight may be significant. While each shareholder will have to pay all costs in connection with the preparation and distribution of proxies himself, management may use the company’s funds to finance its proxies. Not only will management have the benefit of addressing the shareholders by means of proxies prior to anybody else, but also the fact that management may use the proxy machinery free of charge constitutes a significant advantage. Probably there is also an advantage connected to sending proxies to the shareholders in the capacity of board of directors rather than merely as a shareholder. Anyway, experience has shown that management has a better chance of winning a proxy contest than shareholders.

⁵ The use of proxies is not limited to disputes between management and shareholders or among shareholders. In other situations, e.g. where management has negotiated a “friendly” acquisition or merger, proxies are used as part of the preparation of the shareholders’ vote with respect to the result of management’s negotiations.

⁶ The distribution of shares is reflected in the study by Michael C. Jensen & Jerold B. Warner, *The Distribution of Power among Corporate Managers, Shareholders, and Directors*, 20 Journal of Financial Economics 3 at 5-6 (1988). The study shows that, as regards companies listed on the New York Stock Exchange, the five largest shareholders together represent an average of only 24.8 percent of the company’s common stock.

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Based on a study of a sample of 100 proxy contests in the period of 1981-1985, John Pound shows the mechanisms underlying the difficulties for shareholders who dissent with management to gain victory, see Pound, *Proxy Contests and the Efficiency of Shareholder Oversight*, 20 *Journal of Financial Economics* 237 (1988).

2.1.2. Danish law. By changing the charter of a company it is possible to prevent or delay attempts to acquire the company.

The right to change the charter of a company is vested in the shareholders, whereas the board, with very few exceptions, may not make any changes on its own.⁷ This means that all changes of a company's charter for defensive purposes must be submitted to the shareholders for approval.

When it is decided at a shareholders' meeting to amend the charter of a company in order to be prepared for a possible contested takeover attempt, the shareholders should bear in mind that – unless otherwise provided in the company's charter – a majority of two-thirds of both the votes cast and the voting share capital represented at the shareholders' meeting is required to change the charter back to its original shape, cf. § 78 of the Companies Act. Charter provisions that have the purpose of ensuring that all the target-shareholders receive a fair treatment might therefore be protected by boosting the majority required for changing the charter in order to avoid an acquiror that has obtained control changing the charter back to its previous form.

A number of the shark repellents discussed below are designed to protect the minority shareholders in the event of a change of control. If the acquiror himself is a minority shareholder of the target-company at the time of the change of the charter, even he will be able to invoke the protective provisions meant for the minority shareholders, which may have unforeseen consequences.

The focus in the following is on defensive charter provisions. However, it should be noted that rather than having defensive provisions inserted in the charter, shareholders may elect to enter into shareholders' agreements. This option is particularly interesting as regards subject matters which may not be included in the charter. As we shall see later, the Order on Listing Requirements mandates that listed shares must be "freely nego-

⁷ The only resolutions regarding charter amendments that do not require shareholder approval are those mentioned in §§ 16, 38, 42, 47 and 134 e. None of these provisions are material in connection with the discussion in the text.

liable”, with certain modifications. It is possible by means of shareholders’ agreements to reduce such restrictions.

Shareholders may thus bind themselves (but not shareholders who are not parties to the agreement) to exercise their rights as owners of their shares pursuant to specific terms and conditions. The point of departure is that the principle of freedom of contract prevails in the field of shareholder agreements.⁸ For example, shareholders may grant each other rights of first refusal.

The use of shareholder agreements raises a number of questions, including the effect of such agreements vis-a-vis the company and the entire notion of dividing the rights attached to shares. These issues fall outside the scope of this book, but have been dealt with by other authors.

See the extensive discussion of these issues in Gomard, *Aktieselskabsret* p. 248 ff., Gomard, *Aktieselskaber og anpartsselskaber* p. 88 ff., the same author, *Shareholders’ Agreements in Danish Law*, 16 *Scandinavian Studies in Law* 97 (1972) and Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 281 ff.

2.1.2.1. Proxy contests. § 66 of the Companies Act provides that any shareholder may be represented at shareholders’ meetings by means of proxies, cf. Subsection 1. It is a requirement that the proxy is in writing and bears a date. Also, a proxy is not valid for more than one year, cf. Subsection 2.

The charter of a company cannot deprive shareholders of this right to issue proxies.⁹ As we shall see later, the charters of many companies put a “cap” on the number of votes that each shareholder may cast. Frequently, such a charter provision is accompanied by a provision stating that no one may cast votes on behalf of others in excess of a certain maximum. Some commentators have challenged the right to insert this type of charter provisions,¹⁰ but it is difficult to see on what grounds such clauses should be restricted or prohibited.¹¹

⁸ See Gomard, *Aktieselskaber og anpartsselskaber* p. 88 ff. where it is, inter alia, stated that statutory law or mandatory doctrines of law may limit the freedom to contract. See also Gomard, *Aktieselskabsret* p. 257 ff. on the legal effects of shareholder agreements.

⁹ See Thomsen, *A/S-loven med kommentarer* p. 296.

¹⁰ See Werlauff, *Generalforsamling og beslutning* p. 360.

¹¹ See also Thomsen, *A/S-loven med kommentarer* p. 296 expressing the view that such charter provisions should be considered permissible.

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Article 27(1) of the Draft Fifth Directive would provide that any shareholder is entitled to have someone else represent his interests at a shareholders' meeting. In addition, Article 27(2) would allow the charter or the certificate of incorporation to impose limitations on the categories of persons eligible to represent the shareholders at the shareholders' meetings. However, any shareholder must have the right to appoint another shareholder to represent him. A transformation into Danish law of the provisions of the Draft Fifth Directive would make it possible for companies to limit the use of proxies more than can be done under the present regime.

Article 28 of the Draft Fifth Directive would govern the issuance of proxies by shareholders to, inter alia, the company itself, or rather its board. When soliciting proxies, the board would have to state the agenda for the shareholders' meeting regarding which the proxies are solicited. Proxies are limited to that particular shareholders' meeting and a subsequent shareholders' meeting with the same agenda. The solicitation for proxies should include a request for instructions regarding the exercise of voting rights with respect to each of the items on the agenda. Also, the proxy solicitation should include an indication of the guidelines according to which the company will exercise the voting rights thus conferred on it temporarily in the absence of instructions.

In particular, the requirement that proxies are only valid with respect to one or more shareholders' meetings on the basis of the same agenda is a restriction, compared to the law as it is today.

As is the case in the United States, management has at its disposal the "proxy machinery". Within the boundaries of its duties owed to the company and the shareholders, management may thus use the company's funds to prepare and distribute proxies.

Management may not, however, use the company's money to pay shareholders in order to induce them to sign the proxies. Such a step would fall outside the scope of the managerial powers, cf. the principle found in § 114 of the Companies Act, according to which gifts must ordinarily be approved at a shareholders' meeting, whereas the board has very limited powers in this regard.

On the other hand, the board may try to persuade the shareholders to sign the proxies by, for example, informing them about plans of changes of the corporate structure or of the business that, in the board's opinion, supports the stand taken by the board.

Shareholders, who are not board members, are, as a point of departure, free to induce fellow shareholders to sign proxies by promising them consideration of some kind. It is, of course, a condition that payments of this nature do not conflict with the duties which the recipient owes to others. Also, there could be particular circumstances in which payments even to

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non-board members constitute a violation of the general standard on “good marketing practice” in § 1 of the Act on Good Marketing Practices¹².

Even though the board of many major Danish companies listed on the Copenhagen Stock Exchange solicit and obtain proxies from the shareholders in connection with the shareholder meetings and are thus authorized to vote on behalf of a sometimes large number of shareholders at the shareholders’ meetings, proxy contests as they are known from the United States and Great Britain have not been seen in Denmark.

2.2. Delaying or thwarting an acquiror’s attempt to gain control at an extraordinary shareholders’ meeting

2.2.1. American law. An acquiror attempting to take over a company has an interest in exercising his influence over the company at a shareholders’ meeting as soon as possible in order to elect new members to the board who promote his plans and policies and to address the other shareholders for the purpose of changing the target-company’s charter or by-laws, if this is deemed necessary. The management of the target-company, on the other hand, has an interest in slowing down the acquiror’s takeover attempt in order to gain time so that it gets the opportunity to evaluate the contested offer and, if this is in the shareholders’ interest, to motivate the shareholders not to accept the offer.

As regards the shareholders of the company, there might be different interests. Many of the shareholders probably have as their primary interest to achieve the highest possible price for their shares. Others attach importance to keeping control of the company. However, even for the latter group of shareholders the final decision is likely to depend on the price offered for the shares. It is in the interests of all shareholders to have the chance to decide on the acquiror’s offer, but also to avoid a “raid” which deprives them of the opportunity to carefully consider the bid made by the acquiror and to receive the evaluation by management of such bid.

The Delaware General Corporation Law, § 228, provides that, unless otherwise set forth in a company’s charter, any action to be taken by shareholders at shareholders’ meetings may be taken without such meetings, without prior notice and without a vote, if a written consent, setting forth the action so taken, is signed by shareholders having at least the

¹² See Werlauff, *Generalforsamling og beslutning* p. 361 f. where it is, inter alia, pointed out that banks and savings banks are subject to particular restrictions under § 1 of the Act on Banks and Savings Banks, see now Consolidation Act No. 740 of November 30, 1989, as amended by Act No. 306 of May 16, 1990.

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minimum number of votes necessary to authorize or take such action at a shareholders' meeting.¹³ If a Delaware corporation has no staggered board¹⁴, an acquiror who has acquired 51 percent of the votes will be able to remove the entire board of directors without notice and without having to await a vote. Obviously, the fact that an acquiror can exercise his influence or control immediately without having to wait for a meeting of shareholders is a considerable advantage for him.

This advantage may be eliminated by providing in a company's charter that no written consent can take place in lieu of shareholders' meetings. By requiring an acquiror to call for a shareholders' meeting, management gets a little more time to prepare for the meeting and evaluate the takeover attempt made by the acquiror.

Almost as efficient as eliminating written consent is allowing such consent, provided, however, that all shareholders have received notice about the consent procedure and have signed the written consent.¹⁵

Alternatively, it may be stipulated in a company's charter or by-laws that requests for action by written consent must be submitted to the board, who will then stipulate a record date which will determine the shareholders eligible to accept action by written consent.¹⁶

Instead of leaving the board such flexibility a specific notice may be used. However, if a very long notice is used, which will unduly delay any shareholders' action, the by-laws may be invalidated by the courts.¹⁷

Also, unless the state corporate legislation provides for a right for a certain percentage of the shareholders of a company to call for a shareholders' meeting, it may be decided by the board of directors that extraordinary shareholders' meetings can only be called for by the chief executive officer or a majority of the board members. A provision of this nature that

¹³ This principle of written consent under Delaware Law has been criticized, see e.g. Leo Herzel, Scott J. Davis & Daniel Harris, *Consents to Trouble*, 42 Business Lawyer 135 (1986). Several other state statutes also provide for use of written consent but frequently subject such consent to various limitations, see e.g. New York Business Corporation Law § 615.

¹⁴ See 2.5 on this concept.

¹⁵ In some states, written consent is only allowed if all shareholders agree to such procedure, cf. New York Business Corporation Law § 615.

¹⁶ See Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 328 ff.

¹⁷ See *Datapoint Corp. v. Plaza Securities Co.*, 496 A.2d 1031 (Del. 1985). For a discussion hereof, see Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 328 ff.

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may be inserted in a company's by-laws will enable management to evaluate and, if appropriate, fight a contested takeover attempt.

2.2.2. Danish law. When an imminent danger exists that the company will be the target of a contested acquisition it is often too late to establish defensive measures by changing the company's charter. If a contested takeover attempt is in its incipience, management of the target-company may try to arrange for an extraordinary shareholders' meeting in order to obtain shareholder approval for the adoption of defensive charter provisions.

Under Danish law it is not possible for the holder or holders of the majority of the shares of a listed company to act by "written consent" rather than having an ordinary shareholders' meeting, even though it is clear that the shareholder or shareholders have a number of votes that leave no doubt that they have the sufficient number of votes to effect changes of the company's charter or make other decisions at the shareholders' meeting without receiving support for their proposals from the other shareholders. A "true" shareholders' meeting must be held in all circumstances and all shareholders must have the opportunity to express their views with respect to the matters appearing on the agenda.

Any shareholder, including an acquiror already owning shares of the company, has the right to have a matter dealt with at a shareholders' meeting, provided that he submits a written demand for this to the board of the company in time for the matter to be included in the agenda for the shareholders' meeting, cf. § 71 of the Companies Act. This rule means that a matter must be submitted at a point in time that enables the company's board to include the point in the agenda, i.e. in view of the time required for preparing and printing the notice and the agenda. The board may not refuse to include a matter proposed for the agenda by an acquiror if the matter has been communicated to the board early enough to be included in the agenda, considering the usual time required by the board to prepare the agenda.¹⁸

The shareholders of a company may elect to insert a notice in the company's charter regarding matters to be included in the agenda. However, the courts have held that such a notice may not be longer than the time

¹⁸ The question of how much time the board would need to prepare the agenda depends on the circumstances and, in particular, on the usual time required for the preparation of the notice, etc., see Thomsen, *A/S-loven med kommentarer* p. 308.

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necessary for practical reasons to include a matter in the agenda. The shareholders may not adopt a particularly long notice in order to postpone the resolution regarding a proposal made by a shareholder if the proposal was sent to the board at an early point and could have been included in the agenda without difficulties. Such step would constitute an abuse of the notice for matters to be included in the agenda.¹⁹

An acquiror who is already a shareholder of a company may take the initiative to have an extraordinary shareholders' meeting convened. § 70 of the Companies Act provides that an extraordinary shareholders' meeting shall be convened within 14 days if required in writing by shareholders owning 1/10 of the share capital or any lesser fraction set forth in the company's charter. To avoid an acquiror taking steps at an earlier point in time to have such a shareholders' meeting convened, companies having charters where a lesser fraction is required to convene shareholders' meetings may consider changing the charter back in accordance with the "default" rule in § 70.

It may be stipulated in the charter of a company that, in order to be able to attend a shareholders' meeting, shareholders must notify the company a certain number of days prior to the meeting. However, according to § 65, Subsection 2, the notice period may not exceed 5 days. Consequently, notice periods under § 65, Subsection 2, are immaterial in connection with the planning of takeover defenses.²⁰ The Danish Commerce and Companies Agency has expressed the view that the shareholders of a company may not, by providing for this in the charter, leave it to the discretion of

¹⁹ For a related kind of abuse, see *Møller v. Rederiet Frode A/S* (U1918.330, M&C Ct.). This court decision dealt with a company that had a charter provision according to which the ordinary shareholders' meeting was to be held each year prior to the end of April, and matters to be included in the agenda in order to be dealt with at the shareholders' meeting should be submitted to the board prior to February 1. The court found that decisions made at a shareholders' meeting in January were invalid. Compare the particular circumstances in the decision in *Nathansohn v. Dansmidt Trust Company A/S* (U1930.762, E. Cir.). For a discussion of these questions, see Gomard, *Aktieselskaber og anpartsselskaber* p. 157 f., Thomsen, *A/S-loven med kommentarer* p. 307-308, Krenchel, *Håndbog for dirigenter* p. 28, Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 144 ff., Werlauff, *Generalforsamling og beslutning* p. 529 and John Korsø Jensen, *Ugeskrift for Retsvæsen* 1974.B321.

²⁰ On the computation of the five day period, see Thomsen, *A/S-loven med kommentarer* p. 295.

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the board to decide for which shareholders' meetings notification is required to attend the meeting.²¹

§ 67, Subsection 2, of the Companies Act is of particular importance in connection with attempts by an acquiror to gain control of the target-company at an extraordinary shareholders' meeting. According to this provision, it may be stipulated in the charter that a shareholder having acquired shares by means of a transfer shall not be entitled to exercise his voting rights in respect of such shares before the expiry of a certain period. The period in question may not exceed 3 months, counted from the date on which the shareholder was included in the company's list of shareholders or on which he notified the company about his acquisition and provided evidence of his title to the shares. Using a record date within the framework of § 67, Subsection 2, may give target-management and shareholders more time to consider the takeover attempt made by the acquiror. On the other hand, it should be borne in mind that not only acquirors but also "friendly" shareholders must observe the record date. In a decision from the beginning of this century it was held that a shareholder cannot circumvent a record date by obtaining an irrevocable proxy to vote at a shareholders' meeting from the seller of the shares, cf. *Olsen v. J. Koefoeds Skibsbyggeri* (U1919.175, M&C Ct.).

For a general discussion of § 67, Subsection 2, see Thomsen, *A/S-loven med kommentarer* p. 299-300, and Werlauff, *Generalforsamling og beslutning* p. 339 ff. Record dates do not apply to decisions pursuant to § 79, Subsections 1 and 3, of the Companies Act, see Thomsen, *A/S-loven med kommentarer* p. 299. The question if the shares owned by a shareholder who cannot vote due to the record date will have to be included when calculating the two-thirds of the votes represented at the shareholders' meeting pursuant to, inter alia, § 78 of the Companies Act is dealt with under 2.3.2. As to circumventions of § 67, Subsection 2, by means of disguising share transfers as creditor action or by means of purchase rights coupled with irrevocable proxies, see Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 130 f. Generally, transactions that are sheer sham are likely to be invalidated as being arranged for the sole purpose of circumventing the record date, cf. *Olsen v. J. Koefoeds Skibsbyggeri* (U1919.175, M&C Ct.). See also Gomard, *Aktieselskaber og anpartsselskaber* p. 89-90 (note 20).

Danish law allows for the adoption of a charter provision according to which shareholder resolutions must, in order to be valid, receive approval at two consecutive shareholder meetings.

²¹ See Thomsen, *A/S-loven med kommentarer* p. 295.

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As an alternative, the charter may set forth that e.g. two-thirds of the company's share capital must be represented at the first shareholders' meeting where the matter is decided upon. If the proposal receives the sufficient number of votes, but fails to meet the quorum requirement, a second shareholders' meeting is held (at a time when the shareholders of the company are familiar with the plans of the acquiror and have had sufficient time to consider these plans) where the proposal may be adopted without any quorum requirement. It is not advisable for the requirement that proposals must be approved at two different shareholders' meetings to apply to all resolutions since this would result in even the adoption of ordinary and non-controversial proposals constituting a burden for the shareholders.²²

2.3. Supermajority voting requirements

2.3.1. American law. After gaining control of a company an acquiror may, depending on the circumstances, find it advantageous to merge the target-company and the acquiror, as a part of which the minority shareholders of the target-company will be cashed out.

Frequently, this option will be prevented or inhibited by the relevant state corporate statute, cf. VIII.3.4. If no state protection exists there is a risk that the acquiror will treat the minority shareholders unfairly by paying them an unreasonably low price for their shares. To reduce or prevent this risk, it may be stipulated that a merger between the acquiror and the target-company cannot be approved by a bare majority of votes (which is otherwise the case in many states) but requires the approval of 2/3 of the target-shareholders. Another alternative is to require a bare majority among all shareholders not counting the acquiror. Similar supermajority provisions may be adopted in connection with other kinds of shareholder decisions that may favor acquirors.

A variation of the above theme is the so-called "fair price" clause. Such a clause entails that e.g. a merger requires a supermajority vote, unless the price which is offered to the minority shareholders in connection with the cash-out, is equal to or exceeds the highest price which the acquiror has paid for shares of the target-company prior to the merger. By using a minimum price threshold, an acquiror will be compelled to pay a fair price for all shares belonging to minority shareholders.

²² The various ways of drafting charter provisions according to which a resolution must be passed at two shareholders' meetings are discussed in Werlauff & Nørsgaard, *Vedtægt og aktionæraftale* p. 168 f.

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Generally, American courts have accepted the use of supermajority by-law provisions, including fair price clauses, in the takeover context, the argument being that such provisions constitute a reasonable protection of the minority shareholders' interests, cf., for example, *Morressey v. Tower Corp.*²³

2.3.2. Danish law. Under the Companies Act it is a principle that, unless otherwise provided in the Act or the charter of the company, matters to be resolved at a shareholders' meeting are subject to a bare majority requirement, cf. § 77 of the Act. It follows from § 78 of the Companies Act that most charter amendments are subject to a majority of two-thirds of both the votes cast and the voting share capital represented at the shareholders' meeting, cf. below. Therefore, there is ordinarily no real need to deviate from the point of departure in § 77 regarding other shareholder decisions by amending the company's charter.²⁴

Many resolutions that lead to a material change of the structure or business of a company require a change of the scope clause of the company's charter. However, certain resolutions that constitute a radical change of the company and its business may be effected without changing the scope clause. Such resolutions may, depending on the circumstances, include discontinuance, restructuring or sale of the company's business without dissolving the company.²⁵ Unless otherwise provided in the charter, resolutions of this kind may be adopted with a bare majority pursuant to § 77 of the Companies Act. This could be avoided by providing in the charter that proposals regarding changes of this nature require the same qualified majority as is the case with charter amendments.

When construing the term "bare majority", the Commerce and Companies Agency has accepted in its practice to register as valid resolutions that are

²³ 559 F.Supp. 1115 (E.D.Mo.1983) aff'd 717 F.2d 1227 (8th Cir. 1983). In this case the supermajority voting requirement applied to mergers involving shareholders that owned more than 10 percent of the company's shares. See also *FMC Corp. v. R.P. Scherer Corp.*, 545 F. Supp. 318 (D. Del. 1982). In this case the supermajority requirement applied to mergers involving a shareholder which owned at least 10 percent of the company's shares, provided that the merger had not been approved by the board; otherwise a simple majority requirement applied. See also *Seibert v. Milton Bradley Co.*, 405 N.E. 2d 131 (Mass. 1980).

²⁴ See also Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 161-162.

²⁵ See Gomard, *Aktieselskaber og anpartsselskaber* p. 271 f. and Gomard, *Aktieselskabsret* p. 313 See also Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 163 f. and Werlauff, *Generalforsamling og beslutning* p. 97.

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adopted at a shareholders' meeting if just the resolution received more votes than any other (competing) resolution and not necessarily more than 50 percent (relative bare majority), see Thomsen, *A/S-loven med kommentarer*, p. 318. Depending on the structure of ownership it may, therefore, be desirable to stipulate in the charter that resolutions can only be adopted if they receive more than 50 percent of the votes cast (absolute bare majority), whereby it may be avoided that an acquiror with a substantial stockholding, but less than 50 percent of the company's shares, gains control of the company. Relative and absolute bare majority are concepts discussed by Thomsen, *A/S-loven med kommentarer* p. 318, Gomard, *Aktieselskaber og anpartsselskaber efter lovene af 13. juni 1973* p. 82, Werlauff & Nørsgaard, *Vedtægt og aktionæraftale* p. 162 f., Carl Ricard, *Ugeskrift for Retsvæsen* 1977.B 153 at 155 and Jan Kobbernagel, *Dirigenten* p. 59 and p. 105.

As stated above, unless additional requirements are provided for in the Companies Act or the company's charter, charter amendments must be adopted by at least two-thirds of both the votes cast and the voting share capital represented at the shareholders' meeting, cf. § 78 of the Companies Act.

The requirement that at least two-thirds of the voting share capital (the Danish text reads: "stemmeberettigede aktiekapital") represented at the shareholders' meeting must approve a charter amendment has given rise to some uncertainty with respect to shares on which the owner is unable to vote because of the existence of a record date in the charter of the company (record dates are discussed further under 2.2.2.). The Commerce and Companies Agency has taken the position that the term "stemmeberettigede aktiekapital" includes all shares on which the right to vote is limited due to circumstances relating to the particular shareholders owning the shares. If, on the other hand, the limitations of the right to vote arise out of the shares themselves so that – irrespective of ownership – the shares do not carry with them voting rights, it is the opinion of the agency that such shares do not qualify as belonging to the "stemmeberettigede aktiekapital". It follows from this viewpoint that shares on which the holder cannot vote due to the existence of a record date should not be included when calculating the voting share capital represented at the shareholders' meeting. The position of the Commerce and Companies Agency is, inter alia, reflected in a letter from the Agency dated May 12, 1986, in a matter referred to as Docket No. 86-2905, see also Thomsen, *A/S-loven med kommentarer* p. 321. The Commerce and Companies Agency earlier had a different view according to which shares comprised by a record date would have to be included when determining the voting share capital, cf. the practice by the Agency as referred to in Græsvænge & Thomsen, *Aktieselskabsloven med kommentarer* p. 285. Gomard, *Aktieselskaber og anpartsselskaber* p. 159, note 12, shares the more recent view by the Commerce and Companies Agency. For a similar view, see Werlauff, *Generalforsamling og beslutning* p. 479 ff. where it is pointed out that the words "stemmeberettigede

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aktiekapital” should be understood as share capital that actually has powers to vote in favor of or against a particular matter. See also Poul Madsen, *Ugeskrift for Retsvæsen* 1984.B 211.

In *Arnth-Jensen v. A/S Ringkjøbing Bank* (U1991.180, Sup. Ct.) (see X.2.2.) the discussion was put to an end when the present position by the Commerce and Companies Agency was supported by the High Court and subsequently, upon appeal, by the Supreme Court. Emphasizing the wording of § 67, Subsection 2, of the Companies Act (which is the provision that allows companies to adopt rules regarding record dates in their charters) the High Court held that shares comprised by the record date should not be included when calculating the voting share capital represented at a shareholders’ meeting. Moreover, and perhaps more convincing, the court adds that its construction of § 67, Subsection 2, is supported by the fact that if the opposite position were taken, shareholders who participated in the shareholders’ meetings, but remained passive, would achieve the influence which the record date aims at eliminating (temporarily). This point made by the court has strong merits as it is undoubtedly correct that shareholders who face a record date would, by being present but passive at shareholders meetings, in effect be able to prevent many decisions from being made if their shares were to be included when calculating the voting share capital. The Supreme Court adhered to the grounds given by the High Court when affirming the decision.

An earlier proposed text for Article 26 of the Draft Fifth Directive²⁶ would allow companies to insert in their charters a prohibition against the participation in shareholders’ meetings by shareholders who do not have voting rights. It is not clear whether this would mean that companies could prevent shareholders who are temporarily without voting rights due to the existence of a record date from attending shareholders’ meetings. Since Danish corporate law does not allow for shares to be issued without voting rights (see § 67, Subsection 1, of the Companies Act), shares comprised by a record date present the only situation where the aforementioned provision in Article 26 could be relevant.

The fact that § 78 of the Companies Act applies a two-prong test (i.e. both two-thirds of the votes cast and of the voting share capital represented) entails that shareholders who have major stockholdings but a limited number of votes only due to a “cap” in the charter on the number of votes each shareholder may cast, may still be able to influence the decision-making at shareholders’ meetings. By attending such meetings and by abstaining from voting or by voting against proposals, large shareholders have what resembles a “veto”-right.

It is probably not possible to deviate from § 78 of the Companies Act by stipulating in the charter that shareholdings, irrespective of their size, only count for a

²⁶ See the draft prepared by the Council, 9128/89, DRS 45, October 16, 1989.

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specific (limited) part of the “voting share capital represented”. Such a charter provision would conflict with the underlying principle in § 78, which is to grant shareholders influence according to the size of their holding of shares. The Commerce and Companies Agency has expressed a view consistent with the one expressed here, see the Agency’s letter of October 11, 1990, in Docket No. 90-53 390.

As a supplement to the provisions of the Companies Act that prescribe a supermajority in connection with particular resolutions regarding charter amendments²⁷, the shareholders of a company may consider making certain other charter amendments subject to supermajority requirements. It may, for example, be set forth in the charter that changes in the registered share capital of the company or the right to increase such capital on the basis of non-capital contributions are subject to supermajority voting requirements.²⁸ A change of this nature would ensure that the existing shareholders continue to have an influence on the financing of the company even after a change of control. Supermajority requirements in excess of the two-thirds requirement should not apply to any change of the charter since this would lead to impediments for the adoption of even minor changes.

According to § 79, Subsection 1, item 1, of the Companies Act, a resolution regarding a change of the charter whereby the shareholders’ right to dividends or to distribution of the company’s assets is reduced in favor of others than the shareholders of the company and its employees or the employees of its subsidiary is only valid if adopted by all shareholders.²⁹ The same applies to resolutions whereby the shareholders’ obligations to the company are increased or the negotiability of the shares is being restricted or the shareholders are obliged to allow their shares to be redeemed in other cases than liquidation of the company, see items 2 and 3. The effect of § 79, Subsection 1, is that the shareholders are protected in these situations against a deterioration of their rights in the company.

If a resolution regarding a change of the charter entails that the shareholders’ right to dividends or to distribution of the company’s assets is reduced but not in favor of any third party, a majority of more than three-quarters

²⁷ See the discussion of such particular requirements below.

²⁸ See Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 165.

²⁹ Even the consent of shareholders holding shares on which they are not entitled to vote is required. Also, shareholders who do not attend the shareholders’ meeting where the issue is dealt with must grant their consent, see Gomard, *Aktieselskaber og anpartsselskaber* p. 165 and *A/S Vejle Amts Folkeblad v. Nielsen* (U1945.1085, Sup. Ct.).

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of the voting share capital represented at the shareholders' meeting is required, cf. § 79, Subsection 2. An acquiror who obtains more than three-quarters of the votes of a company will thus be able to effect a change of the charter according to which dividend payments will be reduced and a part of the funds otherwise payable to the shareholders will be allocated to reserves. Obviously, this means a reduced income for the shareholders. However, an additional effect may be that the price for the company's shares falls as a consequence of the reduced dividend payments. Altogether, it may appear less attractive for the shareholders to keep their shares of the company. If, however, the acquiror only allows the other shareholders a dividend substantially lower than the dividend usually paid in other companies of a similar size and nature, and provided that there are no particular circumstances that necessitate such lower dividend payments, the acquiror probably violates the minority shareholders' rights.³⁰ If there is no real need for stabilizing the company's financial position further, "starving out" shareholders by reducing dividend payments would constitute a violation of § 80 of the Companies Act.

Mauritzen v. Revisions- og Forvaltnings-Institutet A/S (U1985.183, Sup. Ct.) has made it clear that a company's usual dividend policy may be of crucial importance when the courts have to evaluate if a majority shareholder or majority shareholders have attempted to starve out the other shareholders. In this case the subject company had a record of very conservative dividend payments. A shareholder who had received very limited dividends as a consequence of the company's restrictive dividend policy sought to challenge the resolution regarding dividends made at the shareholders' meeting. Emphasizing that the plaintiff shareholder was familiar with the company's restrictive dividend policy at the time of his acquisition of his shares, the court held that there had been no violation of § 80 of the Companies Act.

As stated by Gomard (*Gomard, Aktieselskaber og anpartsselskaber* p. 171) familiarity with a dividend policy is not always tantamount to acceptance of such policy. On the other hand, one may perhaps argue that there is little reason to protect shareholders who buy shares of a company knowing that the company has a conservative dividend policy. In all circumstances the reasoning by the Supreme Court raises difficulties. What rights would shareholders have if they had not known about a company's dividend policy? Ought there to be an obligation to make oneself familiar with the policy? Should shareholders who know about the policy and shareholders who do not know about the dividend policy be treated differently? The court decision is also discussed by Gomard, *Højesteret 1661- 1986* p. 62 f. (Copenhagen, 1986). See also Thomsen, *A/S-loven med kom-*

³⁰ See Gomard, *Aktieselskaber og anpartsselskaber* p. 171 and Thomsen, *A/S-loven med kommentarer* p. 352.

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mentarer p. 352-353, and Paul Krüger Andersen, *Aktie- og Anpartsselskaber* p. 221 f.

It is frequently difficult for shareholders to prove that an acquiror actually attempted to starve out the minority shareholders. These difficulties may be reduced in the event that the minority shareholders can establish that the reduced dividend payments were effected by the acquiror to suppress the price of the company's shares and part of the acquiror's scheme to acquire further shares of the company at the reduced price. This would constitute a violation of § 80. A similar result would probably follow from the Stock Exchange Rules of Ethics, Rule 7.2.

To protect shareholders against being starved out the charter of a company may provide that resolutions covered by the language in § 79, Subsection 2, are subject to supermajority requirements that exceed the three-quarters requirement. An even wider step would be to require unanimity in these situations. However, this would pose unnecessary difficulties from a practical point of view.

Another option would be to insert a clause in the charter which directly stipulates a minimum dividend to be paid to the shareholders, e.g. giving each shareholder or a certain minority of shareholders the right to claim a specified minimum dividend, see Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 265.

§ 79 is limited to charter amendments and does not include decisions at shareholder meetings where no charter amendments are at focus.³¹ Consequently, § 80 may have special importance in events where acquirors attempt to reduce dividend payments at the annual shareholders' meetings without trying to effect a change of the charter.

Charter amendments whereby the legal relationship among the shareholders is altered, i.e. changes whereby the legal status of certain shareholders is improved at the expense of other shareholders, require the approval of the shareholders whose legal status is adversely affected, cf. § 79, Subsection 3, of the Companies Act. If a company has more than one class of shares, charter amendments that alter the legal relationship between the classes may be effected if adopted by shareholders owning at least two-thirds of the shares represented at the shareholders' meeting belonging to the class of shares whose legal status is being impaired, cf. §

³¹ See Gomard, *Aktieselskaber og anpartsselskaber* p. 167. Thomsen, *A/S-loven med kommentarer* p. 323, argues that § 79, Subsection 1 (with a certain modification), also applies, by analogy, to single resolutions that do not change the charter. The latter construction is hard to reconcile with the wording of § 79, however.

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79, Subsection 3. However, if the alterations are of the kind described in § 79, Subsection 1, unanimity is required anyway.³²

The above mentioned provisions constitute a limit to the possibilities of an acquiror to “squeeze” the other shareholders to sell their shares by having their rights impaired. If, in the case of companies with dual or multiple class stock, an acquiror meets the majority requirements set forth in § 79, Subsection 3, his possible abuse of his dominant influence will, depending on the circumstances, constitute a violation of § 80 of the Companies Act.

While dividend reductions affect all shareholders equally, at least relatively, changes that alter the relationship among shareholders are more often likely to be of a discriminatory nature and thus constitute a violation of § 80. To avoid the element of discretion and thereby uncertainty that is attached to § 80, shareholders of a company may consider supplementing the words of § 79, Subsection 3, by adopting charter provisions that require an additional supermajority or unanimity in connection with any resolutions pursuant to § 79, Subsection 3.

After acquiring control it may be in the interest of an acquiror to merge the target-company and the acquiror, sometimes with the latter as the surviving company. As regards the target-company, such a merger may be adopted by a majority of two-thirds, cf. § 134 e and § 78 of the Companies Act. By adding to the two-thirds requirement an additional majority requirement, the shareholders of the target-company may have more say regarding the merger resolution.

Due to the right to cash out minority shareholders pursuant to § 20 b of the Companies Act, the possibility to merge the target-company and the acquiror with the latter as the surviving entity will not always be used as a means by which to eliminate minority shareholders to the same extent as has been seen in the United States. The right to cash out will probably often be sufficient for an acquiror to obtain 100 percent of the share capital, cf. further about this right under VIII.2.1.6.

The discussion above has focused on the use of supermajority voting requirements in various connections for the purpose of protecting minority shareholders. Instead of tying the supermajority voting requirement to resolutions of a specific nature, the shareholders may provide in the charter that the requirement only applies to resolutions that do not enjoy the sympathy of the board. Such a clause would mean that proposals that have

³² See Gomard, *Aktieselskaber og anpartsselskaber* p. 86.

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not been made by or with the consent of the board are subject to particularly high majority requirements.

Also, the charter may set forth that particularly high quorum requirements apply to resolutions whereby proposals are adopted that do not enjoy the support of the board.

Smith v. A/S Handels- og Landbrugsbanken i Thisted (U1966.465, W. Cir.) attracts interest in this connection.

In this case the board of a bank proposed a clause in the company's charter pursuant to which proposals for charter amendments made by others than the shareholders' committee or board would be subject to a quorum requirement of 50 percent of the share capital and would have to receive two-thirds of the votes cast to be adopted. After the adoption of the charter amendment, one of the shareholders of the bank filed a suit against the bank, claiming, inter alia, that the amendment constituted a strengthening of management's powers to the detriment of the single shareholders. According to the High Court, the proposed change of the bank's charter did not constitute an invalid disregard of the shareholders' rights. In other words, the court accepted that management may be granted certain privileges that shareholders do not have.

The court's rationale in the case includes a reference to an argument made by the company according to which it is "natural to strengthen management whose task it is to shape the development of the bank". It is obviously true that management must shape the development of a company. However, it is hard to see why this role of management should make it almost impossible for shareholders to achieve support for proposals that do not enjoy the sympathy of management. The shareholders have an interest in the future of the company that is, at least, as great as management's. Moreover, there seems to be no reason to assume that proposals made by shareholders should generally be less suited to serve the future of the company. It is not desirable that the shareholders may be forced to remove the board in order to obtain approval for a proposal that has otherwise received the favorable votes of a majority of the shareholders.

The question is why, at all, priority should be given to proposals by management rather than to proposals by the shareholders. If a proposal made by management is deemed by the shareholders to benefit the company, the proposal is likely to receive shareholder approval, and it is difficult to see why proposals made by management should be favored at the expense of other proposals. The view expressed by the court in *Smith v. A/S Handels- og Landbrugsbanken i Thisted* is, in effect, that management is more likely to submit proposals that benefit the company. Nothing suggests that this is necessarily true. Among the prime stakeholders of a com-

pany are its shareholders. Stating that management proposals are generally better fit to serve the interests of the company and thereby its shareholders does not make too much sense, and the result of the case does not appear very convincing.

Smith v. Handels- og Landbrugsbanken i Thisted does not provide much guidance with respect to the limitations which apply in connection with charter provisions that favor management. There seems to be little doubt, however, that the case should not be construed as an endorsement of charters that give the board carte blanche to veto shareholder proposals.³³

Shareholders at a shareholders' meeting may also decide that certain decisions, e.g. changes of the company's share capital or mergers, require the consent of particular shareholders. One way of implementing this concept is to attach to a certain class of shares the right to veto particular resolutions. Such a "disparate" right of veto must not deprive the minority shareholders of their rights under the Companies Act and, likewise, the shareholders will have to administer their veto rights in accordance with the standard set forth in § 80 of the Companies Act.³⁴

2.4. Dual class stock, "capped" and disparate voting rights

2.4.1. **American law.** The introduction of dual class stock or similar basic changes in the capital structure of a company requires charter amendments, which must be approved by the shareholders. However, the use of shares with disparate voting rights has been widely criticized, primarily because it enables management, occasionally supported by groups of shareholders, to insulate itself from the influence which would otherwise be exercised by the majority of the shareholders.³⁵ This made the SEC issue rule 19c-4, which was subsequently vacated, however.³⁶

Historically, NYSE has refused to list shares of companies with either non-voting common stock or with more than one class of common stock having less than full voting rights since 1926. For several decades, the principle "one share,

³³ For a discussion of the case, see also Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 170, Werlauff, *Generalforsamling og beslutning* p. 170 f. and 487 f., Thomsen, *A/S-loven med kommentarer* p. 318 and Gomard, *Aktieselskabsret* p. 339. See also *Dampskibsaktieselskabet "Skandia" v. Aktieselskabet Dampskibsselskabet "Heimdal"* (U1921.283, Sup. Ct.).

³⁴ These types of charter clauses are discussed further in Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 167.

³⁵ See Lowenstein, *What's Wrong with Wall Street* p. 186 ff.

³⁶ See *Business Roundtable v. SEC*, No. 88-1651 (DC Cir., June 12, 1990) (SEC lacked authority). We will, nevertheless, consider the rule.

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one vote” prevailed for listings of shares on NYSE. As a result of, among other things, increased competition from Amex, which had less stringent voting standards, and NASDAQ, which had no minimum voting requirements, NYSE, in September 1986, submitted a proposal to the SEC in effect abandoning its previous policy with respect to listing of shares having disparate voting rights. See NYSE’s Proposed Rule Changes on Disparate Voting Rights, 18 Sec. Reg. & L. Rep. (BNA) No. 37, at 1389-92 (September 19, 1986). One of the more specific reasons for NYSE’s desire to change its policy for listing shares was probably the fact that General Motors, a company listed on NYSE, informed NYSE that the company would issue a new class of stock with 1 1/2 votes per share instead of the ordinary 1 vote per share. When other companies expressed similar desires, NYSE, on a preliminary basis, declared a moratorium regarding its requirements with respect to voting rights. In its proposal to the SEC, NYSE suggested that the listing of a class of common stock with disparate voting rights should be permitted if a majority of the company’s independent directors and “public” shareholders approved the creation of the class of stock, cf. Securities Exchange Act of 1934, SEC Release No. 34-25891/ July 7, 1988, SEC Docket Vol. 41, No. 6, p. 432, at 434. In December 1986, Amex joined NYSE and submitted a proposal to the SEC, which, if accepted, would abandon entirely the already lax rules pertaining to listing of shares on Amex. As a response to the approaches from NYSE and Amex, the SEC on July 7, 1988, issued Rule 19c-4, taking effect on the same date.

Rule 19c-4 limits the rights of stock exchanges to list shares without voting rights or with disparate voting rights. More specifically, the rule imposes on the stock exchanges an obligation to provide in their rules for listings and trade on the exchange that no equity security of a domestic company be listed, or remain listed, if the company issues any class of security, or takes other corporate action, with the effect of “nullifying, restricting or disparately reducing the per share voting rights of holders of an outstanding class or classes of common stock....”.³⁷

While rule 19c-4(c) lists a number of corporate actions which are presumed to have the prohibited effect on a company’s equity securities, the apparent strength of the prohibition is diluted considerably in rule 19c-4(d). It is thus stated that issuance of shares with disparate voting rights pursuant to an initial, registered, public offering is allowed under rule 19c-4. Shareholders who purchase stock with limited voting rights in this situation are not deemed to be disenfranchised as they acquire the shares with the full knowledge of the limits on their individual and collective

³⁷ See Rule 19c-4(a). 19c-4 also applies to national securities associations, such as the NASDAQ, cf. rule 19c-4(b).

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voting power.³⁸ Also, subsequent issuance of lower voting stock is permitted under rule 19c-4. Again, the view of the SEC is that by restricting subsequent offerings to equal or lesser voting stock no existing shareholders are disenfranchised.³⁹ A third exemption from the rule is equal or low-voting shares issued pursuant to a bona fide merger or acquisition. Finally, the SEC has stated that a straight issuance of stock dividend to all holders of an outstanding class of common stock, in which the voting rights of the stock are equal to or less than the voting rights per share of the existing class, would be consistent with rule 19c-4.⁴⁰

However, rule 19c-4 does have some impact on a company's, or rather management's, ability to avoid takeovers. Time-phased voting plans and "capped" voting plans, which limit the voting power of shares based on the number of shares owned by the shareholder, are prohibited. Likewise, high-voting shares issued pursuant to a stock dividend are prohibited. Finally, shares issued pursuant to an exchange offer may not have disparate voting rights, whether such shares are high- or low-voting shares.

Rule 19c-4 has been criticized by Louis Lowenstein, *Shareholder Voting Rights: A Response to SEC Rule 19c-4 and to Professor Gilson*, 89 Columbia Law Review 979 (1989). For a further discussion of the use of dual-class stock, see Karen D. Bayley, *Rule 19 c-4: The Death Knell for Dual-Class Capitalizations*, 15 Journal of Corporation Law 1 (1989), Manning Gilbert Warren III, *One Share, One Vote: A Perception of Legitimacy*, 14 Journal of Corporation Law 89 (1988), and Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 Virginia Law Review 807 (1987). For a discussion of the economic aspects of requiring one share, one vote, see Sanford J. Grossman & Oliver D. Hart, *One Share – One Vote and the Market for Corporate Control*, 20 Journal of Financial Economics 175 (1988). The history behind NYSE's voting rules is described by Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Share One Vote Controversy*, 54 George Washington Law Review 687 at 688-708 (1986).

When the SEC submitted the proposal for rule 19c-4 for comments, a majority of commentators that supported the adoption of the rule stressed the importance of maintaining management accountability to shareholders. These commentators argued that corporate managements have used dis-

³⁸ See Securities Exchange Act of 1934, SEC release No. 34-25891/July 7, 1988, SEC Docket Vol. 41, No. 6 p. 432 at 444.

³⁹ See Securities Exchange Act of 1934, SEC release No. 34-25891/July 7, 1988, SEC Docket Vol. 41, No. 6 p. 432 at 444.

⁴⁰ See Securities Exchange Act of 1934, SEC release No. 34-25891/July 7, 1988, SEC Docket Vol. 41, No. 6 p. 432 at 445.

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porate voting rights plans to insulate themselves from shareholders and the market for corporate control. According to the commentators, such insulation “leads to entrenched, inefficient corporate managements acting in their own best interest instead of the best interest of the company and its shareholders.”⁴¹

The arguments made by the commentators supporting the adoption of rule 19c-4 are only partly reflected in the final wording of the rule. Although e.g. subsequent issues of shares with limited voting rights do not deprive the existing shareholders of their control of the company, it remains a fact that accepting shares with limited rights for listing does constitute a step towards insulating management from the shareholders’ influence.

2.4.2. Danish law. The use by companies of high-vote A-shares and low-vote B-shares is probably one of the greatest obstacles to contested takeovers.

Frequently, the original shareholders of a company decide to have the company issue B-shares for listing on the Copenhagen Stock Exchange, while the A-shares that are not listed remain in the hands of the original shareholders who thereby retain control of the company. The Order on Listing Requirements does not prevent this but merely requires that if shares of a class are listed, the entire class must be listed.⁴²

§ 67, Subsection 1, of the Companies Act provides that no shares may bear more than 10 times the voting value of any other share of the same denomination. With 10 percent of the company’s equity capital as high-vote A-shares and 90 percent as low-vote B-shares, it is not a problem for the A-shareholders to retain control of the company, particularly considering that the B-shares are typically distributed among a large number of shareholders.

By allowing companies to list their B-shares on the Exchange while leaving control with the A-shareholders, such companies have the opportunity to benefit from the public capital market on the one hand, and to

⁴¹ See Securities Exchange Act of 1934, SEC release No. 34-25891/July 7, 1988, SEC Docket Vol. 41, No. 6 p. 432 at 435.

⁴² See Form A attached to the Order, item II.5.

remain what seems to be very close to privately held companies, on the other hand.⁴³

Turning to a different matter, § 172, Subsection 2, of the Companies Act creates an exemption to § 79, Subsection 3, of the Act by stipulating that shareholders may decide by a majority of four-fifths that no shareholder may exercise voting rights attached to his own shares or those of others for more than a specific part of the voting share capital of a company. It is thus possible to “cap” the votes of any shareholder of a company, irrespective of the size of his holding of shares. This means that the aggregate number of votes of a shareholder may be less than 10 percent of the total number of votes attached to his shares, as a consequence of which the shareholders’ votes may be diluted by more than the maximum disparity in voting rights (1:10) set forth in § 67, Subsection 1, of the Companies Act.⁴⁴

Frequently, the charter of a company stipulates, on a “sliding-scale” basis, the number of votes attached to the various sizes of stockholdings – limiting the voting power per share in proportion to the number of shares owned by the shareholders – and including an absolute maximum, with the effect that no stockholding will give the owner a right to a number of votes in excess of such maximum. This type of minority protection may probably be adopted by the shareholders pursuant to § 172, Subsection 2, of the Companies Act.

A more drastic way of limiting the voting rights of shareholders is by limiting each shareholder’s voting power to one vote, no matter how many shares the shareholder owns. In particular, if the shares of a company are spread among many small shareholders, such a voting provision would give management a substantial influence over the company. This influence is further strengthened to the extent that the board obtains proxies from shareholders to vote on their behalf. The shareholders on their part may want to consider if granting management such a strong position is desirable from a shareholder viewpoint. Abandoning the right to influence the company is most likely a disadvantage for them.⁴⁵

⁴³ The implications of this right to entirely divide the economic interests and the right to govern companies and the impact hereof on contested takeovers are discussed further under 16.3.1. See also V.2.2.

⁴⁴ See Gomard, *Aktieselskaber og anpartsselskaber* p. 159, Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 136 and Werlauff, *Ugeskrift for Retsvæsen* 1986.B 233.

⁴⁵ For a further discussion of this, see under 16.3.2.

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Rather than applying the concept universally, “capped” voting rights may be limited to decisions regarding particular matters. It may, for example, be stated that the limitation of voting power should only pertain to decisions regarding election of the board or proposals for mergers and other corporate restructurings of the company. In the latter case it may, in addition, be stipulated that such spread of voting power is only applicable if the acquiror, or a company controlled by him, is a party to the merger or restructuring and such transaction takes place within a specified period after the acquiror’s acquisition of a controlling holding of shares of the company.

Depending on how the “cap” on the voting rights is shaped, one of the consequences may be that the acquisition of more than 50 percent of a company’s shares does not constitute the transfer of a “controlling interest”, cf. the discussion of Rule 4 of the Stock Exchange Rules of Ethics under VIII.2.1.

Disparate voting rights may be tied to the period of ownership so that e.g. a share gives the shareholder one vote for a period of two years after the acquisition but that it will carry ten votes after the expiry of the two year period. There is hardly any basis for making it a condition that the voting right must amount to 10 percent of the “full” voting right within the two year period in the example, cf. § 67, Subsection 1, of the Companies Act, provided that the full voting rights attaching to the shares of the particular class of shares amount to at least 10 percent of the votes attaching to shares of the other classes of shares of the company. However, a rule pursuant to which no votes shall attach to the shares for a period of two years after the acquisition would violate the three month requirement under § 67, Subsection 2, of the Act.

One may raise the question if it is possible in the charter of a listed company to stipulate disparate voting rights that are not tied to the shares but to the owners of such shares. The Companies Act does not directly address the question and the answer as regards non-listed companies is, therefore, subject to uncertainty.⁴⁶ As to listed companies, the problem, however, is whether such a charter provision would comply with § 5 of the Order on Listing Requirements and Form A, item II, 2, attached to the Order, stating that shares shall be freely negotiable. Tying disparate voting rights to the owner of the shares does not fall within what is ordinarily

⁴⁶ In Werlauff, *Generalforsamling og beslutning* p. 347 the view appears to be that differences in voting rights may not be tied to the persons owning the shares. For a different view, see Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 135.

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understood as restrictions on negotiability. On the other hand, there is no doubt that having different voting rights depending on who owns the shares may very well, in effect, lead to the shares not being freely negotiable. A charter provision which, for example, sets forth that the existing shareholders of a company have the full votes attached to their shares while the voting rights are reduced to 1/10 in the event that one or more designated acquirors purchase the shares is a de facto limitation of the negotiability of the shares.⁴⁷ Therefore, it is probably right to assume that charter provisions of a listed company may not contain discriminatory voting rights of this nature.

To avoid a group of shareholders cooperating in order to acquire a controlling holding of shares, the charter of a company may provide that shareholders who may be viewed as a “club” should be treated as if they were one shareholder only. A consequence of this would be that such shareholders cannot jointly exercise more votes than the maximum number of votes per shareholder stipulated in the charter. If a charter does not contain such a clause dealing with “clubs” of shareholders, each member of such a group of shareholders would have the right to cast as many votes as are set forth in the charter.⁴⁸ This probably does not apply if a shareholder by using “dummies” attempts to increase the number of votes he is entitled to cast pursuant to the charter.

A number of the defensive devices discussed here give rise to serious concerns as regards the desire for a market for companies that is able to respond to changes in the business environment. We will consider this – as well as the EC initiatives relevant to these issues – further under 16.

2.5. Elections to the board of directors

2.5.1. American law. Traditionally, shareholders have at each annual shareholders’ meeting elected members for the entire board of directors. However, several state corporate statutes⁴⁹ allow for the use of “staggered” boards, meaning that each board member is elected for e.g. a 3-year term and that the shareholders may only elect a minority of the board members

⁴⁷ The model discussed in the text is different from the use of a record date, which may temporarily prevent not only particular acquirors but any new shareholders from exercising his influence at a shareholders’ meeting.

⁴⁸ Using a shareholder “club” clause may entail that shareholders that cooperate are unable to gain control of a company to the effect that Rule 4 of the Stock Exchange Rules of Ethics does not apply.

⁴⁹ See e.g. Delaware General Corporation Law § 141(d) and New York Business Corporation Law § 704.

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at each annual election. For example, it may be stipulated that out of 3 members of a board, the shareholders have the right to elect member number one in year 1, whereas the second and third members are elected in years 2 and 3, respectively.⁵⁰

A provision on staggered boards may be tied to a clause pursuant to which elections to the board can only take place at the company's annual shareholders' meeting and, as allowed by several state statutes⁵¹, the provision on staggered board may be supplemented by a clause providing that board members can only be removed extraordinarily if such removal takes place for cause.

The use of staggered boards does not protect the board members from being removed. However, even an acquiror who has gained control of the company cannot remove the entire board at once but will have to remove each class of board members successively when their term expires. As long as the incumbent board members still constitute a majority of the board, they are still in a position to amend the company's by-laws and otherwise make decisions, which the acquiror may not necessarily deem desirable. However, the board owes fiduciary duties, not only to the other shareholders but also to the acquiror in his capacity of shareholder. Frequently, boards have difficulties handling these situations, where they may feel tempted to prevent the acquiror from actually exercising control, yet must act with due consideration of the interests of the acquiror.

Also, the voting provisions may be formulated in a fashion that may delay a contested takeover. Unless otherwise provided for, each shareholder is entitled to one vote for each share of capital stock held by the shareholder. However, many state corporate statutes⁵² provide that a company may arrange for cumulative voting instead. This option, which, if chosen, must be reflected in the company's charter, entails that each shareholder will be entitled to cast as many votes for the election of directors as he would otherwise be entitled to cast multiplied by the number of directors to be elected. Each shareholder may cast all his votes for a single

⁵⁰ Although some of the state corporate statutes allow for more than 3 classes of board members, NYSE Listed Company Manual, § 304.00, does not allow securities of companies that have more than 3 classes for listing at the stock exchange.

⁵¹ See, for example, Delaware General Corporation Law § 141(k) and New York Business Corporation Law § 706.

⁵² See e.g. Delaware General Corporation Law § 214 and New York Business Corporation Law § 618.

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director or he may distribute them among the directors to be voted for, as he desires.

The effect of cumulative voting is that management may have an improved basis for gathering a sufficient number of votes to delay, or even prevent, a contested takeover. However, cumulative voting is only attractive from the viewpoint of management if the acquiror owns a substantial holding of shares without owning the majority. If an acquiror is already the owner of a majority of shares in the target-company, cumulative voting will not have any significant beneficial effect from management's viewpoint. If the acquiror is the owner of a minor holding of shares in the target-company only, the acquiror and not management will benefit from cumulative voting.⁵³ It is, however, possible to avoid this drawback connected to cumulative voting by stipulating that cumulative voting is only triggered if an acquiror acquires a certain, large percentage of the shares of the company, e.g. 25 percent. This version of cumulative voting concept is known as "contingent" cumulative voting.

Frequently, cumulative voting is tied to the use of staggered boards and a requirement that board members can only be removed when their term expires, unless for cause.

Sometimes, but less frequently, companies have stipulated that certain groups of shareholders cannot be elected as board members. If provisions of this nature have only been adopted for the purpose of excluding a particular shareholder from becoming a member of the board, such an arrangement will constitute a breach of the board's duties towards that shareholder.⁵⁴

Another way of delaying an acquiror's exercise of control is by reducing the number of board members, which will have the effect that an acquiror who only has a limited holding of shares in the company is prevented from electing a board member and thereby exercising his influence in connection with the management of the company. Even in these cases it is crucial that the reduction of the number of board members does not take place at a point in time and under circumstances where it is clear that the sole purpose has been to prevent a particular acquiror from gaining control of the company.⁵⁵

⁵³ See Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 333.

⁵⁴ See e.g. *Financial Federation v. Ashkenazy*, (transfer binder 1984) Fed. Sec. L. Rep. (CCH) 91,489 (C.D. Cal. May 9, 1983).

⁵⁵ See generally Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 335.

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2.5.2. **Danish law.** The Companies Act allows the use of a “staggered” board so that, for example, only one member out of a total of three members will be elected at each annual shareholders’ meeting. However, such a charter provision does not prevent an acquiror that has a bare majority from removing the entire board at any time, cf. § 50, Subsection 1, last sentence, and *Fuglsang v. Konrad Jørgensens Bogtrykkeri, L. Fuglsang og Sønner Aktieselskab* (U1976.755, W. Cir.).⁵⁶ Consequently, provision of a staggered board in a company’s charter does not protect incumbent board from being removed in its entirety once an acquiror has gained control.

In the *Fuglsang*-case, the court seems to presuppose that shareholders may, by signing a shareholders’ agreement, bind themselves not to remove any members of the board, unless such removal takes place with due respect to the agreed cycle of elections to the board. A shareholders’ agreement of this nature would, in effect, change the state of the law as set forth in § 50, Subsection 1, last sentence, of the Companies Act.⁵⁷

Another means by which to protect the entire board against removal at once is to tie the right to elect each member of the board to particular classes of shares so that, for example, a member of the board is elected and can only be removed by a majority of the shareholders of the class that elected him.⁵⁸

A third option by which the minority shareholders’ interests may be protected is by providing in the charter that a candidate for the board who has received e.g. 25 percent of the votes cast shall be considered to be elected, no matter that the candidate has not received a majority of the votes cast.⁵⁹

The shareholders may also consider adopting a charter provision that would give others than the shareholders a right to elect a number of members of the board. This right may be granted either to third parties (e.g. a major creditor, the founders of the company or a public agency) or to a shareholder or group of shareholders, always provided, however, that the majority of the members of the board shall be elected by the shareholders

⁵⁶ See also Gomard, *Aktieselskaber og anpartsselskaber* p. 125 ff. and Thomsen, *A/S-loven med kommentarer* p. 254-255.

⁵⁷ The particular problem in the *Fuglsang*-case was, however, that there was only insufficient evidence showing that such a shareholders’ agreement existed, see the discussion of the case by Gomard, *Aktieselskaber og anpartsselskaber* p. 127, note 14, and Thomsen, *A/S-loven med kommentarer* p. 255.

⁵⁸ See Thomsen, *A/S-loven med kommentarer* p. 255 and Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 177.

⁵⁹ See Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 174 f.

as such at a shareholders' meeting, cf. § 49, Subsection 6, of the Companies Act.⁶⁰ It is probably possible, in effect, to abandon this requirement by entering into a shareholders' agreement that secures the present shareholders a certain influence even after a majority of the shares of the company have changed hands.⁶¹

Unless otherwise provided in the charter, shareholders that represent a bare majority of the votes can elect all members of the board. It may, however, be provided in the charter that the board shall be elected on the basis of cumulative voting.⁶² For the reasons mentioned under 2.5.1., the shareholders should carefully consider the ramifications of the use of such a voting technique. In addition, the shareholders may consider a trigger mechanism according to which cumulative voting only applies in the event that a major percentage of the company's share capital is disposed of.

Cumulative voting is a technique by which the interests of minority shareholders will be protected, for which reason this voting method will hardly ever constitute a violation of § 80 of the Companies Act.

2.6. Increased authority to management

2.6.1. American law. As previously discussed, the business judgment rule constitutes the main standard for the courts' evaluation of acts made by management in connection with contested takeovers.

The very definition of the business judgment rule indicates that the rule aims at protecting the company's business, i.e., in particular, the economic interests of the shareholders. Managements have often asked for the shareholders' permission to take into consideration non-economic aspects when attempting to fend off a contested acquiror. The interests of the employees, suppliers or society have been referred to in this connection.⁶³ Even without any provisions to this end in a company's charter or by-laws, management is probably entitled to consider the impact of a contested takeover attempt on, at least, the employees of the company. However, in case of a conflict of interests between the shareholders and others, the

⁶⁰ See Gomard, *Aktieselskaber og anpartsselskaber* p. 125 and Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 204 f.

⁶¹ See the principle expressed in the *Fuglsang*-case.

⁶² See Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 174.

⁶³ See under X.3.1.2. for a discussion of the interests managements should pursue and the initiatives which some states have taken to provide for a right for management to consider other interests than the interests of the shareholders.

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shareholders' interests take priority, unless the shareholders decide otherwise.⁶⁴

2.6.2. Danish law. Under X. we attempted to determine the interests which management is expected to pursue in the takeover context according to the Companies Act.

It is not surprising that the Act fails to deal with the question whether shareholders may provide in the charter that the board may take into consideration other interests than those which it is ordinarily supposed to protect and promote when facing a contested takeover attempt.

There is probably nothing to prevent shareholders from adopting such a charter provision. Ordinarily, this kind of charter amendment would require the usual two-thirds majority of both the votes cast and the voting share capital represented at the shareholders meeting, cf. § 78 of the Companies Act. However, depending on the nature of the change, a majority of more than three-quarters (§ 79, Subsection 2) or even unanimity (for example, § 79, Subsection 1, item 1) may be required. Also, if the purpose of such a charter amendment is to procure undue advantage to certain shareholders or others at the expense of the other shareholders or the company, the resolution may not pass muster under § 80 of the Companies Act.

In connection with the drafting of such charter provisions it should also be borne in mind that management may not be granted powers that would violate the Companies Act, including the provision in § 78, according to which charter amendments must be adopted by the shareholders at a shareholders' meeting.⁶⁵

Because of the potential conflict of interests discussed earlier, shareholders should be very careful when allowing management a very wide discretion in connection with management's role in the takeover context.

2.7. Anti-green-mail provisions

2.7.1. American law. As discussed under 7., the management of a company may try to fend off a takeover attempt by repurchasing shares owned by an acquiror. Such a buy-back of shares leads to the acquiror receiving a premium price as compensation for not acquiring other shares in the com-

⁶⁴ For a discussion of these issues, see Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 332.

⁶⁵ See Gomard, *Aktieselskaber og anpartsselskaber* p. 151 ff. and Gomard, *Aktieselskabsret* p. 312 f.

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pany for a certain period of time. Repurchase of shares in this situation – known as “green-mail” – may be very costly for the company and its shareholders. A by-law provision prohibiting green-mail may have the effect that arbitrageurs who only wish to gain a quick profit by threatening companies abstain from doing so. It should be borne in mind, however, that a prohibition against repurchase of shares creates a restriction on management’s right to use such repurchases in connection with “friendly” attempts to acquire control of the company. A prohibition thus prevents management from buying back a minor part of a company’s shares from a third party as a part of an alliance.

2.7.2. Danish law. Under Danish law, substantial limitations apply to the right of a company to acquire its own shares, cf. the 10 percent ceiling in § 48, Subsection 1, of the Companies Act. Moreover, § 16 B, Subsection 1, of the Tax Assessment Act⁶⁶ entails that from a tax point of view it is not very desirable for the shareholders to sell their shares back to the company that issued the shares. For these reasons and because the board’s purchase on behalf of the company of the company’s own shares ordinarily requires authority from the shareholders, cf. § 48, Subsection 2, of the Companies Act, there is only a limited demand for a charter prohibition against green-mail payments.

The right for a company to acquire its own shares under § 48 a of the Companies Act where such acquisition is necessary to avoid “substantial and imminent harm” to the company can hardly be eliminated by means of a charter provision.

Apart from such “cases of emergency” there is nothing to prevent shareholders from adopting by two-thirds majority (cf. § 78 of the Companies Act) a charter provision that prohibits the company’s purchase of its own shares or the payment of green-mail.⁶⁷

2.8. Special repellents which may be considered under Danish law: consent to transfer, ownership limitations and rights of first refusal. In the following we will consider three means of restricting the negotiability of shares.

It follows from § 79, Subsection 1, item 3, of the Companies Act that the introduction of restrictions on the negotiability of existing shares is only valid if adopted with the approval of all shareholders. However, pur-

⁶⁶ See IX.3.3.

⁶⁷ The relevance of § 48 a in the takeover context is discussed further under 7.2.

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suant to § 172, Subsection 1, the shareholders may resolve by a majority of four-fifths of the voting share capital that the company's consent⁶⁸ is required for transferring shares to which voting rights are attached. If such proposed charter amendment does not receive the said number of votes it may, if it has, nevertheless, received four-fifths of the votes cast, be adopted by such lower majority at a subsequent shareholders' meeting.⁶⁹

However, as regards companies having shares listed on the Copenhagen Stock Exchange, the particular provisions of the Order on Listing Requirements apply. This Order provides, *inter alia*, that listed shares must be "freely negotiable" ("frit omsættelige"), cf. § 5 of the Order and Form A⁷⁰, item II, 2.

The above-mentioned provision of Form A adds that the Board of the Copenhagen Stock Exchange may grant an exemption from this principle of free negotiability only if the use of a consent clause cannot lead to market turbulence.

It is remarkable that when speaking about possible exemptions the Form only deals with consent clauses.

This is particularly puzzling because of the criteria that have been fixed as relevant for the granting of exemptions. The "market turbulence"-test focuses on the impact that restrictions on negotiability may have on the market. Market turbulence is caused by investor uncertainty and, generally speaking, one could say that any kind of consent clause by its nature gives the board of a company a certain discretion and is, therefore, likely to lead to market turbulence. But why, then, is the Board of the Stock Exchange not authorized to accept the use of ownership limitations, i.e. charter provisions which stipulate the maximum number of shares which any shareholder may own? Clauses of this kind do not contain any element of discretion and would, consequently, not lead to market turbulence.⁷¹

⁶⁸ The board is the body authorized to grant the consent on behalf of the company unless otherwise provided, see § 20, Subsection 2, of the Act.

⁶⁹ Shareholders who oppose this restriction in the right to transfer their shares freely may demand that the company redeem their shares, cf. § 172, Subsection 4. According to § 18 of the Companies Act, restrictions on the negotiability of shares can only be applied with respect to registered shares.

⁷⁰ Form A is a verbatim reprint of the EEC Directive of March 5, 1979, on the correlation of the conditions for admission of securities for official quotation at a stock exchange (1979/279/EEC).

⁷¹ As we shall see later, however, there are other reasons why ownership limitations should not be permitted in the charters of listed companies.

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Against this background it is not surprising that the Board of the Stock Exchange has had some trouble in connection with its exemption practice, which is illustrated below.

In August, 1988, the Board of the Copenhagen Stock Exchange rendered a decision regarding charter provisions adopted by three Danish banks and pursuant to which transfer of shares would be subject to approval by the board of the bank. The issue was if it would be possible for any of the banks to remain listed on the Copenhagen Stock Exchange even though, according to a charter amendment, no shareholders may own more than a certain percentage of the share capital without obtaining approval from the bank, i.e. the board of such bank. In the case of the three banks the charter provisions also stipulated guidelines for when an approval might be granted by the board. The Board of the Copenhagen Stock Exchange decided that there is nothing that prevents listed companies from adopting charter provisions that subject stock transfers to the company's approval if the transfer would lead to a shareholder owning more than a specific percentage of the company's share capital. However, the Board of the Stock Exchange made it a condition that the threshold for approval is not fixed below 10 percent, and that more detailed guidelines for the administration of the board's right to approve be set forth in the charter.⁷² In the case of one of the banks, Jyske Bank, the charter provided that the board could only grant its approval of a share transfer in connection with the establishment of a holding company or in connection with a restructuring of the bank. Due to the narrow and very specific framework within which approvals may be granted, the Board of the Copenhagen Stock Exchange decided that the approval requirement would not lead to market turbulence. The rationale for this view is probably that it is relatively easy for investors to evaluate the importance and effects of a simple and precise rule of approval that leaves no doubt or uncertainty about the position of the shareholders.

However, the Danish Commerce and Companies Agency, with which charter amendments must be registered, took the position that a charter provision which is worded so specifically and narrowly does not qualify as a consent clause under § 172, Subsection 1, of the Companies Act, the adoption of which would be subject to a majority of four-fifths as it had happened in the case of Jyske Bank. Rather, the Agency took the position that such a clause is, in effect, a limitation on the number of shares any shareholder may own, and thus comprised by § 79,

⁷² See the press release in the daily newspaper *Børsen* on August 25, 1988, second section, p. 2, and the annual report from the Copenhagen Stock Exchange for 1988, p. 4. One of the three banks, Jyske Bank, had wanted to tie the approval requirement to share transfers that would lead to ownership of more than 5 percent of the company's share capital, cf. *Børsen*, August 25, 1988, second section, p. 2. There seems to be no obvious reason why a 10 percent threshold has been chosen by the Copenhagen Stock Exchange.

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Subsection 1, item 3, of the Companies Act. Consequently, the clause would be subject to the approval of all shareholders. In a listed company it is, obviously, virtually impossible to meet this requirement. Against this background, Jyske Bank submitted to the Board of the Copenhagen Stock Exchange a revised consent clause that would give the board of the bank a wider discretion as to the approval of share transfers. The Stock Exchange – and later the Finance Inspectorate – rejected the request for exemption on the basis of the redrafted consent clause stating that such a broad and thereby less precise provision may lead to market turbulence.

Jyske Bank then appealed to the Ministry of Industry's Appeal Board both the refusal by the Commerce and Companies Agency to register the narrowly worded version of the charter amendment and the refusal by the Stock Exchange to approve the more broadly worded version. In neither matter did the bank succeed: the Appeal Board affirmed the decisions by both the Commerce and Companies Agency and the Stock Exchange, cf. Docket Nos. 88-34.009 and 89-32.346 (both decisions by the Board are dated February 28, 1991).

It is obvious that a clear and narrow wording of a consent clause gives rise to less uncertainty than a more broadly worded clause. Applying the market turbulence test thus supports the stand taken by the Board of the Copenhagen Stock Exchange.

It seems as if the true problem for the Board of the Stock Exchange is that it favors the "objective" ownership limitations rather than the consent clauses but lacks authority under the Order on Listing Requirements to exempt ownership limitations from the general requirement that shares must be freely negotiable.⁷³

However, the discussion of whether or not a restriction on negotiability leads to market turbulence has turned the discussion away from a more important matter. The point is thus that both broadly worded consent clauses and ownership limitations (including consent clauses that are for all practical purposes ownership limitations, cf. above) are problematic.

The former category of clauses leaves it up to incumbent board to decide whether a change of control should take place. Although the board will have to exercise its authority pursuant to a consent clause in accordance with the standards discussed under X., the shareholders, in effect, surrender their right to influence when adopting such a clause.

⁷³ As we shall see under XIII.5.1., there are a few companies currently listed on the Stock Exchange, which have in their charters ownership limitations. These companies, or in some instances their predecessors, were listed prior to the coming into force of the principle of free negotiability discussed in the text.

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As regards the second category, ownership limitations, we do not have the problem of the board administrating the clause.⁷⁴ Here our concern is that all shareholders remain small and, consequently, have very limited powers. By limiting their powers, the shareholders enhance the powers of management. As discussed further under 16.3.3., this is hardly in the interest of the shareholders.

A question somewhat related to the above issue is whether the Stock Exchange would accept restrictions in the negotiability of shares by means of a right of first refusal for the other shareholders of a company in case of transfer of e.g. 10 percent or more of the shares of the company. The aforementioned Form A attached to the Order on Listing Requirements does not authorize the Board of the Copenhagen Stock Exchange to grant exemptions with respect to right of first refusal clauses. This suggests that we must adhere to the “freely negotiable” standard, which was our point of departure. Rights of first refusal cannot be reconciled with this notion. Consistently with this, the Board of the Copenhagen Stock Exchange has taken the – correct – stand that clauses providing a right of first refusal may not be inserted in the charter of a listed company.

Nevertheless, companies which have B-shares listed on the Stock Exchange are free to – and frequently do – insert right of first refusal clauses in their charters as regards non-listed A-shares.

2.9. Economic impact of shark repellents. A number of empirical studies have been made to determine the economic effects of shark repellents. Typically, these studies focus on the impact of adoption of such defenses on the price of the company’s stock. It is not possible to evaluate all shark repellents as a whole, rather, we have to examine the various types of repellents.

John Pound has examined 100 companies listed on NYSE that adopted as a package both supermajority and staggered board charter provisions in the period 1973-79.⁷⁵ These 100 companies were compared to a complementary control group of another 100 NYSE-companies. Pound’s study suggests that the adoption of supermajority and staggered board provisions has significant adverse effects on stock prices. The evidence provided in

⁷⁴ In the case of clauses where consent is limited to holding company arrangements/restructurings, the authority of the board to exercise its discretion is so bound that the discretionary element is almost non-existent.

⁷⁵ See John Pound, *The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence*, 30 Journal of Law & Economics 353 (1987).

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the study suggests that these kinds of charter amendments reduce the frequency of takeover bids significantly. As to those takeover bids that succeed, the provisions of this type do not lead to increased gains for target-shareholders.

In an article called “*An Overview of Takeover Defenses*”⁷⁶, Richard Ruback reviews a number of empirical studies dealing with, inter alia, supermajority and staggered board charter provisions. Ruback’s study suggests that there is a negative stock price effect of 5 percent connected to the adoption of supermajority provisions, whereas the effect of adoption of staggered board provisions on stock prices is estimated by Ruback to be 1 percent.

Ruback’s study also shows that the adoption of charter amendments leading to dual-class capitalization are likely to lead to minor positive effects on the company’s stock (2 percent).

However, a study by Gregg Jarrell and Annette Poulsen⁷⁷ leads to a different result. Jarrell and Poulsen thus found negative price effects of 0.82 percent in connection with recapitalizations. The study was based on adoption of dual-class stock from 1976 through May 1987, and in the last year of the sample the greatest loss was experienced, about 2 percent.

The impact of adoption of cumulative voting provisions has been examined by Sanjai Bhagat and James Brickley.⁷⁸ Their study suggests that cumulative voting rights may increase the value of a company and thus be in the interest of its shareholders.

The studies referred to above reflect the reaction by the market upon the adoption of shark repellents. There is another aspect, however, about which these studies are silent. They do not tell us how managerial performance is affected by some of the shark repellents discussed which lead to insulation of management.

We know from our earlier observations that the ability of shareholders to remove management is a vital part of the process whereby companies stay healthy and competitive, see V. Also, we have reasons to believe that impediments to transfer of control lead to economic inefficiency, cf. I.2.2.

We will consider the impact of shark repellents, together with the impact of other defensive devices as a whole, under 16.

⁷⁶ In *Mergers and Acquisitions* (Alan J. Auerbach, ed.) p. 49 ff.

⁷⁷ See Jarrell & Poulsen, *Dual-Class Recapitalizations as Antitakeover Mechanisms, The Recent Evidence*, 20 *Journal of Financial Economics* 129 (1988).

⁷⁸ Sanjai Bhagat & James Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 *Journal of Law & Economics* 339 (1984)

3. Poison pills

3.1. American law. The so-called “share purchase rights plans” or “poison pills” are one of the most widespread defensive devices, used by more than 900 American companies.⁷⁹

The basic poison pill is an agreement between a company and its shareholders⁸⁰ according to which the shareholders have a right to buy shares of the company at a favorable price if a certain percentage of the company’s outstanding shares changes hands. The poison pill, which will normally give the shareholders right to purchase preferred stock of the company, may, for example, be triggered in the event that an acquiror purchases 20 percent of the company’s outstanding stock.⁸¹

Very often an alternative concept is used, pursuant to which the poison pill is triggered if an acquiror purchases a certain percentage of the company’s stock and, in addition, initiates acts which constitute “self-dealing”. Self-dealing poison pills will be triggered if an acquiror uses his influence over the company to make certain transactions involving the acquiror as a party, e.g. a merger between the acquiror and the target-company.

Poison pills are contingent dividend payments by the company to the shareholders and since dividends are declared by the board of directors, the board may adopt a poison pill without shareholder approval.

If a poison pill is triggered and consequently the shareholders exercise their rights to buy shares of the company at a favorable price, the acquiror’s votes will constitute a lower percentage of the aggregate voting stock of the company and thus dilute the acquiror’s influence. Also, a subsequent merger of the target-company into the acquiror will be significantly more costly for the acquiror, who will now have to cash out or exchange a larger number of shares. An acquiror who faces a poison pill will frequently abstain from making an offer to the target-company’s shareholders. Instead, the acquiror will be motivated to initiate negotiations with the target-management. However, as an alternative he may choose to

⁷⁹ Among the so-called “Fortune 500”, i.e. the 500 largest companies in the United States, more than 50 percent have adopted poison pills.

⁸⁰ As a practical matter, the agreement will be entered into between the company and a so-called “rights agent”, i.e. ordinarily a bank, on behalf of the shareholders. Pursuant to this agreement, the bank is obligated vis-a-vis the shareholders to ensure that the terms and conditions of the poison pill are observed.

⁸¹ In recent years the threshold at which poison pills are triggered tends to be lower than was previously the case, and many poison pills are now triggered if an acquiror purchases 15 percent of a company’s outstanding stock.

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make a tender offer to the target-shareholders contingent upon a redemption of the poison pill. Especially if the tender offer is only open for a very short period of time, such a technique exposes target-management to a considerable pressure. Target-management will often try to avoid this risk by having a clause inserted in the poison pill, according to which management is authorized to redeem the poison pill within certain time limits, known as a “window period”.

The poison pill was used for the first time when Lenox, Inc. tried to fend off a takeover attempt by Brown-Forman Distillers Corp. in 1983. Since then, the poison pill has been developed in a number of versions, the two basic concepts being the “call” poison pill and the “put” pill.⁸²

3.1.1. The call pill. The call pill is the classic poison pill, based on the principle outlined above, although many different versions have been developed.

Most call pills include a “flip-over” feature, which means that if an acquiror exercises his control to merge the target-company into the acquiror, the right to purchase shares at a favorable price may be exercised with respect to the shares of the acquiror. Consequently, the shareholders of the target-company, which has ceased to exist, still have a right to buy shares of the surviving company.

A poison pill which is triggered upon a merger of the acquiror into the target-company is designated as a “self-dealing flip-in” pill. The flip-in feature entails that the shareholders who exercise their right to buy stock of the company, get a share of any additional values of the company as a consequence of the merger.

If a poison pill includes a “window period”, within which the board may redeem the pill, it is often stipulated that any rights under the pill cannot be exercised before the expiry of a certain period of time, e.g. 10 or 15 days after the pill has been triggered.

An alternative version provides that the poison pill is only triggered if the self-dealing transaction contemplated by the acquiror has not been approved by the board of directors. For obvious reasons, a pill of this kind leaves a great deal of discretion with the board, which may be tempted to refrain from redeeming the pill if the board is likely to be removed by the acquiror as a part of the transaction. To avoid this possible temptation for

⁸² It should be noted that poison pills may be designed not only to give target-shareholders but also holders of debt securities a right to purchase or sell securities upon the occurrence of a share acquisition or self-dealing.

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the board, it may be stipulated in the poison pill that any redemptions of the pill require shareholder approval.

An example of a poison pill requiring such shareholder approval is the pill introduced by MCA, Inc. in 1987. MCA, Inc.'s poison pill contained a flip-over as well as a flip-in mechanism. Of special interest, however, is the requirement in the pill that if a cash tender offer is made for all shares of the company, not only a part of such shares, the board is obligated to call for a shareholders' meeting in order to have the shareholders decide whether or not to redeem the pill. This version of the poison pill gives the shareholders the final word with respect to redemption of the poison pill in the event that a tender offer benefits all shareholders on equal terms, irrespective of whether or not such tender offer enjoys the approval of the board.

As a practical matter, the principal terms and conditions for a poison pill are set forth in a certificate attached to the share certificate and traded together with the stock. Upon the occurrence of the triggering event, the company will issue separate purchase right certificates, which may be traded separately. The purchase right certificates will, inter alia, reflect the price to be paid when exercising the right. The rights under a call poison pill will typically be subject to a time limitation. Irrespective of this, the board may ordinarily redeem the pill, provided that the right has not been exercised at the time for redemption and also provided that the shareholders receive a certain compensation fixed in advance.

3.1.2. The put pill. Upon the triggering event, the put poison pill gives the shareholders the right to sell their shares back to the company at a favorable price, unless the acquiror offers to buy their shares at a certain minimum price. The put pill, the use of which is not as widespread as the call pill, may, as is the case with the call pill, contain a nominal price at which shares may be sold. However, the pill may instead include a price which is fixed as being the highest price paid by the acquiror for any shares of the company within a certain period of time. By using such a price provision it is possible to ensure that all shareholders will receive an equal price for their shares.

The put pill, like the call pill, is a dividend right and can thus be issued by the board of directors without shareholder approval.

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3.1.3. Poison pills in the courts. In *Moran v. Household International, Inc.*⁸³ the Delaware Supreme Court held that a board of directors' decision to adopt a call pill with a flip-over feature was valid. The court emphasized that the adoption of the call pill and the board's administration hereof, including the possible redemption, is subject to the business judgment rule.⁸⁴

While the courts have accepted that a board's adoption of a call pill may be a valid defense under the business judgment rule, it has been less clear under what circumstances a board may be required to redeem a poison pill. However, the decision in *City Capital Associates Limited Partnership v. Interco Incorporated*⁸⁵ provides a certain clarification. In this case a company's board proposed a restructuring of the company as a response to a tender offer which the board found contained an "inadequate"⁸⁶ price. The proposal for restructuring would, in the board's opinion, lead to a price per share of at least 76\$, while the tender offer contained a price of 74\$ per share. In order to protect the implementation of the proposal for restructuring, the board abstained from redeeming the poison pill. By failing to redeem the pill, the board, in effect, deprived the shareholders of the right to sell their shares at 74\$ per share. The court held that the board had a duty to redeem the pill and give the shareholders the opportunity to choose between selling their shares and awaiting the outcome of the restructuring. In its decision the court stressed that the tender offer had not posed a threat to the shareholders' interests that could justify the board's response.⁸⁷ It is probably fair to read the case as expressing the view that a poison pill may remain in place as long as it works in the interest of the shareholders. In some instances poison pills may, arguably, encourage or

⁸³ 500 A.2d 1346 (Del. 1985).

⁸⁴ See also *Horwitz v. Southwest Forest Industries, Inc.*, 604 F. Supp. 1130 (D. Nev. 1985) and *APL Corp. v. Johnson Controls, Inc.*, 85 Civ. 990 (E.D.N.Y., March 25, 1985).

⁸⁵ 551 A.2d 787 (Del. Ch. 1988).

⁸⁶ While the board did not approve the price in the tender offer, the offer could not be considered unfair to the shareholders or some of them. Had the offer been unfair, the board would undoubtedly have had more flexibility to prevent the takeover.

⁸⁷ For a discussion of this criterion, see *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) and under X.3.1.2. Another element of the City Capital Associates case was that it was not at all certain whether the restructuring proposed by the board would lead to the anticipated share price and thereby give the shareholders a better deal than the pending tender offer.

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facilitate bids from other prospective buyers. On the other hand, the case suggests that a poison pill must be redeemed if it has the opposite effect and prevents buyers from making offers or shareholders from accepting them.⁸⁸ A similar view on a target-board's duties with respect to poison pills has been expressed in *Grand Metropolitan PLC v. The Pillsbury Company*.⁸⁹

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*⁹⁰, the Delaware Supreme Court in its dictum approved the use of a put poison pill. In connection herewith, the court emphasized that in the circumstances the put pill was a reasonable protection of shareholders against a contested takeover at a price below the company's intrinsic value. The court also noted that the pill left sufficient flexibility with the board to address any proposal deemed to be in the shareholders' best interest. The court evaluated the adoption of the put pill under the business judgment rule and concluded that the adoption was the result of a reasonable exercise of directorial business judgment. As a consequence of the *Revlon*-case it seems clear that adoption of a put pill is valid, provided that such adoption meets the standards of the business judgment test.

However, if the put pill leads to the payment of an unreasonably high price to the beneficiary shareholders, or if the threshold triggering the pill is very low, the courts may invalidate the pill.⁹¹

If an acquiror has already acquired shares of the target-company and the target-company's board adopts a put pill which benefits all shareholders but the acquiror, the pill will probably constitute a violation of rule 13e-4

⁸⁸ See also *Southdown, Inc. v. Moore McCormack Resources, Inc.* (1987-1988 transfer binder) Fed. Sec. L. Rep. (CCH) 93,792 (S.D. Tex., April 4, 1988).

⁸⁹ (1988-1989 transfer binder) Fed. Sec. L. Rep. (CCH) 94,104 (Del. Ch., December 16, 1988). In *TW Services, Inc. shareholders litigation v. SWT Acquisition Corp.*, (1989 transfer binder) Fed. Sec. L. Rep. (CCH) 94,334 (Del. Ch., March 2, 1989) it was held that a target-company's management had no duty to redeem a poison pill in a situation where a tender offer was made contingent upon the adoption of a merger agreement. In this case, however, other specific circumstances justified the target-management's failure to redeem the pill. See also the case law mentioned under X.3.1.2. in connection with the discussion of the "just say no"-defense.

⁹⁰ 506 A.2d 173 at 180-181 (Del. 1986).

⁹¹ See also the discussion in *Dynamics Corporation of America v. CTS Corporation*, 635 F. Supp. 1174 (N.D. Ill. 1986).

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of the Williams Act, according to which repurchase of a company's own shares by means of a tender offer may not be selective.⁹²

3.2. Danish law

3.2.1. The call pill. The concept of poison pills as it is known in the United States would encounter a number of problems if it were to be introduced into Danish law.

First, under Danish law dividends are declared by the shareholders at a shareholders' meeting, cf. § 112 of the Companies Act.⁹³ This means that the board of a Danish company cannot on its own issue shares as a form of dividend payment.

Danish law permits the shareholders of a company to authorize the board in the company's charter to increase the share capital by means of an issue of shares at a price stipulated in advance, cf. § 37 of the Companies Act.⁹⁴ However, any authority to the board to increase the company's share capital must comply with the general requirements found in Chapter 5 of the Act pertaining to share capital increases.

One of the fundamental principles set forth in Chapter 5 is that all existing shareholders of a company have a preemptive right to subscribe ("fortegningsret") to any new shares issued by the company, cf. § 30, Subsection 1, of the Act.

As described in further detail under 8.2., the shareholders may, subject to the relevant majority or unanimity requirements, deviate from this point of departure.

Discrimination of an acquiror in connection with a resolution to depart from the rule in § 30, Subsection 1, would require his consent, cf. § 79, Subsection 3,⁹⁵ and § 80.

It follows from these comments that shareholders may not authorize the board to increase the share capital of a company once a certain percentage of the company's shares changes hands, by allowing only the existing shareholders – and not the acquiror – to subscribe to the new shares.

⁹² For further discussion of the "all-holders"-rule, see VII.2.3.3.

⁹³ However, the shareholders may not resolve to pay a higher dividend than proposed or approved by the board. Chapter 13 of the Act stipulates in detail when and how dividend payments are to be made.

⁹⁴ According to § 37, Subsection 1, such authority may only be granted for a 5 year period at a time. However, upon the expiry of such a 5 year period the shareholders may decide to extend the authority for one or more 5 year periods.

⁹⁵ See Gomard, *Aktieselskaber og anpartsselskaber* p. 76.

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We saw under 3.1. that the incentive for shareholders in the U.S. to acquire shares pursuant to a poison pill is the fact that the shares may be bought at a favorable⁹⁶ price. Even this element of poison pills, viewed separately, would create problems under Danish law. If some shareholders were granted the right to acquire shares at a favorable price, it would be necessary to obtain the approval of those shareholders who do not participate in the benefits, cf. § 79, Subsection 3.

The right for shareholders to decide on the issuance of convertible securities which would give the holder a right to convert his security into shares of the company is subject to the same restrictions in terms of deviating from the preemptive rights of shareholders as those outlined above, see § 41, Subsection 2, of the Companies Act.

3.2.2. The put pill. Using the put pill under Danish law would encounter several difficulties as was the case with respect to the call pill.

First, a company may only acquire 10 percent of its own shares, cf. § 48, Subsection 1, of the Companies Act. This obviously constitutes a considerable limitation in the effects of a poison pill.

Second, § 16 B, Subsection 1, of the Tax Assessment Act provides that a shareholder who sells his shares to the company that has issued the shares will be taxed in respect of the entire consideration, cf. IX.3.3.

Third, for reasons similar to those stated under 3.2.1., giving the shareholders – except the acquiror – a right to sell part of their shares back to the company if the triggering event occurs, would constitute an undue discrimination of the acquiror and thus violate § 80 of the Companies Act.

3.3. Economic impact of poison pills. The use of poison pills is probably the defensive device that has been subject to most discussion and criticism. Critics have argued that the use of poison pills insulates management from shareholder control. Poison pills are adopted and administered by the board, typically without prior shareholder approval. Also, critics argue, poison pills entail that the shareholders run a risk of missing opportunities to dispose of their shares at a favorable price. Consequently, crit-

⁹⁶ The amount to be paid for a share under Danish law may not be less than the nominal value of the share, cf. § 13, Subsection 1, of the Act. A price that is lower than the intrinsic value of the existing shares of the company but not lower than the nominal value of the shares to be issued would not violate the prohibition in § 13, cf. Report No. 540/1969 on a Joint Nordic Company Law, p. 67 and Thomsen, *A/S-loven med kommentarer* p. 130.

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ics add, poison pills have a negative influence on the stock price of a company.

See Paul H. Malatesta & Ralph A. Walkling, *Poison Pill Securities, Stockholder Wealth, Profitability, and Ownership Structure*, 20 Journal of Financial Economics 347 (1988) (Malatesta and Walkling have made an empirical study suggesting that poison pills harm shareholder wealth) and Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in *Knights, Raiders, and Targets* p. 314 ff. at 343 ff.

Proponents of poison pills have argued that the pills do not prevent takeovers otherwise desirable but should rather be considered a “lever” for the management to achieve the best possible price for the shares, which is in the best interest of the shareholders.

The effect of the use of poison pills has been subject to various studies. One of the most recent studies is the study by the proxy solicitor firm Georgeson & Co., Inc., dated October 31, 1988, *Poison pills don't kill: Pills do not prevent takeovers or diminish shareholder value*. This study suggests that poison pills do not prevent contested takeovers, but rather lead to higher prices for the tendering shareholders to the extent takeovers succeed. The Georgeson-study has been criticized by Analysis Group, Inc., who in a study entitled *The Effects of Poison Pills on Shareholders: A Re-Analysis of Georgeson's Sample* (December 1988) concludes that no empirical evidence supports the notion that poison pills are in the best interest of shareholders.

Georgeson & Co., Inc. has previously made a study with a similar conclusion as the study published in October 1988. The previous Georgeson-study has been criticized in the Wall Street Journal, March 31, 1988, p. 55. On October 23, 1986, the Office of the Chief Economist of the SEC published a detailed report, *The Effects of Poison Pills on the Wealth of Target Shareholders*, concluding that poison pills are not in the best interest of shareholders. Not all authors share this view, see, for example, Andrew R. Brownstein, *Rights Plans: Still the Most Effective Defense*, Insights, Vol. 1, No. 1, p. 9 ff. (1987).

Even though some poison pills may motivate acquirors or prospective acquirors to negotiate with target-management, no empirical evidence provides a final answer to the question of whether or not poison pills are in general in the best interest of target-shareholders.

However, since members of target-management may have many reasons for not negotiating with an acquiror who plans to remove them, it seems likely that poison pills deter many acquirors from making acquisitions that they would otherwise make. If they know in advance that a poison pill is in place and target-management will do its best to avoid a takeover, ac-

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quirors may abstain from attempting a takeover rather than suing the company in order to have the pill redeemed.

It thus seems right to assume that poison pills are not in the target-shareholders' interest and, moreover, create impediments to transactions in the stockmarket.

As stated earlier, however, we need not be concerned about the spread of poison pills to the Danish stockmarket.

4. The vitamin pill

4.1. American law. In December 1988 a new defensive device was introduced, which, despite the name – vitamin pill – is fundamentally different from the poison pills previously known. The inventor⁹⁷ of the vitamin pill has described the pill as “share price protection repurchase rights”.

The main principle behind the vitamin pill is to commit management to manage the company in a fashion that ensures that the price of the company's shares will reach a certain level at a future date, fixed in advance. If the stock price does not reach the level stipulated, the shareholders of the company will receive a dividend which gives them a right to sell their shares back to the company at a high price.⁹⁸ To enable long-term plans, including research and development projects, to be implemented and reflected in the relevant share price, the time at which the share price must reach the minimum level should be fixed at least a few years ahead. The rationale behind the vitamin pill is that adoption of the pill will lead to an increased stock price and thereby make a contested takeover less likely. As opposed to the poison pill previously discussed, the emphasis in connection with the vitamin pill is put on increasing the value of the shareholders' investment. If management's long-term planning proves not to be successful and the fixed threshold price is not reached, the company will probably have to restructure its business, and the threat of such a restructuring is considered to motivate management to perform at its very best.

It is as yet unknown how the courts will evaluate the vitamin pill. Since the principal purpose of the vitamin pill is to increase the value of the shareholders' investment and not to prevent the shareholders from selling their shares to a contested acquiror, it is likely that the vitamin pill will be

⁹⁷ The vitamin pill was introduced by the New York law firm Wachtell, Lipton, Rosen & Katz in a circular letter to the firm's clients dated December 1, 1988.

⁹⁸ Compare the put pill discussed under 3.1.2.

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reviewed under the business judgment rule and thus be upheld if the business judgment test is met.

4.2. Danish law. Due to the restrictions on companies' right to acquire their own shares and the tax treatment of sales of shares to the issuer, discussed under 3.2.2. above, a "put" vitamin pill would have limited interest in Denmark. Instead, we will try to examine if a "call" version of this pill passes muster in Danish law.

According to § 37, Subsection 1, of the Companies Act, the shareholders may at a shareholders' meeting authorize the board of a company to increase the company's share capital, such authority to be granted for one or more periods of 5 years.⁹⁹

§ 37 sets forth the minimum provisions that must be included in an authority to the board, while there is no reason to believe that the shareholders cannot include in the authority further provisions governing the board's exercise of its authority.

There is probably nothing to prevent shareholders from including in the authority provisions which specify that the authority to increase the company's share capital is only triggered in the event that, on a future date fixed in advance, the company has not reached certain economic targets. This could be done, for example, by stating that the authority can only be exercised if the officially quoted price of the shares is less than X on January 1, 1995.

It is thus possible to use the vitamin pill under Danish law in this modified version where shareholders do not sell their shares to the company but rather have the right to acquire shares if the conditions in the authority to the board are met.

Assuming that all shareholders will have a right to subscribe to new shares, this concept can hardly be challenged under § 80 of the Companies Act or any of the other protective provisions of the Act.

The problem connected to the use of this concept is primarily of an economic nature. We do not know anything about the way the market will re-

⁹⁹ As the authority requires a charter amendment, a two-thirds majority is required, cf. § 78. The authority must include a number of provisions stipulating the features of the new shares to be issued, see § 37, Subsection 2, and § 32, Subsection 1, items 2, 7, and 8, as well as Subsection 2. Also, the means of payment for the shares and possible deviations from the shareholders' preemptive right to subscribe to new shares must be indicated, cf. § 37, Subsection 2, and § 30, Subsection 3.

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act to this kind of device. The reaction may be positive, but may just as well also be negative, or simply nil.

Also, it is impossible to tell what the economic effect of an increase of the share capital in e.g. 5 years will be. It may be that a capital increase will fit into the structure and demands of the company at that time. But it may also prove to have seriously detrimental effects on the capital structure of the company.

Altogether, there is too much uncertainty and too little predictability connected to the use of vitamin pills.

5. The people poison pill

5.1. American law. In January 1989, Borden, Inc. introduced a new defensive device.¹⁰⁰ The new device is known as the “people poison pill” but, despite the name, there is no resemblance between this pill and the poison pills discussed earlier.

According to the people poison pill introduced by Borden, Inc., the company’s management shall obtain an independent expert fair valuation of the company’s shares once a bid has been made for the shares. When determining the value of the company, the experts must take into account at least 50 percent of the economic advantages which would inure to the acquiror upon a subsequent sale of the company’s assets or in connection with a subsequent merger or restructuring of the company. If it is determined that the acquiror’s offer for the shares of the company is lower than the value computed as outlined, the people poison pill is triggered, unless the acquiror acquires at a minimum a (large) number of shares, such number to be fixed in advance. Triggering the people poison pill entails that removal of one member of top management without cause or changes in the responsibility of such member will be considered a removal of the entire management of the company. It will thus be impossible for an acquiror to pick out a few top managers to be removed while letting the rest of management remain in office. If one goes, they all go. Obviously, the fact that there is a risk that the target-company may lose its entire management at once makes it less attractive for acquirors. This is underscored by the fact that upon such removal top management will often receive large amounts of compensation, known as “golden parachutes”, discussed further under 11.

¹⁰⁰ See Borden, Inc.’s letter of January 4, 1989, to its shareholders, containing a description of the new device.

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The American courts have not yet had the opportunity to review the people poison pill and it is, therefore, not known whether the business judgment rule applies in such case and if the courts will accept that the decision whether to accept the bid is in effect made by target-management rather than target-shareholders.¹⁰¹

5.2. Danish law. Members of the board of a company may at any time resign, cf. § 50, Subsection 1, of the Companies Act. While members of the board may in each case decide to resign collectively, e.g. in support of another member of the board, an agreement in advance that all member shall act in unity and resign if only one is removed would hardly coincide with the obligation to act loyally that the board owes the shareholders and the company, cf. X.4.3.3. and 4.4.

6. The pac-man defense

6.1. American law. The pac-man¹⁰² defense is probably best illustrated by an example from court practice. In 1982, The Bendix Corporation launched a contested tender offer in order to acquire control of another American company, Martin Marietta Corporation. Martin Marietta responded by making a tender offer for the shares of Bendix. After this, the parties virtually raced to acquire control of each other, each party attempting to purchase as many shares of the other that would give the party sufficient control of the other company to effect a decision to halt further share purchases. In this probably one of the most bizarre battles for corporate control it turned out to be important that Martin Marietta and Bendix were incorporated in two different states. Under Maryland law, where Martin Marietta was incorporated, the corporate statute provides that an acquiror who acquires a majority of a company's shares, must wait ten days before a shareholders' meeting can be held and he will be able to exercise his control of the target-company. However, under the laws of Delaware, where Bendix was incorporated, an acquiror who has acquired a majority holding of shares of a company may exercise his influence instantly. This meant that Martin Marietta was capable of exercising control of Bendix before Bendix could do so with respect to Martin Marietta. In *Martin*

¹⁰¹ See the discussion about the people poison pill in Corporate Finance, p. 11 (February 1989).

¹⁰² The name of this defense is derived from a popular computer game by the same name.

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*Marietta Corporation v. The Bendix Corporation*¹⁰³, the Maryland court held that the defensive purchase of Bendix-shares by the board of Martin Marietta did not violate the board's fiduciary duties owed to the new shareholder, Bendix. Based on the specific facts of the matter, the court stated that the board had acted in "good faith" and in furtherance of what it believed was a "good" corporate purpose.¹⁰⁴

The pac-man defense is rarely used, probably because the outcome of this technique is difficult to determine in advance and, in addition, this technique requires a considerable cash investment by the target-company.

6.2. Danish law. The legal point of departure is that the authority to acquire shares of another company is vested in the board. However, since a successful use of the pac-man technique would prevent changes in the management of the target-company and deprive the shareholders of the opportunity to sell their shares maybe at a high price, the board would probably have to submit the decision of whether to use this technique to the shareholders of the company. To avoid any doubt, it may be provided in a company's charter that share purchases in order to prevent a change of control can only take place with the approval of the shareholders at a shareholders' meeting.

Using the pac-man strategy requires substantial investments, and considering that the outcome of the use of such strategy depends to a very large extent on circumstances beyond the control of the target-company itself, the pac-man technique should only be employed after carefully considering the factual pattern in each situation.

7. Repurchase of shares and green-mail

7.1. American law. Subject to statutory provisions under state law protecting a company's capital, management may, as a response to a contested takeover bid, decide to change the capital structure of a company by repurchasing the company's shares.¹⁰⁵ The consequence of a company's

¹⁰³ 549 F.Supp. 623 (D. Md. 1982). The battle between Bendix and Martin Marietta is described by Alan Sloan, in *The Bendix-Martin Marietta War*.

¹⁰⁴ See also *American General Co. v. NLT Corp.*, (1982 transfer binder) Fed. Sec. L. Rep. (CCH) 98, 808 (S.D. Tex., July 1, 1982).

¹⁰⁵ Pursuant to state corporate statutes it is generally a requirement that repurchase of shares can only take place if certain protective requirements are met. Under Delaware law it is, inter alia, a requirement that repurchase cannot take place if the capital of the company is impaired or the repurchase would cause impairment

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repurchase of its own shares is that the number of shares on the market will be reduced, which will normally have the effect that the price of the remaining outstanding shares will increase. Increased stock prices make it more costly and thus less attractive for an acquiror to purchase the remaining shares of the company. All other things being equal, the earnings per share payable to the shareholders will increase, whereby shareholders may feel less tempted to sell their shares. On the other hand, stock buy-backs require cash and repurchases may, therefore, put a strain on a company's liquidity. In the circumstances, this strain may lead to a stagnation of the price of the company's stock, or perhaps even a decrease of the stock price, rather than the increase otherwise expected as a result of the share buy-back.

To the extent allowed under the state statutes, share repurchases may be financed through the issuance of debt securities rather than cash. This will, in effect, increase the company's leverage, which will, in turn, make it more difficult for an acquiror to finance the purchase of the company since a junk bond financed acquisition presupposes that the target-company has assets available for securing additional debt.

Occasionally, companies have been forced to sell off assets or reduce their research and development costs in order to finance the share buy-back. The repurchase may, in other words, lead to a competitive disadvantage for the company.

There is another drawback connected to the use of stock repurchases as a defensive means. Unless a substantial number of a company's shares are already in the hands of a shareholder who sympathizes with incumbent management, stock repurchases may not be efficient to fend off the acquiror.

The American courts have reviewed a company's defensive repurchase of stock under the business judgment rule, cf. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*¹⁰⁶

of the capital (subject to certain exceptions), see the Delaware General Corporation Law § 160. Under New York law, a company may purchase its own shares out of surplus, except when the company is currently insolvent or would thereby become insolvent, see the New York Business Corporation Law § 513. No parallel exists under American law to the rule in the Companies Act, § 48, according to which a company may not acquire more than 10 percent of its own shares.

¹⁰⁶ 506 A.2d 173 at 181 (Del. 1986). If a company repurchases its shares by means of a tender offer, the provisions of the Williams Act must be observed, which means that, inter alia, selective tender offers excluding an acquiror are prohibited.

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Instead of acquiring shares in the open market, the management of a target-company may decide to buy back an acquiror's shares, which has led to the phenomenon known as "green-mail".¹⁰⁷ Green-mail is the repurchase by a company of its own shares at a premium price from an acquiror who has threatened to take over the company. It is a condition for the payment of the premium price to the acquiror that he agrees not to acquire shares of the target-company for a certain period of time. Agreements of this nature are called "stand-still agreements".¹⁰⁸

If green-mail payments are made in the best interests of the company and its shareholders, on an informed basis and not with the sole or prime purpose to perpetuate incumbent management, the business judgment rule has led the courts to accept this defensive step, cf. *Polk v. Good*.¹⁰⁹

In recent years various bills have been proposed in order to limit the use of green-mail.¹¹⁰ In 1987 a 50 percent tax was imposed on profits resulting from green-mail transactions, which probably has reduced the use of green-mail.¹¹¹

7.2. Danish law. As we saw under 7.1., buying back shares as a defensive means will make it more difficult for an acquiror to gain control of the target-company.¹¹² A company's buy-back of its own shares will also make

¹⁰⁷ The term green-mail, probably not by coincidence, resembles the word black-mail.

¹⁰⁸ Under the corporate statutes of certain states, green-mail transactions require the approval of the shareholders. In practice, green-mail transactions are relatively few in number but often involve considerable amounts. In the United States there are a number of investors who have gained expertise in green-mailing and they include Carl Icahn, the Bass Brothers and T. Boone Pickens, Jr. It is estimated that T. Boone Pickens' Company, Mesa Petroleum, made profits of approximately one billion dollars as a result of green-mail transactions in 1984.

¹⁰⁹ 507 A.2d 531 at 536-537 (Del. 1986). See also *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964) and *Bennett v. Propp*, 187 A.2d 405 (Del. 1962).

¹¹⁰ See, for example, S 227, 100th Congress, 1st Sess. (1987). According to this proposal, made by Senator D'Amato, a company would have no right to repurchase shares from any shareholder who owns more than 5 percent of the company's equity capital and who has been the owner of such shares for less than 6 months.

¹¹¹ For a discussion of the Revenue Act of 1987, see Peter C. Canellos & Jodi J. Schwartz, *How the 1987 Revenue Act Affects Acquisitions*, Corporate Growth, p. 21 ff. (September/October 1988).

¹¹² Treasury shares are neutral from a voting point of view since no one, including the board of the company, may vote on such shares, cf. § 67, Subsection 3, first

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it more expensive for an acquiror to make a bid pursuant to Rule 4 of the Stock Exchange Rules of Ethics for the remaining shares. Likewise, effecting a merger of the target-company and the acquiror will be more expensive for the acquiror since he will have to be prepared to pay a higher price to the target-shareholders.

From an economic point of view, the purchase by a company of its own shares is tantamount to a reduction of the share capital and payment to the shareholders of a dividend equivalent to the purchase price.¹¹³ If no restrictions existed with respect to the right for a company to buy its own shares, there would be no means by which to prevent the capital structure of companies from being impaired as a result of extensive buy-backs of shares. There are various means by which to reduce this risk. Companies' acquisitions of their own shares can thus be prevented by only allowing buy-backs if certain capital requirements are met, as is seen, inter alia, in the United States. Another alternative is simply to impose a limit to the percentage of shares of a company that the company may own.

§ 48 of the Companies Act uses a combination of the two concepts discussed here.

§ 48, Subsection 1, thus stipulates that a company may not own more than 10 percent of its own share capital. Subsection 4 of the provision adds that buy-backs of shares can only take place if there is "room" to pay such acquisitions within the equity surplus ("frie egenkapital"). Also, buy-backs may never lead to the remaining outstanding share capital being less than DKK 300,000.¹¹⁴

Due to these restrictions, the purchase by a company of its own shares does not have the same significant implications as is the case under American law.

A company's own shares will have to be disregarded when calculating if a proposal has received the number of votes necessary for such proposal to be adopted, cf. § 67, Subsection 3, of the Companies Act.

As a general rule the board cannot effect a buy-back of shares without having the authority from the shareholders, cf. § 48, Subsection 2, of the

sentence, of the Companies Act. See also Gomard, *Aktieselskaber og anpartselskaber* p. 113.

¹¹³ See Gomard, *Aktieselskaber og anpartsselskaber* p. 111.

¹¹⁴ Subsection 5 of § 48 states that buy-backs can only comprise shares which have been fully paid up.

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Act.¹¹⁵ The principal terms and conditions pertaining to the board's repurchase of shares on behalf of the company must be stipulated in advance, cf. § 48, Subsection 3 of the Act. Authority may only be granted for a specific period of time that may not exceed 18 months, cf. Subsection 2.

While giving the board authority to buy shares is typically in the interest of the shareholders, it is hardly in their interest that the board exercises its authority to buy back shares as a response to a takeover attempt.

Although the 10 percent limit restricts the impact of share buy-backs, such purchases may still create an obstacle to acquisitions of the company.

To the extent that the board is authorized to buy shares it ought, therefore, to be stipulated in the authority that the board may not exercise its authority as a response to takeover attempts.

If it turns out in a specific takeover situation that the shareholders deem it to be in their interest to have the company buy back shares, they ought to authorize the board on an ad-hoc basis only.

According to § 48 a, Subsection 1, the board of a company may on behalf of the company buy back shares up to 10 percent of the company's share capital without the approval of the shareholders, provided, however, that such a repurchase is "necessary in order to avoid substantial and imminent harm" to the company.¹¹⁶

As an example of such a situation Thomsen, *A/S-loven med kommentarer*, p. 231, mentions the event where shares of a company are likely to be sold to a competitor. This example is hardly very well chosen. In view of my definition of the interests of "the company" under X., and considering the interests of shareholders, the board should not be permitted to use the "emergency clause" to halt takeover attempts by competitors of the company. Here, as in other events where the company is facing a takeover attempt, the paramount issue is to ensure that it is the shareholders who decide whether or not they should sell their shares.

¹¹⁵ The authority may be adopted by a bare majority, unless otherwise provided in the charter. The authority need not be included in the charter, cf. Thomsen, *A/S-loven med kommentarer* p. 230. In order to avoid renewals of the authority having to be adopted by a two-thirds majority (cf. § 78 of the Companies Act), it may be prudent not to include the authority in the charter.

¹¹⁶ If the board has been granted an authority by the shareholders in advance, it may possibly in such cases of emergency go further as regards the price and number of shares than stipulated in the authority, cf. Gomard, *Aktieselskaber og anpartsselskaber* p. 115.

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Similar views must apply in the event that a takeover attempt takes place with the purpose of liquidating the company. Typically, the shareholders will be strongly influenced by information that an acquiror plans to liquidate a company after the acquisition, which may often lead to the target-shareholders refusing to sell their shares. However, the point is that this decision must be made by the shareholders and not by target-management.¹¹⁷

If the shareholders at a shareholders' meeting approve the repurchase of the company's own shares within the framework of the Companies Act, a repurchase at a price above the current market price (green-mail) subject to the condition that the acquiror abstains from acquiring shares of the company for a period of time (a stand-still agreement) will frequently escape criticism by the minority shareholders. There may, however, be situations where the majority of the shareholders accept to pay an unreasonably high price for the acquiror's shares in an event where the price to be paid to ensure that the majority shareholders remain in control is to be borne by the minority shareholders who may have little or no interest in the majority retaining control. In such events, the green-mail combined with the stand-still agreement may violate § 80 of the Companies Act.

Due to the limitations under § 48, Subsection 1, of the Companies Act and the disadvantageous taxable treatment from a shareholder point of view of the sale of shares to the issuing company pursuant to § 16 B, Subsection 1, of the Tax Assessment Act, repurchase of shares will probably be of limited interest in Denmark.

Instead, management of a target-company may encourage third parties or groups of third parties to buy shares of the target-company. In connection with third party acquisitions of shares, the target-company may succeed in having certain limitations imposed on the third party as to how to vote on the shares and how to dispose of the shares in case the third party wishes to pull out of the company. However, the target-company may not expand its cooperation with the third party to include the granting of loans or the provision of security in connection with the financing of the purchase of the shares, cf. § 115, Subsection 2, of the Companies Act.¹¹⁸

¹¹⁷ Paul Krüger Andersen (Revisions & Regnskabsvæsen No. 7/1988, p. 23 ff. at 35) has taken the position that a "hostile takeover for the purpose of liquidating the company" may be an example of how § 48 a can be used. As indicated in the text, it is doubtful whether this view is correct.

¹¹⁸ See Gomard, *Aktieselskaber og anpartsselskaber*, p. 112. Moreover, it is hardly in accordance with § 115, Subsection 2, for the company to commit itself to reimbursing the third party the premium price paid to the target-shareholders or to

7.3. Economic impact of repurchase of shares and green-mail. Some commentators have argued that green-mail payments are in the interests of a company and its shareholders. They claim that green-mail only has detrimental effects on shareholders if it is used by incumbent management to protect management's position, in which case the green-mail payment will constitute a breach of the business judgment rule. Moreover, it is argued that green-mail, or rather the sequence of events of which green-mail is a part, tends to increase the price of a company's stock.¹¹⁹

Critics of green-mail emphasize, however, that this defense technique is primarily an evil, which is used by management to insulate itself from the effects of contested takeovers without the interests of the shareholders being sufficiently protected.¹²⁰

At least a part of the criticism against green-mail is probably tied to the fact that green-mail payments may drain a company's cash reserves and, at least in some events, have a fatal impact on the company.

The experience of St. Regis Corporation in 1984 demonstrates that green-mail payments may, at least in some events, force a company down on its knees. In March 1984, Sir James Goldsmith, a well-known green-mailer, announced that he had acquired 8.6 percent of the shares of St. Regis Corporation and planned to take over the company. The board of St. Regis Corporation then decided to buy back Goldsmith's holding of shares for 161 million dollars, which represented a considerable premium price. A few weeks later, another acquiror announced that he had acquired 8.5 percent of the shares of the company. This time St. Regis paid 141 million dollars for the shares it bought back. By the end of June, 1984, a third acquiror stated that he had acquired 5.6 percent of the shares of St. Regis Corporation. At this point the company had been weakened considerably as a result of the previous green-mail payments. The end of the story was that St. Regis Corporation approached a third party, Champion International, and later merged into Champion while also the third green-mailer received a premium price for his shares of the company now that St. Regis Corporation had received additional funds.

covering a possible loss incurred in connection with such a share acquisition, see also Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 23 ff. at 35.

¹¹⁹ See Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in *Knights, Raiders, and Targets* p. 314 ff. at 341-342.

¹²⁰ For a review of the different views on green-mail, see Note, *Greenmail: Targeted Stock Repurchases and the Management – Entrenchment Hypothesis*, 98 *Harvard Law Review* 1045 (1985).

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In a Note entitled *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*¹²¹, a number of empirical studies of the economic impact of green-mail are reviewed. It transpires from this that the announcement of green-mail-payment led to a drop in the value of the remaining shareholders' shares by an average of 2 to 7 percent. Whatever one may think about the rationale for green-mail-payments, the empirical evidence seems to leave little doubt that at least the stockmarket perceives such payments as negative. A similar conclusion could be drawn on the basis of the studies compiled by Richard Ruback.¹²²

Our prime concern – in addition to the economic impact of stock repurchases – should probably focus on why and by whom shares are bought back. Leaving it up to target-management facing a takeover to decide whether an authority granted to it by the shareholders should be exercised to prevent the takeover attempt is definitely not advisable. Management's motives in such event are affected by the risk that it will be removed upon an acquisition and it is, therefore, not in the shareholders' interest to give management such powers.

8. Issue and allocation of stock

8.1. American law. A company's charter sets forth the number of shares which the company is authorized to issue. While increases in the authorized capital require the approval of the shareholders, the power to issue shares within the limits of the authorized capital is vested in the board of directors. Frequently, the amount authorized in the charter exceeds the issued shares. In such event the board may decide to exercise its right to issue shares as a means to delay or thwart a contested takeover bid.

The effects of a board's issue of new shares will in part depend on whether the existing shareholders have preemptive rights, i.e. right to maintain their proportionate share of ownership of the company by purchasing a proportionate number of shares of any new issues.¹²³

¹²¹ See 98 Harvard Law Review 1045 (1985).

¹²² See Ruback, *An Overview of Takeover Defenses* in *Mergers and Acquisitions* (Alan J. Auerbach, ed.) p. 49 ff.

¹²³ Preemptive rights are dealt with by state law. In Delaware no stockholder has any preemptive rights to subscribe to any additional issue of stock unless otherwise expressly stated in the company's charter, see Delaware General Corporation Law § 102(b)(3). For a somewhat different approach, see the New York Business Corporation Law § 622.

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If the existing shareholders have preemptive rights and some of them exercise their rights by purchasing shares issued by the board, the shares of all existing shareholders who do not exercise their rights will be diluted. An acquiror who has already gained a stake in the company may also see his holding of shares diluted. To avoid this, he must exercise his preemptive right to buy shares, thereby preserving his proportionate interest in the company. Depending on the amount of shares issued by the target-board, the acquiror may decide not to pursue his takeover plans because acquiring control becomes very costly and less attractive.

If the target-shareholders have no preemptive rights, the board may want to find an ally who will be interested in acquiring the newly issued shares of the company. This has led to the use of so-called “white knights” or “white squires”.

A white knight is a person or a company who wishes to acquire a controlling holding in the target-company and who is willing to let incumbent target-management remain in office. A white knight is in agreement with the plans of target-management and has no – or at least expresses no – intentions to remove management. Provided that such an alliance does not violate the fiduciary duties of management, the use of white knights is a means by which the management may arrange that a third party, whom management favors, acquires control of the company. White knight alliances may be in the shareholders’ interest if, for example, the target-company is restructured as a part of the arrangement with the result that the price of the company’s stock increases.

If the authority granted to the board in the company’s charter includes the right to stipulate the terms and conditions for the issue of shares at the time of such issue – known as “blank-check” stock¹²⁴ – the board has even better possibilities of making “friendly” investors interested in acquiring shares of the company. The fact that a white knight enjoys the sympathy of target-management entails, as a practical matter, that alliances of this nature frequently prove successful. However, the board may not benefit a white knight if this means that the duties which the board owes to the shareholders are breached. Acts by the board in favor of white knights are reviewed under the business judgment rule.

From the viewpoint of management, the most significant risk in connection with white knight alliances is that the white knight might change his mind, for example because management proves to be less efficient than it was thought in the first place. Therefore, it is often seen that manage-

¹²⁴ Ordinarily, such blank-check pertains to issue of preferred stock.

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ment establishes an alliance with a white squire rather than a white knight. A white squire does not plan to acquire a majority of the company's shares or to participate in the contest for control. Instead, issue of stock to a white squire will have the effect that a substantial, but not controlling, holding of shares is placed in the hands of a shareholder who is loyal to management. Management may, therefore, expect that the white squire will support proposals from management without making management as dependent as is often the case in connection with white knights. The very fact that a substantial holding of shares is allocated to a "friendly" shareholder will discourage many acquirors from initiating a takeover attempt. On the other hand, acquirors who are determined to acquire control may still succeed by purchasing a controlling interest in the target-company.

Issue of shares to a "friendly" third party is typically reviewed under the business judgment rule and will thus be permissible if this test is met, see e.g. *Treadway Companies, Inc. v. Care Corp.*¹²⁵

However, if management has entered into agreements with a white knight or a white squire for the sole purpose of allocating a large holding of stock to a "friendly" ally, the alliance may be challenged under the business judgment rule. This is, for example, the case if the third party in question is favored unreasonably at the expense of the company and its shareholders, cf. *Consolidated Amusement Co. v. Rugoff*.¹²⁶ Alliances may also be invalidated if they impose restrictions on management which inhibit management's possibilities to act in the best interest of the shareholders, cf. the discussion on lock-ups etc. under 12.

As an alternative to white knights or white squires it is often seen that target-managements attempt to fend off contested takeovers by the use of employee stock option plans, known as ESOPs. By allocating a company's shares to an ESOP, the company is less likely to become the target of a takeover attempt. Even if such an attempt has already been initiated, having the ESOP buy the target company's shares may discourage the acquiror. The use of ESOPs as a defensive device is facilitated in those situations where members of the board of the target-company are also trustees of the ESOP.

However, trustees of ESOPs are subject to quite strict fiduciary duties set forth in the Employee Retirement Income Security Act.¹²⁷ For obvious

¹²⁵ 638 F.2d 357 (2nd Cir. 1980).

¹²⁶ (1978 Transfer Binder) Fed. Sec. L. Rep. (CCH) 96, 584 (S.D.N.Y. 1978).

¹²⁷ According to this Act, commonly known as "ERISA", the trustees have a duty to act in the sole interests of the participants and beneficiaries of the ESOP.

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reasons, a dual position as target-management and trustee of an ESOP has often proven difficult to handle in the takeover context. In *Buckhorn, Inc., v. Ropak Corporation*¹²⁸, the court enjoined a sale of shares to an ESOP where the board had established the ESOP to halt a contested takeover attempt and to entrench management while there were not benefits accruing to the shareholders from the plan. Along the same line, *Norlin Corp. v. Rooney, Pace Inc.*¹²⁹ suggests that a board's transfer of shares to an ESOP in order to protect its control does not enjoy the "free harbor" constituted by the business judgment rule. The result in this case was probably to a large extent a consequence of the fact that no other motivation was found for the board to act as it did than the desire to defeat the contested takeover attempt. In *British Printing & Communication Corporation plc v. Harcourt Brace Jovanovich, Inc.*¹³⁰ the court held that a sale of shares to an ESOP was justified by the desire to motivate the company's employees to increase the company's productivity, which was deemed of crucial importance for a planned restructuring of the company. Also, the court attached importance to the fact that the target-board did not control the voting of the shares held by the ESOP. One of the most recent Delaware decisions, *Shamrock Holdings, Inc. v. Polaroid Corp.*¹³¹ has established that the use of ESOPs as a defensive means should be reviewed under the standard set forth in the business judgment rule and thus be permitted if the business judgment test is met.¹³²

8.2. Danish law. Increase of the share capital of a company may be effected either as a bonus issue ("fondsaktieemission") or as an issue by subscription ("aktietegning").¹³³

The shareholders of a company may at a shareholders' meeting by a two-thirds majority¹³⁴ decide to effect a bonus issue as a means by which

¹²⁸ 656 F.Supp. 209 (S.D. Ohio 1987) aff'd by sum. ord., 815 F.2d 76 (6th Cir. 1987).

¹²⁹ 744 F.2d 255 (2nd Cir. 1984).

¹³⁰ 664 F.Supp. 1519 (S.D.N.Y. 1987).

¹³¹ 559 A.2d 257 (Del. Ch. 1989).

¹³² For a discussion of management's duties in connection with defensive use of ESOPs, see Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 442 ff. The use of ESOPs is also discussed by Mario L. Baeza and Laura A. Taylor, *A Closer Look at Defensive ESOPs*, Insights, Vol. 3, No. 6, p. 3 ff. (1989).

¹³³ See § 29, Subsection 1, of the Companies Act.

¹³⁴ See § 29, Subsection 1, and § 78 of the Companies Act.

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to avoid a contested acquisition.¹³⁵ In such case all shareholders of the company receive a number of bonus shares proportionate to their existing holding of shares.¹³⁶

A bonus issue of shares entails that the shareholders who own stock of a company at the time of the issue will, in the aggregate, become the owners of stock having a total market value that exceeds the aggregate market value of the stock prior to the issue. The reason for this is that the market reacts somewhat irrationally by not “penalizing” the existing, outstanding shares by means of a reduction of their value equivalent to the value that is transferred to the bonus shares. Typically, the value of the existing shares will drop by a fraction only of the value that is transferred to the bonus shares. Even though this means that the target-company will not receive new funds, the bonus issue will make it more expensive for the acquiror to purchase target-shares or to cash out minority shareholders of the company. On the other hand, the shareholders will, as a whole, benefit from the increased profits that will be obtained if the acquiror succeeds in his takeover attempt. Still, the bonus issue may be a disadvantage to the target-shareholders if they lose the opportunity to sell their shares at a favorable price.

If an issue of stock is made not as a bonus issue but as an issue offered for subscription, a distinction will have to be made between cases where the existing shareholders of the company have a preemptive right and situations where one or more new shareholders are invited to acquire shares.

The point of departure under the Companies Act is that the existing shareholders have a preemptive right to subscribe in connection with new issues of shares, cf. § 30, Subsection 1, of the Companies Act.

If the charter of a company provides for dual or multiple classes of shares, it is the “default” rule of § 30, Subsection 2, of the Act that shareholders belonging to any of the classes are entitled to subscribe to new shares even though the new issue is made in another class, cf. Gomard, *Aktieselskaber og anpartsselskaber* p. 75 and Thomsen, *A/S-loven med kommentarer* p. 185. It follows from this that unless the charter stipulates that the shareholders’ preemptive rights are re-

¹³⁵ The board cannot be authorized to increase the company’s share capital by means of a bonus issue, cf. § 37, Subsection 1, which only refers to increases by “subscription”, and Report No. 540/1969 on a Joint Nordic Company Law, p. 87. See also Thomsen, *A/S-loven med kommentarer* p. 200.

¹³⁶ See §§ 17 and 79 of the Companies Act. See also Gomard, *Aktieselskaber og anpartsselskaber* p. 72, Gomard, *Aktieselskabsret* p. 150, Werlauff, *Generalforsamling og beslutning* p. 173-174, and Thomsen, *A/S-loven med kommentarer* p. 205.

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stricted to issue of shares of the class in which they already hold shares, they may subscribe to shares issued in other classes on the same terms as shareholders belonging to such classes. See also Werlauff, *Selskabsret* p. 166 ff. for a discussion of this.

If an issue takes place at an early point in time where the acquiror is not a shareholder of the target-company, and, consequently, possesses no preemptive rights, the possibilities of fending off an “unwelcome” acquisition attempt may be comparatively good. The preemptive rights for the shareholders entail that the total share capital that will have to be acquired by the acquiror is boosted and, simultaneously, the shareholders have a possibility to increase their interest in the company. Again, however, the target-shareholders ought to consider the “price” they pay in terms of lost sales opportunities.

If, at the time of the issue the acquiror is already a shareholder of the target-company, he may, just like any other shareholder, exercise his preemptive right to subscribe to shares. Even if he should elect to do so, he will, however, have to pay more to acquire the company than before the stock issue since he must exercise his preemptive rights merely in order for him to maintain his percentage interest in the company.

The shareholders may, by the majority required for charter amendments, i.e. two-thirds of both the votes cast and the voting share capital represented at the shareholders’ meeting, depart from § 30, Subsection 1, of the Companies Act, cf. § 30, Subsection 3, and § 78 of the Act. The two-thirds majority requirement may be further qualified in the company’s charter. Unless dual or multiple class stock is used, the existing shareholders may not be deprived of their preemptive rights by a general provision in the company’s charter.¹³⁷

By deciding that all shareholders shall not have the right to subscribe to new shares, the majority of the shareholders may resolve to effect a so-called “directed issue” (“rettet emission”) and, for example, allocate the newly issued shares to one or more “friendly” investors. This could, for example, be done as is indeed sometimes seen, as part of a cross-holding arrangement where two companies issue shares to one another, thereby ensuring that at least a portion of their shares are in “friendly” hands. Rather than having third parties subscribe to new shares it may also be decided

¹³⁷ See *Horsens Landbobank A/S v. Ministry of Trade* (U1977.80, Sup. Ct.) and Gomard, *Aktieselskaber og anpartsselskaber* p. 74 ff., Thomsen, *A/S-loven med kommentarer* p. 183 ff. and Per Schaumburg-Müller, *Ugeskrift for Retsvæsen* 1987.B.270.

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that the right to subscribe to shares should be restricted to some of the shareholders only.

Obviously, departing from the starting point in § 30, Subsection 1, has some serious implications for those shareholders whose legal position is impaired. Consistently with this concern, and depending on the way in which departure is made from the preemptive rights, additional requirements with respect to majority, or even unanimity, apply, cf. § 79 of the Companies Act.

If the principle of equal treatment of shareholders (expressed in e.g. § 17 of the Act) is not observed and, for example, the preemptive rights of one or a few – but not all – shareholders are revoked or limited, such shareholder or shareholders will have to approve the decision, cf. § 78, third sentence, and § 79, Subsection 3.¹³⁸

Shareholders who are in control may thus not decide to deprive an acquiror who is already a shareholder himself of his preemptive right for the purpose of subscribing to the entire new issue of shares themselves and thereby consolidating control.¹³⁹

There is an overlap here between the principle expressed in § 79 of the Companies Act and the general standard set forth in § 80 of the Act.

§ 79 embodies the notion that all shares of a company carry equal rights.¹⁴⁰ Likewise, § 80 of the Companies Act prohibits shareholder decisions which provide undue advantages to some shareholders at the expense of others or at the expense of the company. Discriminating against an acquiror in the fashion described above would require the acquiror's approval pursuant to § 79, Subsection 3. Applying § 80 would lead to a similar result.

As an alternative, the shareholders of a target-company may, therefore, consider other, non-discriminatory, possibilities. Rather than granting to themselves the sole right to subscribe to new shares and thereby discriminating against the acquiror, the shareholders may elect to deviate from the starting point in § 30, Subsection 1, by allocating the new shares to a third party.

If such third party is granted the right to acquire the new shares at a favorable price compared to the market value of the shares of the company,

¹³⁸ See report No. 540/1969 On A Joint Nordic Company Law, p. 81.

¹³⁹ See Gomard, *Aktieselskaber og anpartsselskaber* p. 76.

¹⁴⁰ As we have seen earlier, there are a number of exceptions to this rule, one of them being the right to issue classes of shares with disparate voting rights (A- and B-shares).

the resolution to deviate from the shareholders' preemptive rights requires unanimity, cf. § 79, Subsection 1, item 1. However, unanimity may not be required if the company receives some other kinds of benefit as consideration for the shares.¹⁴¹

If it is decided to depart from § 30, Subsection 1, in favor of a third party who subscribes to the new issue of shares on the basis of the market price, the resolution to increase the share capital can be passed subject to two-thirds majority, cf. § 30, Subsection 3, and § 78.

It has given rise to some doubt whether special restrictions apply to deviations from the preemptive rights merely because the person or company for whose benefit the preemptive rights are departed from is already a shareholder of the company. The Ministry of Industry was concerned with such a situation in the so-called "Vølund"-matter.¹⁴² In this matter, a shareholder of a company had been granted the "sole right" to acquire shares of the company by non-cash payment in connection with an issue of shares. Both the Commerce and Companies Agency and the Ministry of Industry refused to enter the new issue into the Companies Register since, as is stated in the decision by the Ministry, "an alteration of the legal relationship between the shareholders had been made" and the shareholders had not enjoyed equal rights to acquire shares. The decision seemed to presuppose that it is only possible to depart from § 30, Subsection 1, in favor of a shareholder, if such departure takes place with the approval of all the other shareholders. Due to the very general wording, the decision created some doubt with respect to whether any deviation from § 30, Subsection 1, would be contingent upon the approval of all the other shareholders.¹⁴³ In February 1989¹⁴⁴ the Ministry of Industry modified the decision previously rendered by stipulating that "it is the Ministry of Industry's opinion that – where the (Commerce and Companies) Agency should find reason to do so – it is desirable that a more concrete evaluation is made so that mere shareholder involvement does not bring the transaction under the scope of § 79 (of the Companies Act)". On this basis it will

¹⁴¹ See Gomard, *Aktieselskaber og anpartsselskaber* p. 76.

¹⁴² See the Ministry of Industry's Docket No. 101-3-85. The Ministry rendered its decision in the matter on March 7, 1985.

¹⁴³ See the criticism of the decision by Per Schaumburg-Müller, *Ugeskrift for Retsvæsen* 1987.B 270 ff., in particular at p. 274 – 275. See also Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 165, note 2.

¹⁴⁴ See Niels Mørch, *Advokaten* 1989 p. 158 f., discussing the Ministry of Industry's letter of February 10, 1989 (Docket No. 87-1219-56) to the Commerce and Companies Agency.

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be necessary to make an evaluation in each case of whether the minority shareholders' interests have been protected. After this statement by the Ministry of Industry, the Commerce and Companies Agency has adopted the position that an observation of the majority requirements under § 79, Subsection 3, first sentence, is not a requirement in these instances to obtain registration of the new issue of stock.¹⁴⁵

By reversing its earlier decision, the practice of the Ministry of Industry is again consistent with the various approval requirements found in the Companies Act.

Krüger Andersen¹⁴⁶ argues that deviating from the shareholders' rights to subscribe to new shares for the purpose of protecting the company against takeovers that should be considered "harmful" to "the company" would be legal by itself. Krüger Andersen emphasizes that the deviation must be founded on an interest in the development of the company and not an aversion to the acquiror. As an example of a permissible deviation he mentions the issue of a major stockholding to The Employees Capital Pension Fund in order to prevent the company from being acquired by a foreign acquiror. The problem with Krüger Andersen's viewpoint is that it refers to the company as having a "life" of its own independent of the shareholders. The example illustrates this by using a foreign acquiror as a representative of all evils. Where are the shareholders in Krüger Andersen's picture? To them the foreign acquiror may be good news.

The shareholders may at a shareholders' meeting authorize the board to issue new shares, cf. § 37 of the Companies Act. In connection with the authority the shareholders may, within the framework indicated above, depart from the preemptive rights, cf. § 37, Subsection 2, last sentence. However, the board may not on its own depart from the shareholders' preemptive rights in order to seek support against an acquiror from a white knight or white squire.

So far, Denmark has not experienced ESOPs, known from the United States.¹⁴⁷ It is very likely, however, that labor market and pension funds, which already represent considerable equity interest in many companies, will become important players in the takeover context. Depending on whether such funds decide to play a more active role, they may be seen as future white knights or, perhaps even more likely, white squires in connection with contested acquisitions.

¹⁴⁵ See Niels Mørch, *Advokaten* 1989, p. 158 f. at p. 159. See also Thomsen, *A/S-loven med kommentarer* p. 185-186, and Werlauff, *Selskabsret* p. 169-170.

¹⁴⁶ See Paul Krüger Andersen, *Revision & Regnskabsvæsen* No. 7/1988, p. 34-35.

¹⁴⁷ See under 8.1.

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A quite commonly used device, however, is the setting up of a foundation in connection with the use of A- and B- shares. By allocating to the foundation the high-vote, non-listed A-shares while listing and selling to the public the low-vote B-shares an efficient defense against takeovers is established. If the A-shares have already been issued at the time of the arrangement, there are few problems attached to this concept. If, on the other hand, the purpose is to allocate new shares to be issued to a foundation, the restrictions regarding share capital increases discussed above apply.

Instead of using a foundation, the shareholders may establish a holding company, the shares of which are not listed. By having the holding company own the A-shares (that are not listed) while offering the B-shares to the public, the original owners of the company maintain a tight grip on control.

9. Management buy-outs

9.1. American law. Rather than responding in a strictly defensive fashion, target-management may itself decide to attempt to eliminate a contested acquiror by acquiring an equity stake in the target-company.¹⁴⁸ This more offensive approach, known as a “management buy-out” (“MBO”), is commenced by the establishment of a new company. The shares of this acquisition vehicle will be held by target-management as well as by other investors. Typically, management will not become a majority shareholder of the acquisition vehicle: other investors are invited to acquire equity holdings of the new company, while management often remains in control through the use of dual class stock where management receives the high-vote shares, whereas the other investors receive low-vote shares. The second step in the transaction is that the acquisition vehicle acquires the shares of the target-company. This acquisition is often referred to as a “going private” transaction since the concentration of shares often leads to a delisting of the company’s shares from the stock exchanges where the shares have been listed. Frequently, a third step is taken whereby the target-company is merged into the acquisition vehicle and minority shareholders are cashed out.

The public debate in connection with management buy-outs has focused particularly on the inherent conflict of interests which is a part of this phenomenon. On the one hand, it is the duty of a company’s management

¹⁴⁸ Management buy-outs are used not only in response to contested takeover attempts but also frequently as a vehicle for making management owner of a company without the existence of any “threats”.

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to act in the best interest of the shareholders. On the other hand, a management which decides to make a management buy-out has personal interests, which are basically identical with the interests of any other purchaser of shares of the company. Due to its inside position, management presumably possesses information which is not available to the shareholders. In addition, management is in a position to influence the amount and nature of the information provided to the shareholders and, likewise, it has the ability to influence the price of the company's stock, thereby being able to time the acquisition in a way that ensures the best possible economic outcome for management.

Against this background many American courts have not considered the business judgment rule a suited standard for the evaluation of management's decisions and acts in connection with management buy-outs. The practice of the courts of Delaware illustrates this point. The Delaware courts use a test, the purpose of which is to determine whether management made a "fair deal" and if the price paid for the shares was fair, see *Weinberger v. UOP, Inc.*¹⁴⁹ All aspects of a management buy-out must be examined as a whole although, as stated in the *Weinberger*-case, the price paid in a non-fraudulent transaction may be the preponderant consideration outweighing other features of the transaction. As regards the first part of the test, the Delaware Supreme Court stated that fair dealing involves an evaluation of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the shareholders were obtained. According to the court, a party who stands "on both sides of a transaction" has the burden of establishing the entire fairness of the transaction. In the absence of an independent negotiating structure including the appointment of an independent negotiating committee of the company's outside directors, it is probably hard to demonstrate the fairness of the dealing.¹⁵⁰

In a recent decision, *Mills Acquisition Co. v. Macmillan, Inc.*¹⁵¹, the court clarified the nature of management's position and duties in this situation. The court thus held that management may enjoy the protection of the business judgment rule, provided, however, that the committee of directors not only formally but also in reality protect the interests of the shareholders. Consequently, the committee must, on an active and independent basis, ascertain that the necessary information for making the

¹⁴⁹ 457 A.2d 701 (Del. 1983).

¹⁵⁰ For a discussion of *Weinberger v. UOP, Inc.*, see also VIII.4.4.

¹⁵¹ 559 A.2d 1261 (Del. 1988).

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sales decision is provided, including by retaining independent advisers, and lead the negotiations for the sale of the company.¹⁵²

9.2. Danish law. Since the late 1980's Denmark has experienced several management buy-outs of which one of the first involving a listed company was the management buy-out of A/S Plastmontage in July 1988.

As is the case in the United States, a management buy-out of a company will probably always be made through an acquisition vehicle, i.e. a company established by management for the purpose of acquiring the target-company. Ordinarily, management will not become the owner of the majority of the shares of the acquisition vehicle. Rather, management will attempt to have other investors subscribe to the majority of the share capital of the vehicle. Typically, institutional investors, such as pension and labor market funds, have made equity investments in connection with management buy-outs in Denmark. Moreover, the development seen so far suggests that such funds, which in recent years have invested increasingly in the stock market, will become even more active players in connection with management buy-outs.

If management acquires the high-vote A-shares while the remaining shareholders only purchase B-shares, management may, irrespective of the fact that management only holds a minor portfolio of shares, be able to obtain a considerable, if not decisive, influence over the company. The shareholders receiving B-shares act on the basis of the belief that management will be able to operate the company in a profitable fashion. Due to its equity interest, management will have a motivation to increase the value of the investment made by the shareholders, which might be a sufficient basis for the B-shareholders to invest in the low-vote shares only.¹⁵³

¹⁵² For a general discussion of these questions, see Leo Herzel & Dale E. Colling, *Establishing Procedural Fairness in Squeeze-Out Mergers After Weinberger v. UOP*, 39 Business Lawyer 1525 (1984) and Note, *Approval of Take-Out Mergers by Minority Shareholders: From Substantive to Procedural Fairness*, 93 Yale Law Journal 1113 (1984). For a general discussion of management buy-outs, see Dale Arthur Osterle & Jon R. Norberg, *Management Buyouts: Creating or Appropriating Shareholder Wealth?*, 41 Vanderbilt Law Review 207 (1988), Louis Lowenstein, *Management Buy-outs*, 85 Columbia Law Review 730 (1985) and Richard A. Booth, *Management Buyouts, Shareholder Welfare, and the Limits of Fiduciary Duty*, 60 New York University Law Review 630 (1985).

¹⁵³ From a business point of view one may raise the question if incumbent management that may be the cause of the contested takeover attempt in the first place

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In 1989, some of the pension and labor market funds began to express the policy that they prefer investing in A-shares rather than B-shares in order to have a say in the management of the company. Time will show how this will affect management buy-outs.

By making a bid contingent upon the acceptance from shareholders that represent more than 90 percent of the votes as well as the shares of the target-company, management may through the acquisition vehicle obtain the right to cash out such shareholders that refuse to sell their shares, cf. § 20 b, Subsection 1, of the Companies Act.

For the reasons discussed under 9.1., a considerable risk exists that the shareholders' interests will not be 100 percent protected in the context of a management buy-out. The problem is magnified by the fact that it is typically very difficult, if not impossible, for the shareholders at the time when management makes a bid for the company's shares to examine and evaluate whether management has disclosed all relevant information regarding the purchase offer.

§ 58 of the Companies Act does not apply directly to the issue discussed here since that provision only pertains to cases where the company itself is a contractual party, either vis-a-vis management or vis-a-vis a third party. However, the principle expressed in § 58 would probably also apply, on an analogous basis, to management buy-outs where the conflict of interest between management and shareholders is as obvious as can be.

If some – but not all – members of the board participate in a management buy-out, they may not take part in decisions regarding the question whether or not the shareholders should be advised to sell their shares. The decision must be made by the remaining, disinterested board members. This probably does not prevent interested board members from participating in preliminarily discussions and providing information about their planned stock purchase provided that they disclose their acquisition plans to the remaining members of the board.¹⁵⁴

If the entire board plans to acquire the shares of the company, it must be their duty to convene an extraordinary shareholders' meeting for the purpose of electing a new board of disinterested members. The incumbent

would be suited for managing the company in the years to come. The fact that management becomes an equity holder in the company may obviously increase the motivation to serve shareholder interests. On the other hand, motivation may not always be sufficient to operate the company successfully.

¹⁵⁴ See also Gomard, *Aktieselskaber og anpartsselskaber* p. 145-146.

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board will have to disclose to the new board all information in its possession of relevance for the sales decision to be made by the shareholders. It is important that the new board is fully equipped to advise the shareholders. When all relevant information has been provided, the new board must guide the shareholders with respect to whether they should sell their shares or not. This may, depending on the circumstances, lead to a duty for the board to retain independent advisors.

If one or more managers are planning to acquire the shares of the company, the incumbent board shall protect the interests of the shareholders and give them adequate guidance.

As is the case in connection with contested takeovers, § 115, Subsection 2, of the Companies Act creates some impediments to the financing of management buy-outs.¹⁵⁵ In addition, the conditions for taxation of companies on a consolidated basis discussed under IX.3.2. make it more difficult to finance management buy-outs.

There seems to be a clear trend towards increasing the use of management buy-outs in Denmark.¹⁵⁶

10. Leveraged buy-outs

10.1. American law. Under 8. we had a discussion of how the allocation of newly issued shares to a third party may be used as a defense against a contested takeover. Another means by which a “friendly” third party may function as a shield against takeovers is by offering the target-company’s shareholders a higher price for their shares than the price offered by the acquiror. Such a competing offer will, as a practical matter, always be made as a tender offer and therefore be subject to the same rules as apply to tender offers by the “hostile” acquiror, cf. VII.2.3.

As is the case in connection with contested tender offers, tender offers made by “friendly” third parties will ordinarily be financed in part by the issue of debt securities. The sale of assets belonging to the target-company or the spin-off of divisions or subsidiaries enables the company to service the increased debt commitments resulting from the debt financing, from which the name of this type of transaction, “leveraged buy-outs” (“LBO”),

¹⁵⁵ See also Jan Schans Christensen, *Revision & Regnskabsvæsen* No. 12/1988, p. 45 f. regarding the impact of § 115, Subsection 2, of the Companies Act in connection with management buy-outs.

¹⁵⁶ For a discussion of the financial aspects of management buy-outs, see Niels de Coninck-Smith et al., *Revision & Regnskabsvæsen* No. 6/1988, p. 34 ff.

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is derived.¹⁵⁷ As described under II.1. and 2., developments in late 1989 and in 1990 suggest that highly leveraged transactions will be replaced by increased use of equity financing. The following should be read against this background.

A leveraged buy-out by a friendly acquiror will not only protect incumbent management against removal in the specific situation but will also reduce the risk that the company will be subject to future contested takeover attempts. After the consummation of a leveraged buy-out there will, normally, be a limited number of assets in the company that do not serve to secure debt, which means that it will be difficult subsequently to make a contested takeover financed through the target-company's assets. The existence of free target-company assets has, at least until recently, been of vital importance for financing contested takeovers. A leveraged buy-out will make it less attractive for "hostile" acquirors to initiate takeover attempts.

In *British Printing & Communication Corporation plc v. Harcourt Brace Jovanovich, Inc.*¹⁵⁸ – discussed under 15.1. – the court, applying New York law, used a fairness-standard when evaluating if a planned leveraged recapitalization ought to be enjoined.

10.2. Danish law. There are several reasons why leveraged buy-outs should not be expected to gain the same importance in Denmark as has been the case in the United States (at least until recently). § 115, Subsection 2, of the Companies Act (discussed under IX.2.) and the tax issues discussed under IX.3. prevent the leveraging of companies to the extent seen in America.

Also, there is no significant market for junk bonds and, perhaps, even no stock market that would be prepared to buy shares of companies that are highly leveraged.

On the other hand, it seems as if a number of pension and labor market funds are increasingly interested and prepared to participate in the financing of corporate acquisitions. It is possible that the desire to gain larger profits will lead to the acceptance by stock investors of higher leverage than has been seen so far.

¹⁵⁷ The debt is used as a "lever" to finance the acquisition. An acquisition by a "hostile" acquiror or a management buy-out will typically be financed in part by issue of junk bonds and therefore also frequently be referred to as a leveraged buy-out.

¹⁵⁸ 664 F. Supp. 1519 (S.D.N.Y. 1987).

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In connection with the granting of loans and credits banks and other financial institutions apply credit valuation principles that, inter alia, seek to maintain a certain “margin of security” by imposing on the borrowers certain minimum requirements as regards the relationship between debt and equity. Even this might change, however. In other European countries the views on the capitalization of companies seem to be in a flux. One of the effects seems to be that within certain limits debt-financing has gained acceptance as a means by which to increase profits of equity investments.¹⁵⁹

In addition to considering what might happen within the public capital markets, one should bear in mind the use of increased debt-financing by means of the so-called “private placements”. This concept means provision of capital through “private” investors, as opposed to the public share or bond market. Private placements are loans or credits granted by institutions or other legal entities that typically make an evaluation of the borrower’s business and business plans prior to granting the loan or credit. In other words, the lender will possess a higher degree of knowledge about the business, as well as sophistication, than is the case for the average investor in the stock market. Consequently, the lender will have an improved basis for evaluating whether the borrower’s business and business prospects are of such a nature that it will be able to repay the loan or credit on the terms and conditions granted.

It has yet to be seen to what extent private placements will be a means of providing leveraged financing.

11. Golden parachutes and other contingent obligations

11.1. American law. “Golden parachutes” are agreements between a company and its top executive officers pursuant to which the executives are entitled to compensation in the event that a change of control of the company takes place.

All golden parachutes are triggered if the individuals protected by the parachute are removed. In addition, many parachutes are triggered if the executives, following a change of control, are not removed but experience a reduction of their responsibilities, status or compensation. By far the most parachutes are only triggered if the executives do not continue in of-

¹⁵⁹ For a discussion of the increased use in other European countries of debt-financing in connection with corporate acquisitions, see under II.1.

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fice. A few parachutes are triggered if just a change of control takes place and irrespective of whether the executives continue their services or not.

Most golden parachutes provide that the beneficiaries receive a cash amount in the event that the parachute is triggered. The amount payable varies from company to company but will often be equal to an amount between 500,000 and 5 million dollars per executive officer.¹⁶⁰

The purpose of adopting golden parachutes is two-fold: firstly, parachutes ensure that the executives receive a certain compensation in the event that they are removed instantly, and, secondly, it is a means by which making a contested takeover attempt for the company becomes less attractive. However, golden parachutes are usually not a very efficient shield against contested takeovers although the aggregate amount payable pursuant to parachute commitments by the company to its top executives may be substantial. Some companies have chosen to establish golden parachutes for the benefit of not only top executives but also leaders at mid-level, thereby increasing the efficiency of golden parachutes as a defensive means.

A variation of the parachute concept is known as “tin parachutes”, which provide a number of employees of a company a compensation in the event that their employment is terminated within e.g. 2 years after the consummation of a contested takeover.

Another type of parachute is the so-called “pension parachute” which, if triggered, will lead to the payment of a substantial amount by the company to a pension plan established for the benefit of the company’s employees.

A somewhat different concept, known as “legal defense trusts”, has been developed. According to this model, a company pays in advance a substantial amount to a trust established for the benefit of the company’s employees. If subsequently the contracts of some of the employees are terminated in connection with a contested takeover, the trust will pay the necessary legal fees in order to enable the employees to initiate legal steps against the company because of the termination. Obviously, the use of a legal defense trust is not likely to prevent any acquirors from making contested bids. On the other hand, since it is quite costly to commence lawsuits in the United States, legal defense trusts may create a certain protection of the rights of target-employees.

Golden parachutes to executives are adopted by the board. Some have ar-

¹⁶⁰ The largest golden parachute seen so far amounted to 53.8 million dollars, which was paid to F. Ross Johnson, the CEO of RJR Nabisco, Inc., in 1988, as a result of Kohlberg Kravis Roberts & Co.’s acquisition of Nabisco, see *BusinessWeek*, May 1, 1989, p. 47.

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gued that golden parachutes are nothing but an attempt on the part of the board to ensure for the executives an economic advantage without benefiting the shareholders. Others have responded that management of a target-company has no interest in provoking a removal and that golden parachutes are nothing but a reasonable compensation payable to executives in case they are removed without notice.

See the discussion about golden parachutes by Richard P. Bress, *Golden Parachutes: Untangling the Ripcords*, 39 Stanford Law Review 955 (1987) and the references contained in said article. For a sceptical evaluation of golden parachutes, see also Note, *Platinum Parachutes: Who's Protecting the Shareholder?* 14 Hofstra Law Review 653 (1986). Michael C. Jensen has taken the stand that golden parachutes are clearly desirable when correctly implemented, since they help reduce the conflicts of interest between shareholders and executives in the event of a takeover; however, parachutes can also be used to restrict takeovers and to entrench executives at the expense of shareholders, see Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in Knights, Raiders, and Targets p. 314 ff. at 340-341.

Even though a number of golden parachutes have been reviewed by the courts, case law within this area does not tell precisely to what extent golden parachutes will be upheld as a defense. Most court decisions regarding parachutes have reviewed this phenomenon outside the takeover context. In *Koenings v. Joseph Schlitz Brewing Co.*¹⁶¹ the court upheld a golden parachute in a context where no contested takeover bid had been launched. In *Buckhorn, Inc. v. Ropak Corporation*¹⁶² the court upheld golden parachutes for the benefit of six key employees where the company faced a contested bid, concluding that the parachutes had in a reasonable way advanced the shareholders' interest in retaining key officers in their positions during a critical transition period without unduly entrenching management or overburdening the company. In *Orin v. Huntington Bancshares, Inc.*¹⁶³ the court stressed that the payments under the golden parachutes were "comparable to severance pay provided employees in other contexts".

If the purpose of a pension parachute is to entrench management and not

¹⁶¹ 377 N.W. 2d.593 (Wis. 1985).

¹⁶² 656 F. Supp. 209 (S.D. Ohio 1987) aff'd by sum. ord., 815 F. 2d 76 (6th Cir. 1987).

¹⁶³ O. Ct. Comm. Pleas, September 30, 1986.

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to benefit the employees, the parachute will be challenged by the courts, see e.g. *Minstar Acquiring Corp. v. AMF, Inc.*¹⁶⁴

In *GAF Corporation v. Union Carbide Corporation*¹⁶⁵ the court suggests that pension parachutes established and administered pursuant to the business judgment rule will not be challenged. For an illustration of a more rigorous use of the business judgment rule in such cases, see *Gailard v. Natomas Company*.¹⁶⁶

The majority of legal authors seem to be of the opinion that golden parachutes should be evaluated pursuant to the usual standards, including the business judgment rule, and that reasonable parachutes may be in the interest of shareholders.¹⁶⁷

Apart from golden parachutes, a company may adopt provisions in loan agreements or other vital contracts providing for a right to the lender to require repayment of the loan or giving the other contracting party a right to cancel the agreement if a change of control occurs. Such change of control provisions will probably also be evaluated pursuant to the business judgment rule.

11.2. Danish law. When discussing golden parachutes, a distinction should be made between parachutes arranged in favor of the board and parachutes that benefit the managers and other employees of the company.

The question of the extent to which the majority of the shareholders of a company can enter into golden parachutes¹⁶⁸ for the benefit of the board depends on whether such transaction would be in the interest of the shareholders at large. Typically, it will be in the interest of all shareholders that

¹⁶⁴ 621 F. Supp. 1252 at 1259-1261 (S.D.N.Y. 1985). See also *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 at 265 (2nd Cir. 1984).

¹⁶⁵ 624 F. Supp. 1016 (S.D.N.Y. 1985).

¹⁶⁶ (1989 transfer binder) Fed. Sec. L. Rep. (CCH) 94,369 (C.A. Cal., March 23, 1989).

¹⁶⁷ See Kenneth C. Johnsen, *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 Yale Law Journal 909 (1985), Robert A. Profusek, *Executive Employment Contracts in the Takeover Context*, 6 Corporation Law Review 99 (1983). For a different view, see Note, *Platinum Parachutes: Who's Protecting the Shareholder?* 14 Hofstra Law Review 653 (1986), suggesting that a "reasonableness standard" be used instead of the business judgment rule.

¹⁶⁸ In Denmark the term "gyldne håndtryk" ("golden handshakes") has been applied to describe payment to board and managers that by far exceed what management would legally be able to claim, see e.g. Werlauff, *Revision & Regnskabsvæsen* 1983, p. 273 ff. at 279 f.

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the board receives a reasonable compensation in the event that it is removed at very short or no notice in connection with a contested acquisition. A reasonable golden parachute may thus protect the company against claims for damages raised by the board and perhaps triggering a public discussion in disfavor of the company. In addition to this, the parachute may generally facilitate the change of management.

If, on the other hand, the payments to be made to the board substantially exceed what would be necessary in order to give the board a fair treatment in the event of a removal, such payment may constitute a violation of § 80 of the Companies Act. This is particularly likely to be the case if it is clear that the parachute has been established for the purpose of deterring potential acquirors from taking over the company. Especially, if the controlling shareholders are also those members of the board that benefit from the golden parachutes, a violation of § 80 may be likely since the minority shareholders would indirectly be exposed to economic discrimination simultaneously with the majority shareholders' protection of their control of the company.

Golden parachutes for the benefit of the managers may be granted by the board and it is hardly a requirement that such golden parachutes are submitted for shareholder approval.¹⁶⁹ When determining the payments under a golden parachute, the board will always have to ensure that the payment is in the best interest of the shareholders and does not, in effect, interfere in the shareholders', or some of the shareholders', opportunities to dispose of their shares as they wish.¹⁷⁰

The power to adopt parachute obligations in favor of employees of the company is probably vested in the board, cf. § 54, Subsection 2, of the Companies Act. Again, the interests of the shareholders will have to be taken into consideration when the board decides if it should adopt golden parachutes for the benefit of the employees. If the obligation to pay amounts under the parachute is only triggered if the employment of the employees is materially changed as a consequence of the takeover, and provided that the payments do not exceed the costs that the company would otherwise have to pay under statutory law or pursuant to collective agreements entered into in the labor market by very much, the parachute payments would probably be a reasonable price for achieving a smooth

¹⁶⁹ See *Philipson v. Creditreformforeningens A/S* (U1930. 237, M&C Ct.). In this case, the court held that the board of a company had the powers to grant to a former manager a pension on behalf of and binding on the company.

¹⁷⁰ See also § 63 of the Companies Act.

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change of the management in the interest of all shareholders. Material changes of the employment of the employees may include termination of the contracts of employees as well as removal of plants, etc.

If parachutes have been arranged in favor of the employees and include payments clearly exceeding what would be reasonable in the interests of the shareholders, the adoption of such parachutes would probably constitute a violation of § 63 of the Companies Act.

Contingent obligations as a part of a scheme to prevent a contested takeover will probably be scrutinized carefully by the courts. These kinds of commitments frequently constitute a violation of § 80 or 63 of the Companies Act if the price to be paid for leaving control with the majority shareholders is that the minority shareholders' opportunities to sell their shares at a fair price is unduly restricted. The board of a company, perhaps influenced by the majority shareholders, would not be entitled to obtain loans or otherwise create debt if the purpose of such transaction is to avoid a change of control by e.g. providing that the loan or other debt must be repaid the moment such change of control occurs. A provision of this nature would entail that severe economic effects might be the consequence of a contested acquisition, perhaps resulting in potential acquirors abstaining from takeover attempts.

While the board, supported by the majority shareholders, may not enter into the above arrangements for the purpose of retaining control, there is probably no doubt that the parties contracting with the company, e.g. its bank connection, may request, for business reasons, that the loan or credit be granted on the condition that e.g. certain large shareholders continue to be shareholders of the company. It may also be made a condition that certain key members of the board remain in office. Such conditions that are motivated by business considerations obviously do not constitute a violation of § 80 or § 63.

In practice, however, it may be very difficult to ascertain the background and purpose of a condition made by the lender in a loan document or as part of a credit facility. It is probably often impossible to find the true motive for such a condition, in particular because most lenders would not mind having a right to terminate the loan or credit facility in the event of a change of control. Even without such specific provision, most standard loan documents or credit facilities stipulate that the bank may at any time and at short notice terminate the loan or credit facility.

12. Lock-ups and other agreed restrictions on target-management

12.1. American law. A lock-up is a right granted by a target-company, or rather its management, to a third party friendly to management. It is designed to give the friendly third party an advantage over other prospective acquirors, in particular “hostile” acquirors. Lock-ups are known in several different versions, but the basic concept is that the beneficiary has an option to purchase stock or assets of the target-company at a specified discount price and on terms and conditions fixed in advance. Frequently, lock-ups are used to encourage a third party who is sympathetic to target-management and who has, for example, initiated negotiations for the acquisition of the target-company at a point where another prospective acquiror initiates a contested takeover attempt. The option to purchase the designated assets or the stock may be exercised if the planned, negotiated acquisition by the “friendly” acquiror fails due to the interference by the contested acquiror. The rationale for providing benefits to a third party in this situation is that the party will often have to decide whether to participate in the battle for control under a substantial time pressure and without being in possession of all relevant information and, in addition, without knowing if his acquisition will materialize. Since the option to purchase assets or stock at discount price is triggered if a hostile acquiror obtains control of the target-company, the lock-up may also have an effect as a defensive device. In particular if the lock-up grants the ally the possibility to acquire vital assets or crucial projects – this is known as “crown jewel lock-ups” – many acquirors will not deem it attractive to take over the company. Similarly, the option to acquire a substantial holding of shares of the company may deter contested takeover attempts.

When determining if management of a company is entitled to enter into lock-up agreements, the standard set forth in the business judgment rule will apply. In addition to the terms and conditions for the lock-up, which must reflect the interests of the shareholders, the timing of the lock-up is decisive. If the lock-up is agreed at an early point in time and induces or facilitates prospective bidders to make offers for the company, the lock-up may be in the interest of the shareholders and therefore permissible, cf. *Hastings-Murtagh v. Texas Air Corporation*.¹⁷¹ If it is, however, inevitable that the company will be sold – and the only outstanding questions are to whom and on what terms and conditions – management is normally not entitled to enter into lock-up arrangements since this would

¹⁷¹ 649 F. Supp. 479 (S.D. Fla. 1986). For a general discussion of these issues, see Ferrara, Brown & Hall, *Takeovers – Attack and Survival* p. 476.

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inhibit or prevent an “auction” for the company, cf. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*¹⁷² A lock-up agreement which is established during the course of an auction for the company will probably only be in the interests of the shareholders if target-management has attempted to solicit bids from others prior to the lock-up, and provided that the lock-up results in a substantial increase of the final offer made for the company’s shares, cf. *Mills Acquisition Co. v. Macmillan, Inc.*¹⁷³ Unless these conditions are met, the lock-up will foreclose competing bids rather than facilitating such bids, see *Hanson Trust plc v. ML SCM Acquisition, Inc.*¹⁷⁴

The so-called “cancellation fees”¹⁷⁵ often have the same effect as lock-ups. Cancellation fees are amounts fixed in advance payable to an ally in the event that e.g. a negotiated merger does not materialize due to the intervention by a contested acquiror. The American courts have generally treated cancellation fees according to the principles as outlined above with respect to lock-ups.

A third type of tying arrangement are the so-called “no-shop” clauses which target-management agrees upon with an ally and which prevent management from actively soliciting competing bids. Often such arrangements are supplemented by “no-negotiation” clauses which, in addition, prevent management from negotiating with other potential acquirors who approach management. Obligations of this nature restrict management’s right to solicit other bids and will only in very rare cases be in the interest of shareholders, see *Mills Acquisition Co. v. Macmillan, Inc.*¹⁷⁶

Management has a greater degree of flexibility with respect to the so-called “best efforts” clauses. Agreeing to such a clause entails that management, once it has accepted a purchase offer, commits itself to presenting and recommending the offer to the company’s shareholders at a shareholders’ meeting. It is a requirement, however, that management does not thereby change its role vis-a-vis the shareholders, whose interests still have first priority. In *Jewel Companies v. Pay Less Drug Stores*¹⁷⁷ it was

¹⁷² 506 A.2d 173 (Del. 1986).

¹⁷³ 559 A.2d 1261 (Del. 1988).

¹⁷⁴ 781 F.2d 264 (2nd Cir. 1986).

¹⁷⁵ Also known as “break-up fees”, “bust-up fees” or, in Wall Street jargon, “good-bye kisses”.

¹⁷⁶ 559 A.2d 1261 (Del. 1988). The case suggests that the use of no-shop clauses should be subjected to even more rigorous limitations than those pertaining to lock-up arrangements.

¹⁷⁷ 741 F.2d 1555 (9th Cir. 1984).

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held that a company's board is entitled to enter into a merger agreement contingent upon shareholder approval and, as a part of the agreement, commit itself not to enter into agreements which would conflict or compete with the agreement until the shareholders have decided whether to adopt the agreement or not. If an alternative purchase offer is made which is more favorable than the offer accepted by the board, the board must loyally submit and recommend the alternative offer to the shareholders, see *ConAgra, Inc. v. Cargill, Inc.*¹⁷⁸

12.2. Danish law. Even though the board of a company has far-reaching powers to dispose of the company's assets, sale of the entire activities of the company or other transactions of similar importance probably require the approval of the shareholders.¹⁷⁹

The right for the board or the majority of the shareholders to grant to a third party the right to acquire a substantial part of the company's assets, including, for example, a subsidiary or a division, at a favorable price and contingent upon the change of control over the company, is subject to substantial restrictions. Transactions of this kind frequently protect the majority shareholders' control at the expense of the minority shareholders, who face restrictions in their opportunities to sell their shares. Therefore, § 80 and § 63 of the Companies Act would typically prohibit lock-ups.

Potential buyers of shares of the company would be even more reluctant to acquire such shares if a so-called "crown jewel lock-up" has been arranged. The right for a third party to acquire e.g. a vital research division or the rights to a valuable product being developed if a change of control occurs and at a favorable price would ordinarily not coincide with the minority shareholders' interests as protected under § 80 and § 63 of the Companies Act.

It may, in some instances, prove difficult to determine if an option granted to a third party to acquire a research division is of a nature that conflicts with § 80 or § 63. Sometimes, the option may be granted in a context that reflects a balancing of the interests of the company as well as its shareholders and the buyer. The fact that the option may be exercised in

¹⁷⁸ 382 N.W. 2d 576 (Neb. 1986). See also *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

¹⁷⁹ See Gomard, *Aktieselskabsret* p. 313 and Werlauff, *Generalforsamling og beslutning* p. 97. If a transaction is tantamount to an amendment of the objects clause of the charter, a two-thirds requirement rather than a bare majority requirement would apply, cf. §§ 78 and 77 of the Companies Act.

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the event of a change of control does not per se render the option a violation of § 80 or § 63 although it may often suggest that the arrangement was meant to protect management rather than the interests of the shareholders. A careful review would have to be made of the entire background and purpose of the arrangement. If, from a business point of view, the transaction makes sense for the company and its shareholders – including the minority shareholders – the lock-up may be justifiable.

Principles similar to those outlined above apply to the so-called “cancellation fees”.

It is very hard to imagine that “no-shop” or “no-negotiation” clauses which the board agrees upon would ever coincide with the interests of the shareholders. The duty of the board to promote and protect the interests of the shareholders on an independent basis presupposes that the board is not bound by agreements with any third party. It is in the very nature of no-shop or no-negotiation clauses that the board is restricted in its right to contact or negotiate with prospective buyers of the company’s shares, other than the person or legal entity favored by such clause.

On the other hand, there is probably nothing to prevent the board from agreeing upon a so-called “best effort”- clause with a prospective buyer of the company so that – after negotiating on a loyal basis and reaching a proposal for the acquisition of the company – the board undertakes an obligation to submit and recommend the proposal to the shareholders who would have to approve the transaction. It is always a condition, however, that the board does not deprive itself of the right to submit, and, if the interests of the shareholders so dictate, to recommend, an alternative, more favorable purchase offer. In other words, the board is entitled to accommodate the reasonable interest of a prospective buyer in ensuring that the results of the negotiations between such prospective buyer and the board are treated fairly and promoted vis-a-vis the shareholders, as long as the board does not thereby limit its own freedom to advise and assist the shareholders in the best possible fashion.

13. Liquidation, sale of target-assets and spin-offs

13.1. American law. Assuming that when valuing the shares of a company the stockmarket does not value all assets of a company 100 percent efficiently, the consequence would be that the company possesses hidden “reserves”. If this assumption is correct, there may be scenarios where the shareholders may have an economic interest in selling the company’s assets and liquidating the company in order to distribute the proceeds result-

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ing from such liquidation among the company's existing shareholders.¹⁸⁰ If the existing shareholders wish to gain the profits arising out of such liquidation, the necessary steps to liquidate the company should be taken before any acquiror succeeds in acquiring a holding of stock which will enable him to influence the decision about liquidating the company.¹⁸¹

In the event that it becomes clear that the motive for a contested takeover attempt is to acquire certain desirable assets of the target-company, a contested takeover may be avoided simply by selling such assets and without liquidating the company.

Similarly, if certain activities of a concern are carried out in one or more subsidiaries, a takeover may be avoided by selling the subsidiaries, which is known as "spin-offs".

The general attitude on the part of the courts has been to review the above types of transactions under the business judgment rule, see, for example, *Whittaker Corp. v. Edgar*¹⁸² and *GM Sub Corp. v. Liggett Group, Inc.*¹⁸³

13.2. Danish law. Liquidation of a company requires two-thirds of both the votes cast and the voting share capital represented at the shareholders' meeting, unless a higher threshold is stipulated in the charter, cf. § 116, Subsection 2, and § 78 of the Companies Act.

If these voting requirements are met, there will rarely be any basis for the minority shareholders to criticize the decision to liquidate the company. § 80 of the Companies Act may, however, apply in events where the majority obtains an undue advantage at the expense of the minority shareholders, for example, if the majority shareholder is also a competitor

¹⁸⁰ Obviously, the procedure described in the text is not feasible if the undervaluation by the market of the company's shares is due not to the undervaluation of the company's assets but rather to the market's failure to appreciate planned research and development projects or investments. In such a situation a liquidation will not lead to any economic gains for the shareholders.

¹⁸¹ For a discussion of this concept, see Sub-committee on Telecommunications, Consumer Protection and Finance, 99th Congress 2nd Session, *Corporate Takeovers: Public Policy Implications for the Economy and Corporate Governance*, p. 13-18, 40-48 and 57-63 (Comm. Print 1986) and Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 University of Pennsylvania Law Review 1 at 32-33 (1987).

¹⁸² 535 F. Supp. 933 at 951 (N.D. Ill. 1982), aff'd, Nos. 82-1305, 82-1307 (7th Cir., March 5, 1982).

¹⁸³ C.A. No. 6155 (Del. Ch., April 25, 1980).

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of the company and has a particular interest in liquidating the company while the other shareholders do not share this interest.

The rights of the board to dispose of substantial assets in order to make the company less attractive as a target for a contested acquisition would be subject to restrictions similar to those pertaining to lock-ups, etc., see 12.2.

14. Target litigation

14.1. American law. Evidence has shown that in the majority of contested takeover attempts one of the target-companies' responses is to initiate lawsuits against the acquiror. Frequently, target-management seeks to obtain injunctive relief with respect to a contested bid, arguing that the bid violates the provisions of the Williams Act, state blue sky laws or corporate statutes, or applicable antitrust laws.

Most courts have taken the position that contested bids must be evaluated in the market place and by the players in the market rather than by the courts. However, exceptions apply to the extent that an offer or a transaction envisaged in connection with an offer is illegal, see, for example, *Caesars World, Inc. v. Sosnoff*.¹⁸⁴

Litigation as a defensive means only thwarts a takeover attempt in very rare cases, for which reason such step, as a practical matter, is always accompanied by other and more efficient techniques.¹⁸⁵

14.2. Danish law. Generally, the use of litigation in Denmark is less widespread than in the United States. Perhaps because of a different corporate "culture" it seems as if litigation is only used as a means of last resort.

However, even in Denmark, the commencement of legal proceedings against an acquiror may be seen, on various grounds.

As long as an acquiror is not yet a shareholder of the company, his acts will be governed by the general principles of Danish tort law. Consequently, the aforementioned culpa-rule applies, unless more rigid standards are imposed by means of statutes or caselaw.

Once the acquiror has become a shareholder of the company, there are rules of the Companies Act restricting his rights to act as he may wish.

¹⁸⁴ CV 87-1622 WJR (C.D. Cal., June 8, 1987).

¹⁸⁵ For a discussion of litigation as a defense, see Michael Rosenzweig, *Target Litigation*, 85 Michigan Law Review 110 (1986).

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We have earlier on several occasions discussed the various provisions of the Act protecting minority shareholders as well as the general standard in § 80.

If an acquiror thus uses his influence to have the shareholders' meeting adopt a resolution, which was not legally adopted or which violates the Companies Act or the charter of the company, a dissenting shareholder may bring a lawsuit not later than three months after the date of the resolution, cf. § 81, Subsections 1 and 2. The three month deadline does not apply if the resolution could not be legally adopted, even with the consent of all shareholders, cf. § 81, Subsection 3, item 1.¹⁸⁶ The defendant in a lawsuit initiated pursuant to § 81 is the company and not its management.¹⁸⁷

If the court finds that the resolution adopted by the shareholders at a shareholders' meeting is illegal or in violation of the company's charter, it will rule that the resolution is invalid or must be altered, cf. § 81, Subsection 4. The decision rendered by the court is *res judicata* even vis-a-vis the shareholders who are not parties to the suit.¹⁸⁸

An acquiror who is a shareholder and who has acted in violation of the Companies Act or the company's charter, either intentionally or through gross negligence, will in the circumstances be liable for the damages incurred by the company or the other shareholders, cf. § 142. The fact that the liability is limited to events where the acquiror has acted intentionally or in gross negligence in practice means that the prime area of liability will be cases where a majority shareholder or a group of shareholders have actively used their influence to adopt resolutions that unduly benefit certain shareholders at the expense of the minority shareholders.

Contrary to what is the case regarding the board and managers of a company, the shareholders do not have a general obligation to take an active part in the management of the company and ensure that its operations are conducted in a legal manner. Ordinarily, shareholders may choose to remain passive and, for example, abstain from attending or voting at the shareholders' meetings, see Gomard, *Aktieselskaber og anpartsselskaber* p. 324 ff. and Thomsen, *A/S-loven med kommentarer* p. 443-444.

¹⁸⁶ See also Gomard, *Aktieselskaber og anpartsselskaber* p. 172.

¹⁸⁷ See *Petersen v. Korsgaard* (U1925.511, E. Cir.). For a discussion of this case, see Gomard, *Aktieselskaber og anpartsselskaber* p. 172. See also Thomsen, *A/S-loven med kommentarer* p. 333.

¹⁸⁸ See § 81, Subsection 4, last sentence, Gomard, *Aktieselskaber og anpartsselskaber* p. 172 and Thomsen, *A/S-loven med kommentarer* p. 335-336.

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The limitation of liability provided for in § 142 may, when compared with § 80 of the Act in particular, appear to provide a very limited protection of the minority shareholders' interests. By specifying in the charter of a company what transactions constitute a violation of minority interests an increased protection of the minority shareholders may be obtained, since such a provision would reduce the discretionary element of § 80 of the Act.¹⁸⁹

Resolutions regarding the possible institution of proceedings against shareholders by the company shall be made at a shareholders' meeting, cf. § 144, Subsection 1, of the Companies Act. If it is resolved that the company should not commence legal proceedings, shareholders representing at least one-tenth of the share capital may, nevertheless, bring an action, cf. § 144, Subsection 3.

If the shareholders resolve that the company should initiate legal proceedings in order to recover losses that the company has suffered, the individual shareholders are barred from raising individual claims to the extent that such claims are considered to be included in the company's claim.¹⁹⁰ If, on the other hand, the losses were suffered not by the company but by the shareholders individually, they will be entitled to file lawsuits and, if they succeed, to recover damages directly from the defendant without involving the company.¹⁹¹

If the acquiror is also a board member he may be held liable in this capacity if he breaches his duties, see X.2.

As we saw under VI., Rule 4 of the Copenhagen Stock Exchange Rules of Ethics regarding mandatory bids is not binding upon acquirors. Failure to observe the rule can lead to no liability for acquirors.

15. Changing the stock market valuation of the target-company

15.1. American law. Acquirors attempting to take over a company on a contested basis will make a bid for the target-company's shares that con-

¹⁸⁹ See Werlauff & Nørgaard, *Vedtægt og aktionæraftale* p. 189 f.

¹⁹⁰ In the event that the individual claim "overlaps" the claim already raised by the company, the case will be dismissed, cf. *Amanda Busrejser ApS v. Henriksen* (U1980.825, E. Cir.) and Gomard, *Aktieselskaber og anpartsselskaber* p. 328.

¹⁹¹ Depending on the circumstances, the shareholders will receive damages both indirectly as equityholders of the company and directly in connection with the individual losses they have suffered.

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tains a price exceeding the existing market price for the shares in order to induce the target-shareholders to sell. The payment of such a premium price is only feasible from a business point of view if the acquiror expects that, after having acquired the company, he may obtain some kind of gain over and above the premium price paid.

The philosophy behind most defensive devices is to inhibit or prevent a contested takeover by adopting defensive measures, including mechanisms which will lead to a substantial reduction of the target-company's value once a contested acquisition has been consummated.¹⁹²

Perhaps a more constructive way to protect a company is rooted in the view that the stock market is not capable of valuing all of a company's assets in a 100 percent efficient manner. It might, therefore, be helpful to "assist" the market in the valuation process so that hidden or undervalued assets can be revalued. Some businesses, such as those of oil companies, mining companies¹⁹³, radio and broadcasting companies as well as other media companies, may be difficult to value by the market. To the extent that this has not already taken place, it may be advantageous to single out the activities particularly difficult to value, to be continued in new companies. In some events restructuring has proved an efficient way of creating a higher degree of "transparency" in connection with the activities. Increased transparency is tantamount to an increased level of information with respect to such companies' shares in the market place, which, in turn, may facilitate a revaluation of the company's shares.

After allocating the assets or activities to one or more new companies, the shares of such companies may be either distributed among the shareholders of the parent company or remain in the parent company. In the latter event, it may be agreed that the shares of the new company or new companies will automatically be distributed among the shareholders of the parent company in the event that a contested bid is made for the shares of the parent company.¹⁹⁴

Not only the above-mentioned businesses but also other kinds of activities may benefit from being separated into new companies, thereby giving the business a more distinct profile in the market and enabling the market

¹⁹² The latter group of strategies is also known as "scorched-earth defenses".

¹⁹³ As regards oil and mining companies it may, for example, cause difficulties to value reserves which are expected but not yet proven.

¹⁹⁴ Instead of allocating the assets of a company to a new company or new companies, a general partnership may be established and the assets transferred to such new partnership, which would have the target-company or a subsidiary hereof as the general partner.

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to revalue the business and thereby the company. Frequently, the market fails to fully appreciate the value of e.g. real estate owned by a company, for which reason it may make sense to have real estate owned by separate legal entities.

However, a low market value of a company's shares is not always due to the market's difficulties in valuing the assets of the company. The stock price may also be low, at least in part, because of a restrictive dividend policy on the part of the board of the company. Boards may, therefore, want to increase dividend payments to the shareholders, which is often perceived as a sound signal by the market and may result in an increased stock price.¹⁹⁵

Defensive strategies of the nature mentioned above are ordinarily considered to benefit the shareholders and will rarely be challenged by the courts. In *British Printing & Communication Corporation plc v. Harcourt Brace Jovanovich, Inc.*¹⁹⁶ – where a recapitalization included issue of junk bonds and allocation of shares to an ESOP – the court emphasized that the completion of a reorganization of the target-company did not prevent acquirors otherwise financially sound from acquiring the company. Likewise, the court found no basis for stating that the reorganization would lead to a reduction of the value of the company for the shareholders. Accordingly, the court found that the proposed recapitalization was fair to the shareholders and denied to enjoin it.

15.2. Danish law. Economically, similar principles as those referred to above regarding American companies apply to Danish companies.

Contrary to what is the case in the United States, it is the shareholders of a Danish company who decide at a shareholders' meeting what dividend payments, if any, should be made. However, the shareholders may not resolve to pay a higher dividend than proposed or approved by the board, cf. § 112 of the Companies Act. The board may, for the purpose of boosting the price of a company's shares, propose increased dividend payments, always provided, however, that the provisions under Chapter 13 of the Companies Act are observed. If adopted by the necessary majority,

¹⁹⁵ The positive effect on the share price of increased dividend payments only occurs if the dividend payments do not exceed certain limits. If dividend payments are so substantial that the company will lack funds for the necessary investments, including for research and development, the market will lose its faith in the company, which will be reflected in the share price.

¹⁹⁶ 664 F. Supp. 1519 (S.D.N.Y. 1987).

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increased dividend payments cannot ordinarily be challenged by the shareholders or some of the shareholders.

As the Danish stock market is comparatively less “transparent” than the American one, it may perhaps make sense to consider raising the price of a company’s shares by increasing the flow of information to the Copenhagen Stock Exchange. Increased information will create increased “transparency”, which will, in turn, frequently be reflected in the price of the shares.

16. Are regulatory changes desirable?

16.1 Introduction. From an economic point of view resources ought to be allocated to those uses where their value is highest. If obstacles are created to the optimal use of capital, they will prevent maximum efficiency from being achieved.

Assuming that, as is virtually always the case, acquirors offer a price for target-shares that exceeds the present value of such shares, we could say that the shares have a higher value for the acquiror than for other investors in the market. Applying the economic reasoning just mentioned, maximum efficiency can only be achieved if we ensure that the transfer of the shares from the lower value which they have for their present owners, to the higher value which they have for the acquiror, can take place without impediments of any kind. This reasoning, in other words, suggests that we ought to disallow any kind of defenses since they constitute impediments to efficiency.

However, there may be defenses which are obstacles to maximum efficiency but which we would, nevertheless, want to permit for other reasons. There could thus be circumstances where we would accept a trade-off meaning that our interest in efficiency would be subordinated to our desire to protect other interests, e.g. those of the target-shareholders.

We will now consider the various categories of defenses but, before we do so, we will make ourselves acquainted with some initiatives on the EC level that, as we shall see later, may have an impact on the use of defenses.

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16.2. EC initiatives. In May 1990 the EC-Commission prepared a communication to the EC-Council labelled "Obstacles to takeover and other general bids".¹⁹⁷

Pertinent parts of this communication read:

"It is desirable from the standpoint of a level playing field in a Single Market that the openness of companies in different Member States to takeovers should be broadly similar. This is very difficult to achieve in view of the different levels of capitalization of different national markets within the Community and other structural differences. The Commission is conscious, in bringing forward the regulatory proposals which follow, that they do not themselves overcome this underlying problem.

It should be stressed that the Commission does not wish to encourage takeover bids as ends in themselves. Its standpoint is rather that, in general, takeover bids may be viewed in a positive light in so far as they encourage the selection by market forces of the most competitive companies and the restructuring of European companies which is indispensable to meet international competition. It is important here to ensure that the fate of the target company be decided by all of its shareholders".

Later in the communication the Commission divides the obstacles referred to into two categories. The first category concerns maintenance of the company capital, and the second concerns the voting rights of the shareholders.

More specifically, the first category consists of the power of the directors to acquire the company's own shares and the right of a subsidiary to acquire shares in a holding company and to exercise the voting rights carried by these shares. The obstacles referred to in the second category are, more specifically, disproportion between a shareholder's holding in the company capital and his voting rights, difficulties with proxy voting and difficulties in bringing about changes in the management of the company.

After defining the obstacles, the Commission in its communication proposes measures by which to remove the obstacles.

First, the Commission points out that the Draft Takeover Directive must clearly restrict the power of the target-board to acquire the company's own shares while a takeover bid is open. In such case the board should need the authority of the shareholders to purchase the company's shares. The

¹⁹⁷ See SEC (90) 901, Final, May 10, 1990. The Communication was prepared after the Commission had reviewed the Booz Allen-report discussed under XIII. and the recommendations made therein.

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Commission's proposal is reflected in the most recent Draft Takeover Directive, Article 8, see X.4.4.

Second, the rules in the Second Company Law Directive on the acquisition of the company's own shares should be extended to cover acquisitions by subsidiaries. A subsidiary would only be entitled to acquire shares of its parent if the conditions laid down for the acquisition of its own shares by the parent company itself were met.

Third, the Draft Fifth Directive ought to be amended to the effect that non-voting¹⁹⁸ preference shares cannot be issued for a value exceeding 50 percent of the total share capital. (If the company does not actually grant the special advantages carried by such shares within a stated time, the shares would automatically become voting shares, according to the Commission's communication).¹⁹⁹

Fourth, the Draft Fifth Directive ought to provide for the abolition of the possibility of restricting the voting rights which may be exercised by any one shareholder.²⁰⁰

Fifth, the Draft Fifth Directive ought to stipulate that neither the law nor the charter may require a majority greater than the absolute majority for a decision to make changes in the board of a company.²⁰¹

Sixth, the Draft Fifth Directive ought to forbid charter provisions giving certain shareholders the exclusive right to propose the appointment of all directors.²⁰²

It has yet to be seen if the EC-Council will follow the viewpoints expressed by the Commission in the communication.

The communication, which attempts to create a more uniform framework for corporate acquisitions within the EC countries, addresses various questions of which some seem more relevant in the Danish context than others.

¹⁹⁸ The communication only mentions non-voting shares and not shares with reduced voting rights.

¹⁹⁹ As discussed further under 16.3.1., Article 33, Section 2, of the most recent Draft Fifth Directive contains provisions that limit the right for companies to issue low- or non-voting shares.

²⁰⁰ As a consequence of this proposal, Article 33, Section 2, of the Draft Fifth Directive has been changed, see further under 16.3.2.

²⁰¹ Article 36, Section 3, of the most recent version of the Draft Fifth Directive reflects this proposal.

²⁰² See now the latest Draft Fifth Directive, Article 4, Section 5, which stipulates that no class of shareholders may be given the exclusive right to appoint the majority of the board members.

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16.3. Proposing changes. As suggested under 16.1., defensive devices or strategies ought to be divided into those that should be considered counter-efficient without having any virtues that justify them, and those which may be counter-efficient but offer some other benefits or advantages that may make them acceptable. In short, some defenses could be labelled as evil per se whereas others may turn out to be justifiable when examined closer.

First, we will consider defenses belonging to the former category.

16.3.1. A- and B-shares and the notion of “one share one vote”. The proposal made here is the following:

The principle “one share one vote” ought to be applied to companies listed on the Copenhagen Stock Exchange for the purpose of ensuring that the voting power of any shareholder is proportionate to his holding of shares. Listing of companies at the Stock Exchange ought to be limited to companies whose shares all carry “full” voting rights. Companies that have issued low-voting shares ought not to be admitted to listing.

The use of A- and B-shares leads to one or a few shareholders holding the high-vote A-shares being able to control a company, although the B-share capital often represents by far the largest investment in the company. In other words, those in control of a company are frequently not those who own the majority of the shares of that company. Board members elected by those in control frequently cannot be removed, although holders of the majority of the capital desire to do so.

A capital structure of the kind discussed here impedes changes of corporate control and thus erects barriers to the ability of capital to be used in the most efficient way.

Also, the difference of interests of management and shareholders (see V.2.3.) is a reason why management should not be insulated from shareholder control.

In order to “reinstall” shareholder influence it is a prerequisite that we tie together the right to receive the fruits and the risk connected to the business on the one hand, and the right to govern the business on the other hand.

The only way this can be achieved is by ensuring that shareholders de lege have powers to affect management and, if necessary, remove it. In addition, it is obviously necessary that shareholders exercise their influence. But before we get to that point we must ensure that they have the right of influence. Therefore, the use of high- and low-vote shares by listed companies ought to be outlawed.

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Article 33 of the Draft Fifth Directive, as a point of departure, stipulates that the voting rights of a shareholder shall be proportionate to his holding of the company's share capital, see Section 1 of Article 33.

However, Section 2 of Article 33 provides that the EC-member states may allow some deviations from the starting point. Member states may, inter alia, provide in their national laws for a limitation or elimination of the voting rights as regards shares that enjoy special rights, provided, however, that such shares do not constitute more than 50 percent of the total share capital of a company.

Article 33, Section 2, provides that even shareholders who own shares with no or limited voting rights must have certain remedies once things have turned really bad: if the company fails to discharge the obligations owed to such shareholders for a period of three successive fiscal years, these shareholders are granted voting rights proportionate to their capital investment.

It should be noted that Article 33 only creates a "floor" of how much the member states may limit shareholder influence. Member states may, therefore, maintain or enact laws which give shareholders a stronger position.

The question is thus if disparity in voting rights among various classes ought to be allowed at all in connection with listed companies.

Perhaps it may be argued that it may be in the interest of a company to obtain additional capital from the stock market without having to transfer influence. This could be an argument for allowing companies to have at least part of their capital structure consist of low-vote shares (e.g. B-shares).

The Amsterdam Stock Exchange has adopted provisions in its Stock Exchange Rules which only allows low-vote preferred shares to be issued in an amount up to 50 percent of the total share capital of a company, see Article 4. This and other changes in the Stock Exchange Rules of the Amsterdam Stock Exchange are discussed by A.G. van Solinge, *Aanpassing van het Fondsenreglement met Betrekking tot Beschermingsconstructies*, de naamloze vennootschap 67/3, March 1989, p. 60 ff.

A similar view is expressed by one of the dissenting members of the group preparing the report, *Ägande och inflytande i svenskt näringsliv*, Huvudbetänkande från ägarutredningen (SOU 1988:38) p. 327 (statement by Per Westerbergh).

This is the very core of the problem, however. By using the stock market to obtain capital while at the same time retaining control, the company's management keep shareholders off the path of influence.

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At present, there is nothing to prevent a company from issuing low-vote B-shares that exceed 50 percent of the aggregate share capital of the company. Also, the communication from the EC-Commission only imposes a 50 percent limit on the issue of non-voting shares.

The imposition of a “ceiling”, e.g. a 50 percent “cap”, even on the issue of low-voting shares would be a step towards increasing shareholder influence. However, the fact remains that even such a rule would prevent full shareholder participation in the monitoring and controlling of the board and the managers.

It is notable that the Draft Fifth Directive does not ban shares that have no votes at all. At present, Danish law does not allow a difference in voting rights exceeding a ratio of 10:1 and, for the reasons explained above, it would not be advisable to amend the Companies Act in order to provide for non-voting shares.

The right under Article 33 of the Draft Fifth Directive to issue shares with limited or no voting rights is conditional upon such shares having other special rights. Typically, this would mean special economic rights, i.e. status as preferred stock. Preferred stock is characterized by enjoying a priority position compared to common stock as regards dividend payments and fulfilment in the event of bankruptcy.

However, special rights may also have the form of rights to appoint a certain number of board members or other kinds of rights that entitle the shareholders belonging to the class to influence corporate governance.

Shares that merely have a preferential position economically, but limited or no voting rights, may seem acceptable in the sense that the investor receives some kind of “sweetener” to compensate for his lack of influence.

However, from a corporate governance point of view, preferred shares of this nature are hardly advisable since they, in effect, tend to turn shareholders into mere lenders or creditors. Obviously, the holders of preferred shares have limited or no means by which to monitor and control the board and the managers.

If the “price” which is paid for giving investors limited or no voting rights is that they get other means by which to influence corporate management, the use of low-vote shares may be acceptable. It ought to be noted, however, that limitation or elimination of voting rights of one class is only desirable from society’s viewpoint if the shareholders of that class have other and strong means by which to monitor and control the management. Since the point of having limited or no-vote shares is to eliminate such influence, it is very unlikely that the means which shareholders

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get in exchange for their voting rights would ever meet the standards necessary to keep the board and the managers alert.

The majority of companies which at present have A- and B-shares are only “semi-public”. A part of their shares (typically the B-shares) is traded on the stock exchange while the remaining shares (the A-shares) remain on a limited number of hands.²⁰³ This creates impediments to the transfer of corporate control. It is problematic that the requirements pertaining to listing of shares at the Stock Exchange in great detail regulate the shares to be listed, while, simultaneously, the non-listed shares, which are the ones that really matter in terms of control, escape regulation. A prerequisite for a well-functioning market for companies is that the right to control or influence is also transferred when the shares of the company are traded.

Recent articles about the use of A- and B-shares include an article by Johan Schlüter in *Revision & Regnskabsvæsen* No. 1/1990, p. 10 ff. and an article by Werlauff in *Revision & Regnskabsvæsen* No. 9/1990, p. 33 ff.

16.3.2. The voting power of shareholders. While there has been a great deal of focus on the use of A- and B-shares and the implications resulting therefrom, less attention has been paid to other limitations on shareholder influence. It ought to be noted, however, that limitations on, for example, shareholder voting power give rise to the very same concerns as A- and B-shares.

The proposal submitted here is that it ought to be a requirement that charters of listed companies do not include provisions which seek to limit the voting power of shareholders and thereby dilute the “one share one vote” principle. No caps on the number of votes any one shareholder may cast ought to be accepted.

A similar picture as we saw regarding A- and B-shares emerges with respect to restrictions on the shareholders’ voting power, except that here there may not even be one or a few shareholders in control. Limiting the voting power of each shareholder irrespective of the size of his stockholding in effect entails that the shareholders surrender their powers to influence to management.

An earlier version of the Draft Fifth Directive, Article 33, would provide for a right for member states of the EC to limit the number of votes that any one shareholder may cast if such limitation applied to all shareholders

²⁰³ See XIII.5.1.

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of that class. However, as a result of the aforementioned communication from the EC-Commission, this right for member states has been abolished in the most recent version of the Draft Fifth Directive.

Consequently, it should be expected that the Draft Fifth Directive, if adopted in the amended version, would lead to changes of Danish law. I welcome such changes since they would prevent a dilution of the “one share one vote” principle.

For a thoughtful discussion and criticism of the right under German law to limit the voting rights in listed companies, see Theodor Baums, *Höchststimmrechte*, Die Aktiengesellschaft, 6/1990, p. 221 ff. See also the different view expressed by Rüdiger Liebs, *Abschaffung des Höchststimmrechts mit Hilfe des Vollmachtstimmrechts?*, Die Aktiengesellschaft 7/1990, p. 297 f.

16.3.3. Limitations on ownership and consents to acquisitions. A third group of defensive charter provisions which is problematic encompasses clauses that limit the number of shares any one shareholder can own as well as consent clauses (see 2.8.), which, in effect, restrict the right to acquire shares.

Here I submit that it ought to be a requirement that no charter provisions of listed companies impose limitations or restrictions on the right to own or acquire shares.

The principal feature of ownership limitations is that they leave shareholders “small and weak” and boost the powers of management.

Although the argument frequently made for adopting and maintaining such provisions is that they aim at protecting small shareholders or maintain “shareholder democracy”, the fact of the matter is that not only owners of majority holdings of a company but also minority shareholders surrender their right of influence to management. When all shareholders are voiceless, the power of management is boosted.

Consent clauses are perhaps even more troubling because to an even higher degree they vest control in management. Allowing management discretion to decide whether shares should change hands is tantamount to giving management the right to veto acquisitions which it disfavors. Neither shareholders nor society has an interest in this.

16.3.4. Other takeover defenses. The three types of defenses discussed above have, as their common denominator, the feature that they create obstacles to efficiency while at the same time they seem to have no virtues

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that can compensate for their negative impact. On the contrary, they lead to a shift of control from shareholders to management, which, for the reasons discussed earlier, is undesirable.

But what about the other defenses described earlier in this chapter? The very fact that they are “defenses” against the company being taken over suggests that they make it more difficult and time-consuming for somebody to acquire the company. Sometimes these defenses may even prevent the takeover. What all this indicates is that defenses as such are very hard to reconcile with the desire to achieve maximum efficiency.

However, this does not end our analysis. We still have to determine if these defenses could be justified for reasons other than efficiency maximization.

It may be useful at this point to divide the defenses we are discussing here into two sub-groups. The first sub-group consists of defenses or strategies which are not adopted as a response to a specific takeover attempt, but rather seek to make it more difficult to acquire control and, once control has changed, put limits on the exercise of control. The second sub-group includes any step that is made in order to respond to a specific takeover attempt.

The first sub-group encompasses a variety of different defenses, including, for example, the use of record dates, supermajority provisions, staggered boards and cumulative voting.

Some of these defenses, for example the use of record dates, may give the target-shareholders more time to consider and prepare themselves for the influence that the acquiror is going to have. While slowing down the acquiror is counter-efficient, we could argue that society may have a desire to ensure that target-shareholders are not exposed to dawn-raids, whereby they do not have sufficient time to consider the impact of a change of control or the possibility of receiving alternative offers. It is hard to draw any final conclusions in this respect, however, since the shareholders may also have an interest in allowing prospective buyers that want to offer a premium price for their shares to do so without impediments.

A similar picture can be drawn with respect to those defenses belonging to the first sub-group which aim at protecting minority shareholders. Many commentators would probably agree that protecting this vulnerable group of shareholders may be so important that we have to accept that we may not at the same time be able to achieve optimal efficiency. But the question here again is what is really in the best interest of minority shareholders. Is it to create a number of protective measures which ensure that the minority has a true say in the management of the company after a change

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of control? Or is it rather to ensure that prospective buyers of the company's shares encounter as few obstacles as possible so that, everything else being equal, the minority shareholders, like any other group of shareholders, may benefit from the increased willingness of acquirors to acquire the company and either offer them to buy their shares at a premium price or to increase the value of the company upon acquiring it? In continuance of the latter point, could we say that § 80 and the specific minority protection provisions of the Companies Act create an adequate protection of the interests of minority shareholders and that no further steps are necessary in this regard?

The point of departure is, and should be, that shareholders have the right to decide in matters regarding corporate governance. Only if decisions are counter-efficient and, at the same time, otherwise lack justification, should we interfere as it was proposed under 16.3.1.-16.3.3. above.

Defenses which give target-shareholders more time to consider the advent of an acquiror and the possible impact of his influence may, at least in some instances, be considered as a benefit for target-shareholders. Likewise, we cannot rule out that the advantage of minority shareholders having a greater say in the governance of the company may, at least in some instances, exceed the possible loss of opportunities. In particular, the fact that one of the key protective provisions of the Companies Act, § 80, contains a large element of discretion, may be a good reason for protecting minority shareholders by more specific charter provisions.

The point I am trying to make is not that these defenses are always in the interest of the shareholders. Sometimes they may be, sometimes they are not. But the important thing is that we lack sufficient grounds for concluding that these defenses are per se detrimental to shareholders and society. In this connection it ought to be noted that the defenses discussed here do not leave the fate of the shareholders in the hands of target-management. Some of them may strengthen the position of management, but the shareholders still have the right to remove management and change the charter if deemed necessary.

The second of the aforementioned sub-groups poses questions that are akin to those just discussed.

While a purely efficiency focused approach would suggest that there ought to be no barriers for an acquiror who offers a price that is above the market price, this is only part of the facts that the target-shareholders would want to consider. The other part is what happens to the value of their investment in the event that no change of control takes place or somebody else offers a higher price than the acquiror is willing to pay.

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Perhaps management has proposed plans which, if they prove to be successful, would give the target-shareholders an even higher gain. Or there may be other factors which are valuable or beneficial in the eyes of the shareholders.

In other words, a decision by the shareholders to prevent an acquiror from gaining control could very well make sense because the shareholders expect that they will be better off by not selling, or not selling to the acquiror. We should not interfere in this decision as long as it is made by the shareholders and not by target-management. As was the case with the first sub-group, we have no conclusive grounds on the basis of which we could propose that these types of defenses ought to be outlawed as evil per se.

It goes for both the first and the second sub-groups of defenses that they will have to be adapted and exercised in accordance with the framework of shareholder protection set forth in the Companies Act, including the specific provisions protecting minority interests and the general standard in § 80. This body of regulation, together with the restrictions on acts by target-management once a takeover attempt is imminent or has been made, proposed in X.4.3.3. and 4.4. above, probably create an adequate framework as to these defenses.

XII Control of corporate acquisitions

1. Introduction – economic rationale for controlling corporate acquisitions

The terminology “control of acquisitions” is used here to describe regulation of corporate acquisitions, which has as its prime goal to assure competition in the markets for products and services.

The terminology used here resembles the more widely used term “merger control”. The latter designation is somewhat confusing, however, for our purposes, since we focus on acquisitions and not mergers. Both control of acquisitions and merger control are designations which are used to “carve out” specific issues that belong to the body of regulation frequently referred to as “trade regulation” or, probably for historic reasons, “anti-trust”.

Pursuit of competition is founded on the belief that competition is a means by which consumer demands may be satisfied at the lowest prices and by using the fewest resources.¹

Using the concepts introduced under I.2.2., we could say that competition is desirable because it maximizes consumer utility and, at the same time, increases efficiency by allocating resources to their best use. Also, suppliers are encouraged to be progressive in order to remain in the market.²

While most commentators agree to the overall object of having competition, different opinions have emerged with respect to how to achieve this goal and to what extent government should seek to regulate the activities in the markets.

There has been a great deal of discussion in the United States about these issues. It is particularly interesting to see how, starting in the 1970's, a number of scholars have integrated microeconomics into trade regulation. In his famous book the *Antitrust Paradox: A Policy at War with Itself*, Robert Bork criticizes the caselaw developed by the American courts for showing a lack of understanding of economic mechanisms. Also, Bork points out that the courts do not follow a consistent path in their policy. Robert Bork, then a professor at Yale, has been one of the strong proponents of having a “free market”, i.e. very limited interfer-

¹ See Ernest Gellhorn, *Anti-trust Law and Economics in a Nutshell* p. 41 ff.

² See Ernest Gellhorn, *Anti-trust Law and Economics in a Nutshell* p. 41 ff.

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ence by government. For an economic approach to trade regulation, see also Richard Posner, *Economic Analysis of Law* p. 265 ff.

Turning to the European stage, the increased level of merger and acquisition activity has given rise to discussions about the effects of large concentrations on competition. As we shall see later, the EC-Commission has been concerned with issues of concentration for a number of years.

2. The Danish Competition Act

The Danish Competition Act ("Konkurrenceloven")³ contains no provisions that control corporate acquisitions. The requirement under § 5, Subsection 1, of the Competition Act, according to which agreements and concerted practices that constitute or may constitute a dominating influence in a market must be reported to the Competition Council ("Konkurrencerådet"), generally does not apply to corporate acquisitions. However, it cannot be excluded that acquisition agreements may contain provisions that in the circumstances constitute a dominating influence in restraint of competition and thus must be filed with the Council.⁴

The Act on Monopolies and Restrictive Practices ("Monopolloven"), which preceded the Competition Act, included a requirement that single businesses and associations that exercise or may exercise a substantial influence on prices, production, trade or transportation in Denmark or parts of Denmark should be notified to the Monopolies Authorities. This notification requirement has been abandoned in the new Competition Act. The notification requirement was found in § 6, Subsection 2, of the Act on Monopolies and Restrictive Practices. The background for abandoning this requirement is discussed in Ministerial Report No. 1075 of June 24, 1986, p. 212 f.

The Competition Act is based on the general principle that parties in the market have the freedom to act and enter into agreements regarding business issues as they wish. The economic system is based on the market forces and production is determined by supply and demand, the underlying assumption being that in a market where no limitations exist, the relative prices reflect the conditions for production as well as the consumers' preferences. Accordingly, the Competition Act is devised to facilitate increased competition and efficiency within industry and trade.

In connection with the preparation of the bill for the Competition Act it was stressed that production, as well as trade, is becoming more and more

³ Act No. 370 of June 7, 1989.

⁴ See Peter Fosdal, *Konkurrenceloven* p. 163.

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international. This increased internationalization combined with the current change of the business structure and the completion of the EC internal market are expected to have an active effect on competition.⁵

The philosophy behind the Competition Act is that increased "transparency" is the best means of facilitating competition. In this context transparency means the easiest and cheapest provision of information for manufacturers, dealers and consumers about prices, business conditions and other factors affecting competition. The notion of transparency at focus here is clearly consistent with our desire to achieve efficiency.

As suggested earlier, the Competition Act should not be expected to play a major role in connection with contested takeovers.

3. EC control of concentrations

3.1. Background. On December 21, 1989, the EC-Council adopted Regulation 4064/89 on the control of concentrations between undertakings (the "Regulation"), which came into force on September 21, 1990.

In order to ensure a smooth introduction and operation of the Regulation, the EC-Commission has adopted a regulation (2367/90 of July 25, 1990) determining the rights and duties of the Commission as well as the undertakings involved in a transaction. Also, the EC-Commission issued two notices (90/C 203/05 and 90/C 203/06), *inter alia*, providing guidelines with respect to the terms "ancillary" restrictions and "concentrations".

The passing of the Regulation was preceded by many years of political discussions as well as some important decisions rendered by the EC-Court of Justice. Since, as will be seen later, these decisions may still have some importance, they will be briefly considered here.

In July 1973, the EC-Commission submitted a draft regulation on the control of concentrations between undertakings to the EC-Council. The Council, however, did not agree to the draft. The governments of a number of member states, including, in particular, the British, the French and the German government, were opposed to a transfer of authority in this area from the national legislatures to the EC-Commission. In November 1981 the draft was amended and the new draft was discussed by the Council in 1987 where it was agreed in principle that merger control of some kind would be desirable. However, it was still not possible to agree on the draft submitted by the Commission. After revisions of the draft during 1988 and 1989, the Council adopted the draft in December 1989.

⁵ See the explanatory memorandum to the bill for the Competition Act, the Official Report of the Parliamentary Proceedings ("Folketingstidende") 1988/89, addendum A, column 4447 ff.

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Contrary to the European Coal and Steel Treaty of 1951, which includes a specific provision for control of mergers and acquisitions (Article 66), the Treaty of Rome does not provide for this.

However, the scope of the EC-Commission's authority to regulate mergers was to some extent clarified in 1973 when the Court of Justice rendered its decision in the *Continental Can*-case.⁶ Pursuant to the doctrine developed in this case, Article 86 of the Treaty of Rome, which prohibits the abuse of a dominant position of an undertaking, creates the basis for control of mergers and acquisitions of companies. In *Continental Can*, a U.S. manufacturer of metal containers acquired (indirectly) 81 percent of the shares of its principal competitor in Europe, in which it already held 10 percent of the shares. The EC-Commission stated that by doing so Continental Can abused its dominant position in the EC because the American company virtually eliminated competition in a substantial part of the EC. The EC-Court of Justice reversed the Commission's decision on various technical grounds but noted that abusive conduct could be present where an enterprise in a dominant position strengthens that position to the point where the degree of domination achieved substantially hampers competition with the effect that only enterprises that in their market conduct are dependent on the dominant enterprise would remain in the market.⁷

The EC-Commission has subsequently used the *Continental Can*-case as a basis to review proposed corporate mergers and acquisitions.

In 1987 the EC-Court of Justice took another step that could be construed as an expansion of the powers of the Commission. In the *British American Tobacco*-case⁸ the Court thus held that control of mergers and acquisitions can be based on Article 85 of the Treaty of Rome as well. Article 85 prohibits anti-competitive agreements and concerted practices. According to the Court, a company's acquisition of a minority stockholding of a competing company in the circumstances may constitute an agreement infringing Article 85. The Court said that the acquisition by one company

⁶ *Euroemballage Corp. & Continental Can Co. v. Commission*, February 21, 1973, Case 6-72, Rec. 1973-2, p. 215, Common Mkt. Rep. (CCH) # 8171.

⁷ The *Continental Can*-decision is discussed by Karen Banks, *Mergers and Partial Mergers under EEC Law*, 11 Fordham International Law Journal 255 at 266 (1988). For a general discussion of Article 86, see Ivo van Bael & Jean-François Bellis, *Competition Law of the EEC* p. 260 ff.

⁸ *British-American Tobacco Ltd. and R.J. Reynolds Industries Inc. v. Commission*, November 17, 1987, joint cases Nos. 142 and 156/84, O.J. C 329, December 8, 1987, p. 4.

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of an equity interest of a competitor does not in itself constitute conduct restricting competition. Nevertheless, such an acquisition may “serve as an instrument for influencing the commercial conduct of the companies in question so as to restrict or distort competition on the market on which they carry on business”. The acquisition of shares in the *British-American Tobacco*-case was the subject matter of agreements entered into by companies that had remained independent after entering into the agreements, which suggests that the judgment only applies to acquisition of minority stockholdings. The scope of the principle established in the case is somewhat unclear and controversial, however.

When stating its conclusions, the Court provided some guidelines as to when an acquisition would be within the scope of Article 85. The Court said: “That will be true in particular where, by the acquisition of a shareholding or through subsidiary clauses in the agreement, the investing company obtains legal or de facto control of the commercial conduct of the other company or where the agreement provides for commercial co-operation between the companies or creates a structure likely to be used for such co-operation”. These guidelines, by referring to “control” as one of the possible decisive factors, seem to support the view that not only minority shareholdings but even takeovers may be governed by Article 85. Valentine Korah & Paul Lasok fear that the *British-American Tobacco*-case “may be extended to the acquisition of virtually the total equity”, see *Philip Morris and its Aftermath – Merger Control?*, CML Rev. p. 333 at 367 (1988). The ramifications of the *British-American Tobacco*-case are not clear, see the analysis by Karen Banks, *Mergers and Partial Mergers under EEC Law*, 11 Fordham International Law Journal 255 (1988). See also Jean Pierre Blumberg & Martin Schödermeier, *EC Merger Control – No Smoke without Fire?*, International Financial Law Review p. 35 ff. (January 1988), Willem J.L. Calkoen & J.J. Feenstra, *Acquisition of Shares in other Companies and the EEC Competition Policy: The Philip Morris Decision*, International Business Lawyer, p. 167 ff. (April 1988). See also Jens Fejø in Revision & Regnskabsvæsen No. 4/1988, p. 28 f. and Jesper Lett, Revision & Regnskabsvæsen No. 11/1988, p. 40 f.

It is quite certain, however, that even a very narrow reading of the decision suggests that Article 85 may be applied to agreements whereby one company acquires a minority equity interest in a competitor.

3.2. The Regulation

3.2.1. Concentrations. The Regulation pertains to concentrations having a “community dimension” within the meaning of Article 1 and, in the affirmative case, it is subject to prior notification to the EC-Commission as

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set forth in Article 4 and suspension of implementation as described in Article 7 of the Regulation.

The Regulation deals with “concentrations” between undertakings. Article 3 contains a definition of concentration and states that a concentration shall be deemed to arise where two or more “previously independent” undertakings merge, or one or more persons already controlling at least one undertaking, or one or more undertakings, acquire, whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or part of one or more other undertakings. As it appears, the word “concentration” includes both typical mergers and acquisition of “control”.

Control may be acquired directly or indirectly and by purchase of shares or assets, by contract or by any other means.⁹ As a consequence of this definition, takeovers that meet the size thresholds set forth in the Regulation would be governed by the Regulation.

3.2.2. Community Dimension. “Community dimension” is determined in terms of two criteria, turnover and geography. Both criteria must be met in order for a concentration to qualify as being of “community dimension”. There are two prongs of the turnover test. A concentration has a “community dimension” where (1) the aggregate worldwide turnover of all the undertakings concerned is more than 5 billion ECU and (2) the aggregate community-wide turnover of each of at least two of the undertakings concerned is more than 250 million ECU.

A concentration that meets the economic thresholds mentioned here would, nevertheless, be exempted from the regulation if each of the undertakings concerned achieves more than two-thirds of its aggregate community-wide turnover within one and the same member state.¹⁰

In the original draft the aggregate worldwide turnover of all the undertakings was fixed at 750 million ECU. In order to obtain support for the adoption of the draft Regulation, the EC-Commission subsequently increased the aggregate worldwide turnover threshold to 2 billion ECU with a 5 billion ECU threshold applicable in a transition period until December 31, 1992. Simultaneously, the Commission proposed a reduction of the three-quarters threshold pertaining to the aggregate community-wide turnover to two-thirds. For a discussion of these proposals, see BNA’s Corporate Council Weekly, May 17, 1989, p. 4, and April 19, 1989, p. 1 and p. 8.

⁹ See Article 3 of the Regulation.

¹⁰ See Article 1 of the Regulation.

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Article 5 sets forth in detail how to calculate the turnover. Also, Article 5 contains special rules regarding financial and insurance undertakings. According to Article 1, Section 3, the thresholds mentioned in the text will be reviewed before the end of the fourth year following the adoption of the Regulation.

3.2.3. Notification, suspension and appraisal. Parties to a concentration covered by the Regulation must notify the Commission not more than one week after the conclusion of the agreement or the announcement of a public bid, or the acquisition of a controlling interest, whichever occurs the first.¹¹

A concentration that meets the economic thresholds set forth in the Regulation may not be put into effect for a period of 3 weeks following notification.¹²

The Commission must examine the notification as soon as it is received. First, the Commission will have to verify that the concentration has a “community dimension”. Where the Commission finds that a notified concentration does not fall within the scope of the Regulation, it must so inform the local supervisory authorities and the undertakings concerned without delay.¹³

If the Commission finds that a concentration falls within the scope of application of the Regulation, it shall immediately publish the main contents of the notification.¹⁴

Where the Commission finds that a concentration meets the economic thresholds set forth in the Regulation and thus falls within the scope of the Regulation but, nevertheless, does not raise “serious doubts” as to its compatibility with the Common Market, it must decide not to oppose the transaction and must make a declaration regarding the compatibility without undue delay.¹⁵ If, on the other hand, the concentration falls within the scope of the Regulation and gives rise to serious doubts as to its compat-

¹¹ See Article 4, Section 1, of the Regulation. Notification must be made jointly by the parties concerned in the event of a merger or the acquisition of joint control, and otherwise by the party or parties seeking to acquire control, cf. Article 4, Section 2.

¹² See Article 7, Section 1, of the Regulation. The Commission may in certain cases take steps to further suspend a concentration, see Section 2.

¹³ See Article 6, Sections 1 (a) and 2, of the Regulation.

¹⁴ See Article 4, Section 3, of the Regulation.

¹⁵ See Article 6, Section 1 (b) and 2, of the Regulation.

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ibility with the Common Market, the Commission must decide to initiate proceedings.¹⁶

In such case the Commission shall appraise the concentration in order to establish whether or not it is compatible with the Common Market, see Article 2.

In making its appraisal, the Commission shall take into account the need to preserve and develop effective competition within the Common Market considering, *inter alia*, the structure of all markets concerned and the actual or potential competition from undertakings located either within or outside the Community. Also, the Commission shall take into account the market position of the undertakings concerned and their economic and financial power, the opportunities available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends with the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress, provided that it is to consumers' advantage and does not form an obstacle to competition.

A concentration which does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the Common Market or in a substantial part of it shall be declared compatible with the Common Market.¹⁷

The Regulation provides for quite strict time limits. Not later than one month after receiving proper notification the Commission must decide if the concentration has a "community dimension" or not and if it raises serious doubts with respect to its compatibility with the Common Market.¹⁸

In the event the concentration gives rise to such "serious doubts", the Commission shall initiate proceedings which must be concluded as soon as possible and not later than four months after they were initiated.¹⁹

According to the Regulation, concentrations which, by reason of the limited market share of the undertakings concerned, are not likely to impede effective competition may be presumed to be compatible with the Common Market. Such compatibility may be presumed where the market share of the undertakings involved does not exceed 25 percent either in the Common Market or in a substantial part thereof.²⁰ However, a review of a concentration may show that the concentration creates an effective

¹⁶ See Article 6, Sections 1 (c) and 2, of the Regulation.

¹⁷ See Article 2, Section 2.

¹⁸ See Article 10, Section 1.

¹⁹ See Article 10, Sections 2 and 3.

²⁰ See the preamble to the Regulation.

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impediment to competition even though the above market share threshold has not been reached.

3.2.4. Enforcement. Undertakings that fail to comply with the Commission's decisions may be fined pursuant to Article 15. Also, if a concentration has already been implemented but is not compatible with the Common Market, the Commission is empowered to break it up, cf. Article 8, Section 4.²¹

3.2.5. Intervention by the EC-Commission in cases where the thresholds have not been met. Although it was, from the outset, the idea to delimit areas of responsibility where the EC-Commission and the member states, respectively, were solely responsible, this principle has been eroded in the negotiation process preceding the adoption of the Regulation. The attempt to have either the Commission or the relevant member state exercise control (the principle of "one-stop") is thus made subject to some exceptions.

One of the important exceptions is set forth in Article 22, Section 3, of the Regulation, which creates a procedure by which a member state may ask the Commission to intervene in a concentration which does not qualify as having a "community dimension" but which, nevertheless, threatens to create or strengthen a dominant position which would significantly impede competition within the territory of the subject member state.

Article 22, Section 3, thus establishes a system whereby the EC-Commission may evaluate concentrations although the thresholds set forth in Article 1 have not been met.

The question then is when a concentration that does not meet the thresholds would be considered to have such an adverse effect on competition to give the Commission grounds to intervene. In this connection it should be noted that, upon the adoption of the Regulation, the Commission stated that a concentration is normally not considered to affect trade between member states if the worldwide turnover of the involved undertakings is less than 2 billion ECU, or the community-wide turnover of the undertakings involved is less than 100 million ECU. According to these guidelines it should be expected that intervention by the Commission in cases initiated pursuant to Article 22, Section 3, will ordinarily be confined to concentrations that fall within the ranges between 2 and 5 billion ECU and 100 and 250 million ECU, respectively.

²¹ The investigative powers of the Commission are outlined in Article 13.

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When assessing a concentration falling within these brackets, the Regulation does not provide any guidance with respect to the test of compatibility to be used. However, it is likely that the Commission will attempt to obtain some guidance from the principles set forth in Article 2 of the Regulation.

It should be borne in mind that the likelihood of a member state inviting the EC-Commission to review a concentration is increased in countries, like Denmark, where there is little domestic control of merger and acquisition activity.

Conversely, pursuant to Article 9 of the Regulation, the EC-Commission may refer a notified concentration to the competent authorities of the member state concerned. Article 9 of the Regulation sets forth the conditions for such referral.

3.2.6. Residual effects of Articles 85 and 86 of the Treaty of Rome. The Regulation has been adopted on the basis of, inter alia, Article 87 of the Treaty of Rome, which empowers the Council to adopt regulations for the implementation of Articles 85 and 86.

The fact that the Commission exercises its powers pursuant to the Regulation, and thereby in part applies the two Articles, is not tantamount to saying that the Regulation exhausts the powers contained in Article 85 and Article 86. This is particularly true because the Treaty of Rome, being the “constitution” of the EEC, ranks higher than any regulation adopted pursuant to the Treaty.

The point that the Regulation has not exhausted the powers under Article 85 and Article 86 is underscored by the fact that Article 89 empowers the Commission to investigate possible violations of the two mentioned Articles upon application by a member state or on its own initiative. Consequently, the Commission can still apply Articles 85 and 86 on the basis of Article 89 to concentrations that have or that do not have a “community dimension”. In a statement accompanying the adoption of the Regulation, the Commission has indicated that, although, as a matter of law, it has the right to do so, it does not, normally, intend to apply these Articles to concentrations with a community dimension. In such cases it should be expected that the Commission will only use the powers conferred on it in the Regulation.

As to concentrations that fall below the thresholds of the Regulation, the Commission has expressly made the point that it reserves the right to ex-

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ercise its powers pursuant to Article 89, at least to the extent that concentrations exceed the thresholds discussed under 3.2.5. above.

The Regulation is discussed by Wolfgang Feldmann, *Die Europäische Fusionsskontrolle – ein Überblick für die Praxis*, Wettbewerb in Recht und Praxis, p. 577 ff. (September 1990), and Cornelis Canenbley & Andreas Weitbrecht, *EEC Merger Control Regulation: A Preliminary Analysis*, International Business Lawyer, p. 104, Vol. 18, No. 3 (1990). See also Jytte Boesgaard & Claus Gulmann in Ugeskrift for Retsvæsen 1990.B 265 ff.

4. Conclusion on Danish law

In the light of the lack of takeover control in the Danish Competition Act and due to the thresholds applicable to review of takeovers by the EC-Commission, it should be expected that the rules discussed above will have a limited impact only on takeovers involving Danish companies.

5. Comparative aspects

To obtain a picture of the extent to which Danish law on control of corporate acquisitions differs from the laws of other countries, we will take a brief look at the control laws of the United States, Great Britain and the Federal Republic of Germany, respectively. Both Great Britain and the Federal Republic of Germany are members of the EC and, consequently, the national legislation of these countries is supplemented by the EC rules of control.

Section 7 of the U.S. Clayton Act prohibits corporate acquisitions which take place in any line of commerce or in any activity affecting commerce, and which may substantially lessen competition or tend to create a monopoly.²² For a long time the Justice Department and the Federal Trade Commission, which are the two federal executive agencies monitoring the Clayton Act, had difficulties policing violations of the Act in an efficient manner. While the substantive regulation did not give rise to any significant problems, the fact that the courts turned out to be very reluctant to reestablish status quo by ordering a divestiture of companies involved in corporate acquisitions made in violation of the Clayton Act frustrated the

²² See 15 U.S.C. § 18. In addition to the Clayton Act, the federal trade regulation includes §§ 1-7 of the Sherman Act, 15 U.S.C.A. § 1 of the Sherman Act is the equivalent of Article 85 of the Treaty of Rome.

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efforts made by the Justice Department and the Federal Trade Commission. In addition, the courts often refused to issue preliminary injunctions preventing proposed transactions deemed to be contrary to the Clayton Act.²³

Against this background, Congress adopted the so-called Hart-Scott-Rodino Antitrust Improvements Act of 1976, whereby Section 7 A was added to the Clayton Act.²⁴ The Hart-Scott-Rodino Act provides for the advance notification of all mergers and acquisitions of a certain size to the Justice Department and the Federal Trade Commission. If a transaction involves parties one of which has gross assets or, as regards companies engaged in manufacturing, sales of at least 100 million dollars, and the other party has gross assets/sales of a minimum of 10 million dollars, a pre-merger notification must be filed with the above two authorities. However, notification is only required if the transaction will lead to the acquiror holding 15 percent or more of the gross assets or voting stock of the target-company, or if such gross assets or voting stock have a value exceeding 15 million dollars. After filing of the pre-merger notification, a "waiting period" of 15 days applies if the acquisition is based on a cash tender offer and 30 days as regards acquisitions on a non-cash basis.

If the parties to the acquisition have not been approached by the Justice Department or the Federal Trade Commission before the expiry of the waiting period, the transaction will ordinarily not be halted subsequently. However, there is nothing precluding the authorities from, after the consummation of a transaction, initiating an investigation of such transaction and taking legal steps in order to divest the companies involved if it is suspected that Section 7 of the Clayton Act has been violated, cf. *United States v. E.I. DuPont de Nemours & Co.*²⁵

Although the U.S. control of corporate acquisitions, including the notification system, seems to be very strict, it remains a fact that the enforcement of control, which was very strict during the 1960'es and 1970'es, has been very lenient during the Reagan era of the 1980'es. The free market proponents, including Robert Bork, mentioned earlier, have prevailed

²³ See Pfunder, Plaine & Whittemore, *Compliance with Divestiture Orders under Section 7 of the Clayton Act: An Analysis of Relief Obtained*, 17 Antitrust Bulletin 19 (1972).

²⁴ See 15 U.S.C. 19 a.

²⁵ See 353 U.S. 586 (1957). Recently, the Federal Trade Commission has investigated two possible violations of Section 7 of the Clayton Act more than one year after the acquisitions in question took place, cf. Hoechst Corporation, Docket No. 9216 and Coca Cola Company of the Southwest, Docket No. 9215.

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during the 1980'es. It seems as if the Bush administration will follow in the footsteps of Bush's predecessor.

An extensive description and discussion of the United States' federal trade regulation may be found in Phillip Areeda & Donald F. Turner, *Antitrust Law*.

As to British law, the so-called Fair Trade Act 1973, as amended by the Companies Act 1989, (the "Fair Trade Act") stipulates that mergers²⁶ that have as their result that two undertakings "cease to be distinct" must under certain circumstances be submitted to the Monopolies and Mergers Commission²⁷, cf. Section 64 of the Act. Undertakings are considered to have ceased to be distinct if they become owned or controlled by the same person or if one of the undertakings ceases to exist.²⁸ Accordingly, the acquisition of a controlling holding of shares of a company by means of a contested takeover may fall within the powers of the Monopolies and Mergers Commission.

The Director-General of Fair Trading (the "Director-General") must, on a current basis, monitor transactions already completed as well as planned mergers and acquisitions and, on the basis thereof, recommend to the Secretary of State for Trade and Industry (the "Secretary of State") what steps, if any, should be taken.²⁹

The decision of whether a given transaction should be submitted to the Monopolies and Mergers Commission is made by the Secretary of State. The Secretary of State may, but is not obliged to, submit a transaction to the Commission if the undertakings involved cease to be distinct, provided that the enterprises together supply or consume at least 25 percent of any goods or services in a market geographically defined as Great Britain or a substantial part thereof, or if the gross value of the assets acquired as a result of the transaction exceeds 30 million pounds.³⁰

As a result of changes in the Fair Trade Act brought about by the Companies Act 1989, a voluntary pre-notification system has been established³¹. Although the system of pre-notification is voluntary, it is clearly

²⁶ Despite the use of the word "mergers", the Act also includes acquisitions.

²⁷ The Monopolies and Mergers Commission consists of 24 members appointed by the Secretary of State for Trade and Industry. Typically, economists, accountants, lawyers and businessmen with relevant experience are appointed, rather than civil servants.

²⁸ See Section 65 of the Fair Trade Act.

²⁹ See Section 76 of the Fair Trade Act.

³⁰ See Section 64 of the Fair Trade Act.

³¹ See Sections 75 A ff. of the Fair Trade Act.

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inspired by the American Hart-Scott-Rodino-Act. When notice of a transaction has been given to the Office of Fair Trading, a “waiting period” of 20 working days applies, and this period may be extended by additional periods of 10 and 15 working days.³² Once the waiting period has lapsed, the transaction thus notified cannot be referred to the Monopolies and Mergers Commission if it is completed within 6 months after the expiry of the waiting period.³³

It follows from the City Code that offers lapse if a proposed transaction is referred to the Monopolies and Mergers Commission, see Rule 12 of the City Code. In connection with mandatory offers (see VIII.2.1.8.), it is a consequence of Rule 9.4 of the City Code that the offer must be reinstated if the Monopolies and Mergers Commission allows the transaction. It is unlawful to acquire shares of a company which is subject to a reference to the Monopolies and Mergers Commission, cf. Section 75 (4A) of the Fair Trade Act.

When a matter is submitted to the Monopolies and Mergers Commission, the Commission will examine the effects of the transaction, seen in conjunction with public interests, including aspects that relate to price and competition, other consumer interests as well as the effect on the industry and on jobs.³⁴ The conclusion reached by the Commission and the grounds hereof are stated in a report to be prepared by the Commission.³⁵ If the conclusion is that the transaction coincides with the interests of the public, the parties may consummate the transaction without further hesitation. In such event, the Secretary of State cannot interfere in the completion of the transaction. If, on the other hand, the Commission’s conclusion is that a transaction is in conflict with the interests of the public, the Secretary of State may request the Director-General to contact the parties to the transaction for the purpose of making such amendments as would make the transaction coincide with the interests of the public.³⁶ If it proves impossible to reach a satisfactory solution by voluntary means, the Secretary of State is authorized to prohibit a planned transaction or, if a transaction has already been consummated, to order the parties to divest the undertakings involved.³⁷

³² See Section 75 B of the Fair Trade Act.

³³ See Section 75 C(1)(e) of the Act.

³⁴ See Section 84 of the Fair Trade Act.

³⁵ See Section 70 ff. of the Fair Trade Act.

³⁶ See Section 88 of the Fair Trade Act.

³⁷ See Sections 73 and 75 of the Fair Trade Act and Schedule 8 to the Act.

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As a consequence of the changes of the Fair Trade Act in 1989, the Secretary of State is empowered to accept undertakings by the parties to a transaction in lieu of referring the matter to the Monopolies and Mergers Commission, cf. Section 75 G of the Fair Trade Act.

The relevant rules under German law are found in the German Cartel Act ("Gesetz gegen Wettbewerbsbeschränkungen", "GWB") of 1957.³⁸

The GWB provides that certain corporate transactions referred to as "mergers" must be notified in advance to the Federal Cartel Office ("Bundeskartellamt"). Plans regarding "mergers" must be filed with the Cartel Office if, during the last fiscal year, one of the undertakings participating in the merger had sales of 2 billion DM or more, or at least two of the undertakings involved each had annual sales of 1 billion DM or more.³⁹

The term "merger" ("Zusammenschluss") encompasses a number of different corporate transactions. Of particular interest for our purposes is the definition pertaining to acquisition of shares: acquisition of 25 percent, 50 percent or a majority interest of the voting capital of an undertaking is considered a merger for the purposes of the GWB.⁴⁰

The Federal Cartel Office shall prohibit a planned merger (as defined above) where it will create or strengthen a dominating market position.⁴¹

Contrary to what is seen in most other jurisdictions, the GWB lists a number of scenarios where it should be presumed that a dominating market position exists. In addition to stating (in Section 22) that an undertaking is presumed to have a market domination when it meets no substantial competition or enjoys a superior market position (both criteria are defined in further detail in the Act), the GWB contains a set of presumptions pertaining to oligopolies.

When receiving a complete notification on a planned merger, the Federal Cartel Office, as a general rule, has a four month period for investigating the matter. If the Office decides to prohibit the merger, such decision must, with a few exceptions, be made within the four month period.⁴²

It is common that mergers which do not give rise to any problems are cleared prior to the expiry of the four month period.

In addition to the pre-merger notification system, the GWB includes provisions of post-merger notification. When a merger has been consummated, the Federal

³⁸ Dated July 27, 1957, as amended, Federal Gazette III 703-1.

³⁹ See Section 24 a of the GWB.

⁴⁰ See Section 23(2) of the GWB.

⁴¹ See Section 24(1) of the GWB.

⁴² See Section 24 a of the GWB.

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Cartel Office must be notified without delay if the parties to the merger have a market share of 20 percent on any market, or had, collectively, aggregate annual sales of at least 500 million DM, or in the most recent business year had, collectively, at least 10.000 employees, cf. Section 23(1) of the GWB. Whenever the Federal Cartel Office receives a complete notification of a consummated merger it has an investigation period of one year. This means that prohibitions can not be issued after the expiry of this period, see Section 24(2) of the Act.

The GWB and its importance for corporate acquisitions is discussed in further detail by Rainer Bechtold & Werner Kleinmann, *Kommentar zur Fusionskontrolle*, and Wernhard Möschel, *Recht der Wettbewerbsbeschränkungen* p. 445 ff.

The merger control regulation of the Federal Republic of Germany is known to be one of the strictest and most heavily enforced merger control laws of the world. It was to a large extent the German authorities' belief that they were better at monitoring mergers than the EC-Commission that caused the delay of the adoption of the EC-Regulation discussed earlier.

Although it could seem as if the control of corporate acquisitions under both U.S. and German law is very strict, there is hardly any doubt that with the current trend in enforcement policy the German authorities are more likely to be concerned with concentration of economic powers than is the case in the United States.

As to Great Britain there seems to have been a trend in recent years towards the Monopolies and Mergers Commission playing an increasingly important role.

Time will show to what extent the coming into force of the EC-Regulation will affect the desire by national authorities to pursue these issues in situations where the thresholds of the Regulation have not been met.

XIII The Danish market for takeovers

– some broader implications

1. Introduction – the Danish market for takeovers

Earlier in this book an attempt was made to evaluate the impact of contested takeover activity on shareholders as well as on society at large. I reached the conclusion that contested takeovers are one of the means by which changes in corporate control can be effected, thus making a substantial contribution to the ability of the Danish business sector to adjust to the new demands which are likely to follow from the increased competition to be expected in the years to come. On the basis of this conclusion I stated that the focus from a policy viewpoint ought to be on regulating contested takeovers rather than outlawing them.

In terms of regulation, we focused first on the nature and substance of Danish regulation of corporate acquisitions and, in this connection, I proposed some changes in the regulation of share purchases.

Next, we examined the particular aspects of takeovers from the minority shareholders' point of view. One of the proposals made in this respect was to abandon Rule 4 of the Stock Exchange Rules of Ethics. I found that Rule 4 is counter-efficient and also seems to be based on a highly questionable notion of equality.

We then turned to the financial and tax aspects of contested takeovers and found that some of the rules in these areas impede while others facilitate corporate acquisitions.

I proposed a standard for managerial behavior in the takeover context and we focused on a variety of takeover defenses. In addition to clarifying the position of management vis-a-vis the shareholders and the relationship among the shareholders, I analyzed what is likely to be the economic impact of the various defenses. The analysis concluded that some takeover defenses ought to be disallowed because they are counter-efficient without having other features that could justify them, whereas other defenses may be counter-efficient but arguably, at least sometimes, generate benefits of other kinds to shareholders.

Finally, we focused on the impact of control of corporate acquisitions.

All of these different aspects of the phenomenon known as "contested takeovers" give us, when viewed together, a picture of this kind of activity, including the various obstacles to takeovers that exist.

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However, we still have not completed our picture and thus need to make some further inquiries before we obtain a true impression of the extent to which barriers to contested takeovers actually exist in Denmark. Although we may not be able to get a picture that is 100 percent complete we would like to achieve this as far as possible for two reasons: first, an exact answer to the question of the amount of barriers will tell us if the problem of obstacles to takeovers is at all something we ought to be concerned about; second, we would like to know if the environment in Denmark in this respect differs significantly from that of other countries where the companies are based with which Danish companies will have to compete in the years to come.

In the following we will consider some legal as well as non-legal factors affecting the market for takeovers in Denmark. We will thus consider the structure of ownership of Danish listed companies, stock exchange capitalization and liquidity, regulatory constraints and the prevalence of takeover defenses.

To put things into perspective, we will include some comparative aspects.

The European countries, including the EC-countries, represent a very varied picture as regards their markets for takeovers. In order to determine some of the differences among EC-countries, the EC-Commission retained Booz Allen Acquisition Services to prepare a study of the European takeover environment. The Booz Allen-report¹ was submitted to the Commission in January, 1990.

Although the Booz Allen-report does not cover all aspects of takeovers in depth, it gives us an impression of barriers to takeovers across the EC. Nevertheless, the analysis in the following will be based on other sources as well.

2. Structure of ownership

2.1. Denmark. We are interested in knowing about the structure of ownership because this may give us an idea of how “accessible” Danish companies are.

¹ Report to the Commission of the European Communities, DGXV B-2 Direction Général – Institutions Financières et Droit des Sociétés, *Study on Obstacles to Takeover Bids in the European Community, Executive Summary* (hereinafter the “Booz Allen-report”).

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The Booz Allen-report (p. 31, Exhibit 29) indicates that 62 percent of the shares of Danish listed companies are owned by households and non-financial companies. The report does not separate ownership by households and non-financial companies. The second large investor group consists of financial institutions and the state. Those two categories of investors in the aggregate hold 34 percent of the shares of listed companies. Foreign investors represent shareholdings of 5 percent of the listed companies. The figures mentioned here show the shareholding spread in 1987/88.

A Swedish parliamentary report provides some further insight into the structure of ownership of, *inter alia*, Danish listed companies.² The report is interesting because it not only focuses on the spread of shares but also shows the influence of various groups of shareholders.

The statistics pertaining to Danish listed companies provided in the report are based on a study of companies listed at the Copenhagen Stock Exchange in 1986.

The study reflects the influence on companies by so-called “dominating owners”.³

According to the study, 60 percent of the companies listed at the Copenhagen Stock Exchange were controlled by “dominating owners”. With respect to the remaining 40 percent of the listed companies it was not possible to find any dominating owner.

Natural persons were dominating owners in 36 percent of the listed companies, whereas private foundations were dominating in 12 percent of the companies. Private foundations together with a limited number of natural persons were found as dominating owners in approximately 4 percent of the companies, whereas the Danish state and municipal authorities were dominating in approximately 2 percent of the companies, and foreign interests represented dominating ownership in 6 percent of the companies.

Out of the 59 banks that were included among the listed companies, only one bank had a dominating owner, which explains the high number of companies where no dominating owner could be found. Among indus-

² See the parliamentary report designated, *Ägande och inflytande i svenskt näringsliv, Huvudbetänkande från ägarutredningen* (SOU 1988: 38) (hereinafter “the Swedish Parliamentary Report”). The statistics regarding Denmark are found at p. 169-171.

³ By and large this term refers to owners that hold a majority of the votes of a company, cf. p. 170 of the report.

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trial companies more than four-fifths had dominating owners and in more than 50 percent of these cases this owner was a natural person.

Institutional investors, including, in particular, The Employees Capital Pension Fund, The Danish Labor Market Supplementary Pension Fund, pension funds, banks and savings banks, and insurance companies, represented ownership of more than one-fourth of the aggregate value of companies listed at the Copenhagen Stock Exchange.

There has been an increasing amount of merger and acquisition activity involving Danish listed companies, and it is, therefore, likely that the picture drawn in the Swedish report has changed somewhat now. However, there is no reason to believe that the statistics regarding owners with dominating influence have changed significantly. It is likely, however, that the investments by institutional investors in the stock market have increased since 1986.

This development is illustrated by an article in the daily newspaper *Børsen*, June 2, 1989, p. 32-33, which includes a list of 20 listed companies in which labor market funds and pension funds have interests in the range from approximately 23 percent to approximately 57 percent.

2.2. Comparative aspects. In the United States households and non-financial companies (aggregated) own 63 percent of the shares of listed companies. 32 percent is held by financial institutions and 5 percent by foreign investors.

The figures reflect holdings in 1987/88, see the Booz Allen-report, p. 31, Exhibit 29. The percentage of shares held by U.S. households and non-financial companies (63) comes very close to the similar figure in Denmark (which is 62 percent). However, it ought to be noted that the aggregation of households and non-financial companies makes it difficult to draw any final conclusions in this regard. The Swedish Parliamentary Report indicates that 51 percent of the value of the stock listed on the U.S. stock exchanges in 1980 were held by natural persons, see p. 182.

Although we do not have exact statistics in this respect, it seems that very few of the listed companies in the United States are controlled by one large shareholder.⁴

⁴ See p. 181 ff., particularly p. 184, of the Swedish Parliamentary Report. See also Michael C. Jensen & Jerold B. Warner, *The Distribution of Power among Corporate Managers, Shareholders, and Directors*, 20 *Journal of Financial Economics* 3 (1988).

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Financial institutions own 53 percent of British listed companies while households (singled out) own 28 percent. 10 percent is owned by non-financial companies and 6 percent by foreign investors.⁵ We do not have statistics that show exactly to what extent British companies have controlling owners but there seems to be quite a considerable spread in most British companies.⁶

In France 39 percent of the shares of listed companies are owned by households (singled out). 25 percent is owned by financial institutions as well as the state (aggregated) while 24 percent is owned by non-financial companies and 10 percent is owned by foreign investors.⁷ Out of the 500 largest companies in France by the early 1980'es, 50 percent were controlled by a majority shareholder, defined as one shareholder holding a minimum of 50 percent of the shares of the company.⁸

As to the Federal Republic of Germany the largest shareholder group consists of non-financial companies which own 27 percent of the shares of listed companies. 26 percent is owned by households, 21 percent by financial institutions, 18 percent by foreign investors and 8 percent by the state.⁹

A salient feature of the German structure of ownership is the role played by the German banks. Contrary to what is the case in many countries, no ban exists against German banks holding shares of public companies. Although the figures mentioned above perhaps do not fully reflect this, there is no doubt that German banks have a firm grip on many major German listed companies. Two-thirds of the German listed companies are controlled by a majority shareholder (as defined above). The figure reflects the ownership structure in 1983.¹⁰

See also the Booz Allen-report p. 29. On page 56 in the Booz Allen-report it is, correctly, pointed out that the involvement of banks as "industrial operators" leads to "undesirable concentration of power within the banks and further conflicts of interest, with banks potentially benefiting from inside managerial information for their purely financial activities".

The Netherlands show a somewhat different picture than we have seen so far. 43 percent of the shares of Dutch listed companies are owned by for-

⁵ Booz Allen-report, p. 31, Exhibit 29.

⁶ See p. 181 of the Swedish Parliamentary Report.

⁷ Booz Allen-report, p. 31, Exhibit 29.

⁸ See the Swedish Parliamentary Report, p. 176.

⁹ Booz Allen-report, p. 31, Exhibit 29.

¹⁰ According to the Swedish Parliamentary Report, p. 188.

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eign investors. 38 percent is owned by households and non-financial companies and 19 percent is owned by financial institutions and the state.¹¹

2.3. Some further reflections. There are two issues that in particular attract our interest as regards the structure of ownership of Danish listed companies.

The first is the fact that 60 percent of companies listed at the Stock Exchange were in the control of a dominating owner. In this respect Denmark seems to resemble other Continental European countries, in particular the Federal Republic of Germany and France where concentration of ownership also seems to be widespread as opposed to the U.S. and Great Britain where it is not very common for companies to have any dominating shareholder.

We do not know if concentration of ownership on a few hands should be viewed as an advantage or disadvantage from the viewpoint of society.

In a study by P.-O. Bjuggren¹², referred to in the Swedish Parliamentary Report, the relationship between concentration of ownership and efficiency of Swedish listed companies was examined. The study suggests that there is a positive relationship between the degree of concentration in the ownership of a company and the company's efficiency.

Although a certain degree of concentration may be necessary to create efficient control and monitoring of the board and the managers we probably – as suggested in the Swedish report – lack empirical basis for drawing any conclusions with respect to this issue.¹³

In this connection it ought to be noted that there is a problem tied to determining the impact of corporate ownership on corporate efficiency. We thus need to take into consideration the importance of shareholder behavior, and thereby also the ability and willingness of shareholders to influence management. It cannot be excluded that the ability and willingness of shareholders to act and influence management has a larger impact on the efficiency of companies than the structure of ownership itself.

¹¹ Booz Allen-report, p. 31, Exhibit 29.

¹² See P.-O. Bjuggren, *Ownership and Efficiency in Companies listed on the Stockholm Stock Exchange 1985*, S.N.S. Occasional Paper, No. 7, Stockholm, 1988.

¹³ The Swedish Parliamentary Report thus recommends that any conclusions in this regard ought to await further studies, see p. 299. The report also reviews some of the American studies that have been made in this field, see p. 296-299.

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This, naturally, leads us to focus on the second interesting issue, namely the trend towards increased institutional ownership that Denmark seems to experience.

Interestingly, a number of other countries have experienced a similar development towards increased institutional ownership. This, for example, is the case in Great Britain and France, see p. 180 and p. 175-76 of the Swedish Parliamentary Report. In the U.S. there seems to be a similar trend, although the evidence is less conclusive, see p. 182-183 of the Swedish Parliamentary Report.

It is hardly possible to reach a final conclusion with respect to the desirability of increased institutional ownership.

In favor of this development it could perhaps be argued that institutional owners typically have the resources and expertise that enable them to monitor efficiently the management of the company of which they hold shares. Assuming that institutional shareholders in general pursue the same goal as other shareholders, institutional ownership thus could be said to represent a cheap and efficient way to motivate and monitor corporate managements. Altogether, this would be in the interest of the other shareholders as well as society.

In support of increased ownership by institutions it should also be mentioned that such institutions are in a position to make large amounts of funds available to listed companies that would otherwise not flow into the stock market. Institutional investors which have accumulated vast capitals are able to respond to the increased demand for capital that many companies are likely to have in the future, which makes financing cheaper since the costs of financing will decline as more money is invested in the stock market.

On the other hand, it could be argued that the concentration of control of companies in the hands of institutional investors – or any kind of investors for that matter – may have anti-competitive effects, in particular if a few institutional investors control a large number of major Danish companies. Perhaps this would have an adverse effect on the ability of such companies to respond to changes in the business environment.

However, although it is likely that concentration of control of a majority of listed companies with a few institutional investors would have anti-competitive effects it is more difficult to assess the situation we have at present, where institutional investors represent major stockholdings in many companies but do not control many. In this connection it ought to be noted that institutional investors often hold the low-vote B-shares while other shareholders hold the high-vote A-shares.

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The answer to the question of the desirability of increased institutional ownership to a very large extent depends on the role that institutional investors will play in the future. If they decide to pursue a “free-rider” policy and just sell their shares if they do not feel comfortable with management, their role as actors on the corporate stage may prove disastrous. On the other hand, if they decide to become active and use their influence to motivate and monitor management of companies, their presence may be useful and desirable, not only from the viewpoint of other shareholders but also from society’s viewpoint.

3. Stock exchange capitalization and liquidity

A stock exchange is a market for shares and thereby also a market for companies. All other things being equal, a large stock market with many listed companies and a high turnover of the shares of each company would provide the best basis for achieving efficiency.

3.1. Denmark. Out of the 100 largest companies (in terms of turnover), only 30 are listed at the Copenhagen Stock Exchange.¹⁴ The stock market capitalization is “thin” compared to the stock markets of other countries.

There are currently 252 Danish companies listed at the Copenhagen Stock Exchange.¹⁵

Some of the characteristics of the Danish stock market are that trading volumes are limited (which is not surprising considering the size of the country) and, more interestingly, that there is a very low portfolio turnover compared to other EC countries.¹⁶ Stated differently, most shareholders are not very active in the stock market. It is, therefore, fair to say that in this regard the Danish stock market is not very liquid.

Approximately 47 percent of the Danish trading market activity (volume) focuses on the top 5 percent most traded companies. This figure reflects a fair spread of the trading among the shares listed.¹⁷

3.2. Comparative aspects. Out of the 400 U.S. companies that had the largest 1987-turnover, 99 percent were listed. Out of the 100 largest companies in Great Britain, 67 are listed. The similar figures for France and

¹⁴ See the Booz Allen-report, p. 23, Exhibit 21.

¹⁵ This figure reflects the number of Danish companies listed as per June 1, 1990, see 5.1.

¹⁶ See the Booz Allen-report, p. 28, Exhibit 27.

¹⁷ See p. 28, Exhibit 28, of the Booz Allen-report.

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the Federal Republic of Germany are 56 and 45, respectively. As to the Netherlands, the figure is 23.¹⁸

In the U.S. there are 2,970 listed companies.¹⁹ The number of domestic listed companies in Great Britain is approximately 2,000, whereas the similar figures for France and the Federal Republic of Germany are in the range of 400-500. In the Netherlands there are approximately 250 domestic listed companies.²⁰

In terms of liquidity the portfolio turnover is high in the U.S. as well as in Great Britain. This is to a much lesser degree the case in France, the Federal Republic of Germany and the Netherlands.²¹

As regards concentration of trading, it is noteworthy that 75 percent of the trading volumes in Germany focuses on the top 5 percent most traded companies. The similar figures for Great Britain, France and the Netherlands are approximately 63 percent, 48 percent and 58 percent, respectively.²²

3.3. Some further reflections. One of the most significant features of the Danish stock market is the fact that there is a small number of active shareholders only, compared to what we have seen in the other EC-countries. We do not know the reason for this. Perhaps a part of the explanation is to be found in the fact that so many companies have dominating owners, see 2.1. above. When the majority of shares of a company is owned by one large shareholder, this very fact will tend to reduce the turnover of shares of that company. There is simply a limited number of shares for sale.

One could ask if the fact that most companies have adopted defensive devices (see 5.1.) would have an inhibiting effect on the trading activity. There is no reason to believe that this is so, however. Perhaps even on the contrary. If shareholders are voiceless, the only remedy they have if they are dissatisfied with management is to sell their shares.

4. Regulatory constraints

4.1. Denmark. We have already discussed the Danish regulation that has a direct impact on takeover activity, see VIII.2.1. (on Rule 4 of the Stock Exchange Rules of Ethics,) IX.2. (on § 115, Subsection 2, of the Compa-

¹⁸ See the Booz Allen-report, p. 23, Exhibit 21.

¹⁹ See the Booz Allen-report, p. 26, Exhibit 25.

²⁰ See the Booz Allen-report, p. 27, Exhibit 26.

²¹ See the Booz Allen-report, p. 28, Exhibit 27.

²² See p. 28, Exhibit 28, of the Booz Allen-report.

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nies Act), IX.3. (on tax issues) and XII. (on control of corporate acquisitions).

Obviously, several other laws, orders and other sets of rules affect, in different ways, the possibilities of acquiring companies.

Parts of this body of regulation specifically focus on stock ownership and acquisitions and impose constraints on this kind of activity, see, for example, the Act on Banks and Savings Banks discussed earlier. § 7 b, Subsections 1 and 2, of this Act provide that acquisition of 10 percent of the share capital or the votes of a bank or savings bank is subject to the prior approval of the Finance Inspectorate. Approval is also required if shares are acquired which give the owner a “substantial influence”. A similar requirement applies when a holding exceeds 20, 33 or 50 percent of the share capital or votes. Another example is the Act on War Equipment.²³ According to § 6, Subsection 1, of this Act, 60 percent of the share capital of a company that manufactures war equipment must be in Danish hands. Foreigners may not through ownership of shares or otherwise exercise a controlling influence on such companies, see § 6, Subsection 2.

Other kinds of regulation do not focus specifically on corporate acquisitions but, nevertheless, have an impact on the carrying out of such transactions, see, for example, the Act on White Collar Employees (“Funktionærloven”).²⁴ Other examples include laws on environmental protection.

4.2. Comparative aspects. The U.S. and the various EC countries represent a very diverse picture of regulation that puts a constraint on takeover activity.

We saw under XII. that the control of corporate acquisitions varies from country to country. Similarly, tax laws, laws affecting the means by which to finance acquisitions, laws regulating specific sectors (e.g. banking, insurance and defense industry), laws restricting foreign investments, etc., vary from country to country.

It is difficult to list countries in an order that shows the aggregate regulatory constraints companies in each country are subject to, and this hardly makes too much sense either. But if we consider the actual amount of takeover activity this suggests that the United States and Great Britain

²³ See Act No. 400 of June 13, 1990, on War Equipment (“Lov om krigsmateriel m.v.”)

²⁴ Consolidation Act No. 516 of July 23, 1987.

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create the fewest impediments to takeovers, while there seem to be more obstacles in the regulatory framework of the Continental European countries.

4.3. Some further reflections. When we speak about takeovers, one of our prime goals is to ensure maximum efficiency in the market since this offers society the best use of the resources invested in the stock market.

However, we will have to make trade-offs in connection with this goal in events where we deem that other interests have a higher priority than market efficiency. For example, laws have been enacted to protect the jobs of employees. Such protection sometimes cannot be reconciled with efficiency, but yet we find that the harm that employees may be exposed to if no protection existed offsets the reduced efficiency.

Also, sometimes national interests take priority over efficiency. We thus value the interest in a proper defense of the country higher than the virtue of having no obstacles to stock purchases, see e.g. the aforementioned Act on War Equipment.

Another sector where we may want to make a trade-off is the energy supply sector. Our interest in security of supply if for example an energy crisis occurs will frequently be considered to be more important than maximum efficiency.

In accordance with these points, undertakings which we want to shield from the market forces are often seen to have a legal structure that prevents contested takeovers. The alternatives vary, but typically such undertakings do not obtain their capital through listing at the Stock Exchange. Frequently they operate on the basis of a concession or permit which, in effect, gives them a sole right to supply their products or services within a specified field. In other events we see that such undertakings are structured as partnerships.

The trend since the late 1980's towards privatization, in part inspired by developments abroad (e.g. in Great Britain and France) raises some interesting questions in this regard.

To what extent should we allow companies of this nature to disregard the traditional concerns of, for example, security of supply and instead focus on efficiency alone? Is it at all certain that efficiency conflicts with these other goals? Could we not achieve these goals by imposing on the private companies commencing activities within these fields duties to meet the requirements that we consider important?

By means of illustration, in the case of e.g. society's interest in having minimum reserves of oil available at any time, a duty has been imposed on

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private oil companies to maintain certain minimum quantities of oil at any given time.²⁵

These questions will not be pursued further here but will undoubtedly become more important in the years to come.

5. Prevalence of takeover defenses

5.1. Denmark. For the purposes of determining the prevalence of takeover defenses I have made a study of the charters of all Danish companies listed at the Copenhagen Stock Exchange as per June 1, 1990. The study includes 252 companies of which 54 were banks²⁶. 173 companies were listed at stock market I, 60 at stock market II, and 19 at stock market III.

The basis of the study was the official list of companies listed at the Copenhagen Stock Exchange on June 1, 1990. During the months July-September, the Commerce and Companies Agency retrieved all the charters of the companies in question. My review took place in the same period, and as there had been a few changes in the meantime (in particular some mergers had been effected), charters of companies that had been delisted were disregarded. To the extent that existing companies were replaced by new companies as a result of mergers, the new companies were included in the study.

Out of the total of 252 listed companies, 128, or approximately 51 percent, had more than one class of shares.

Out of the 128, 125, or approximately 50 percent of the total number of listed companies, had issued classes of shares with different voting rights.

Almost all of these companies (124) had in their charters the maximum difference in voting power allowed under the Companies Act, i.e. 10:1.^{27 28} Only two companies had provided for a difference in voting rights among classes that is more “narrow” than permitted under the Act (5:1).

²⁵ See Consolidation Act No. 306 of June 25, 1985 on minimum storage of mineral oil and mineral oil products and Order No. 307 of June 25, 1985, issued pursuant to the Act.

²⁶ The term “banks” refers to banks as well as savings banks (“sparekasser”).

²⁷ Out of the 124, 100 companies were listed at stock market I, 8 at stock market II, and 16 at stock market III.

²⁸ Typically, the high-vote shares are referred to as “A-shares” or “common” (“ordinær”) while the low-vote shares are frequently designated “B-shares” or “preferred” (“præference”).

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8 companies had shares listed with no voting rights attached.²⁹

The great majority of listed companies with more than one class of stock have only listed the low-vote class. This is the case for 88 out of the total of 128 having more than one class of stock. In other words, approximately 69 percent of companies with dual or multiple class of shares are only “semi-public”.

Another widespread defense is the use of limitations on the voting rights of shareholders. 62, or approximately 25 percent of all listed companies, have adopted such limitations in their charters.³⁰

Most of these companies (35) have charters that stipulate the maximum number of votes of each shareholder, sometimes determined by reference to a specific percentage of the company’s share capital. In the charters of 18 companies, the use of a sliding scale limitation was seen. Some variations exist but in most cases this concept means that there is a specified number of votes attached to each stockholding of a certain size, with the number of votes attached to each nominal amount of shares decreasing when specified thresholds are exceeded. In addition, a “ceiling” applies, meaning that no shareholder can have more votes, irrespective of the size of his stockholding.

6 companies simply grant each shareholder one vote, regardless of the size of his holding.

Out of the aforementioned 62 companies, 15 have adopted so-called “shareholder club” clauses, which entail that shareholders who cooperate or act in concert are viewed as being one shareholder.

It is in particular among the banks that limitations on voting rights are found. Out of the 54 banks, 48, or almost 89 percent, had limited the shareholders’ voting rights.

7 companies have in their charters ownership limitations (the figure includes consent clauses, see XI.2.8.).

Out of the total number of listed companies, 32, or approximately 13 percent, have in their charters quorum requirements which are limited to proposals for resolutions that are not made or supported by the board or council of representatives (“repræsentantskab”).

²⁹ These shares were subscribed to prior to January 1, 1974, when the right to issue non-voting shares was abandoned, see now § 67, Subsection 1, of the Companies Act.

³⁰ Of these 62 companies, 27 belong to stock market I, 35 to stock market II, and 0 to stock market III.

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Record dates are used by 156, or approximately 62 percent of all listed companies. The great majority of these companies have provided for record dates that prevent shareholders from exercising their voting rights for a period of 3 months after they acquire their shares.³¹

Another means by which to prevent dawn-raids is the use of quorum requirements which apply to resolutions at shareholders' meetings regarding, for example, charter amendments, mergers or liquidation, but which are waived if the proposal receives the sufficient number of votes at the shareholders' meeting and at a subsequent shareholders' meeting. 130 out of the total of 252 companies, or approximately 52 percent, have adopted this kind of charter provision.

As these statistics show, Danish companies have displayed a great deal of innovativeness in terms of adopting defenses. Let us briefly consider how many companies could be viewed as "fortresses" because of their charter provisions. In other words, we focus on the prevalence of those takeover defenses that tend to make companies "takeover-proof":

- (a) Out of the 252 listed companies, 125, or approximately 50 percent, had issued classes of shares with disparate voting rights. Approximately 70 percent of these companies were semi-public in the sense that only the low-vote class of shares was listed.
- (b) Another 57 companies, or approximately 23 percent of all listed companies, have limited the voting rights of their shareholders, while another 5, or 2 percent, have adopted limitations on ownership.³²
- (c) In other words, 187 of the listed companies, or 74 percent, have adopted charter provisions which make it very difficult, and sometimes impossible, to take over the company against the will of incumbent management.

A number of companies combine these very strong defenses. 5 companies thus have both more than one class of shares and limitations on voting rights. 16 companies combine the use of more than one class of shares with the use of quorum requirements that favor the board (see above).

In addition to the defenses that may be found in the charters of the listed companies we have seen that other defenses have been used. For example,

³¹ The 3 month period is the maximum allowed in § 67, Subsection 2, of the Companies Act.

³² The figures mentioned here do not include companies that have limitations on voting rights/ownership limitations as well as more than one class of shares. Here we focus on companies that have in their charters limitations on voting rights/ownership, but which do not also have dual or multiple classes of shares.

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in order to fend off an attempt by a Gibraltar company to acquire the semi-public utility SEAS, the board of SEAS paid a premium price in connection with the buy-back of SEAS shares held by the potential acquiror (green-mail).

Also, even though we do not have records of this, there is little doubt that the boards of some companies have managed to prevent a takeover by using an authority to issue shares and thereby diluting the holding owned by a “hostile” acquiror.

See, e.g., the matters dealt with in *Lorentzen v. A/S Schweitzers Bogtrykkeri* (U1934.1081, W. Cir.) and in *Arnth-Jensen v. A/S Ringkjøbing Bank* (U1991.180, Sup. Ct.) (see X.2.2.).

Other defensive means that we have seen include the use of cross-holdings with a friendly investor, the allocation of shares to a foundation, and holding company arrangements.

The overall picture we get from this is that the vast majority of companies are to be considered very difficult to acquire against the will of their management. Also, it appears that some of the most commonly used defenses (high-vote and low-vote shares and limitations on voting rights) are those that leave control of the company with management.

5.2. Comparative aspects. We saw earlier how a very large number of U.S. companies are shielded (at least partly) from takeovers, inter alia, by using poison pills. Also, a wide variety of other defenses are commonly seen.

Turning to the European countries it is notable that British companies have adopted comparatively few defenses. For example, while British company law leaves flexibility with the shareholders to adopt a variety of shark repellents, British shareholders have so far been very reluctant to use defensive devices of this nature.

Also, although shareholders may adopt poison pills, this is not a very common phenomenon among British companies. It cannot be excluded that this view may be changing, which is perhaps illustrated by the adoption of a vitamin pill by the British company, Consolidated Goldfields plc in 1989.³³ Frequently, shareholders enter into shareholder agreements that

³³ The vitamin pill, which was developed in the United States, is discussed under XI.4. As a response to a “hostile” takeover threat by Minorco S.A., Consolidated Goldfields committed itself to paying its shareholders an extraordinary dividend in the form of preferred stock for an aggregate amount of £ 1.3 billion if the earnings-per-share of Consolidated did not reach a particular level within a 3 year

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stipulate the exercise of the shareholders' voting rights and set forth the procedure to be followed in the event that one of the shareholders desires to dispose of his shares.³⁴

Another common way of preparing for a contested takeover attempt is to use so-called "share swaps" (cross-holdings).³⁵

The British Companies Act does not prohibit the issue of shares with no or limited voting rights. However, the International Stock Exchange is opposed to the use of shares with no or very limited voting right. As a consequence of this policy it should be expected that shares having such features will not be accepted for listing at the Stock Exchange.³⁶ The Companies Act contains provisions which restrict a British company's ability to purchase its own shares or to provide financial assistance for the purchase of its own shares. A company may only buy its own shares if sufficient distributable profits are available to fund the acquisition. Once the shares are bought, they must be cancelled.³⁷ A number of management buy-outs have been experienced in Great Britain, some of which have been in response to contested takeover threats.³⁸

The adoption of golden parachutes is also subject to restrictions contained in the Companies Act. Companies may not grant directors service contracts in force for more than 5 years without prior shareholder approval.³⁹

A number of companies have included in their loan agreements and other contracts provisions pursuant to which e.g. a loan becomes due in

period. The purpose of this arrangement is to persuade shareholders that it is in their interest to keep their shares and participate in the extraordinary dividend. In case the earnings-per-share-target is not reached, it is likely that Consolidated will have to restructure its activities, and e.g. sell off part or all of its assets. The vitamin pill is described in Consolidated's circular letter to its shareholders dated April 4, 1989, and in Wall Street Journal, April 26, 1989, p. A 13.

³⁴ This type of arrangement is described by M.A. Weinberg, M.V. Blank & A.N. Greystoke, *On Take-overs and Mergers* p. 579 f.

³⁵ See M.A. Weinberg, M.V. Blank & A.N. Greystoke, *On Take-overs and Mergers* p. 580 ff. See also the discussion about share swaps by Matthew Crabbe, *Fending off Unwelcome Attentions*, Euromoney, p. 84 (February 1989).

³⁶ See Matthew Crabbe in *Fending off Unwelcome Attentions*, Euromoney, p. 84 (February 1989).

³⁷ See Section 160 ff. of the Companies Act 1985.

³⁸ The quite widespread use of management buy-outs in Great Britain is discussed in Financial Times, January 30, 1989, p. 21.

³⁹ See Section 319 of the Companies Act 1985.

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the event of a change of control. When examining such arrangements, the courts will consider whether there is a commercial justification for such provisions or if management exceeded the borders of its fiduciary duties.

As regards substantial asset acquisitions and disposals it should be noted that the Yellow Book contains rules that provide for shareholder approval in the event that an acquisition or disposal exceeds 25 percent of the assets of the company.⁴⁰

In France it is common for the charter of a company to provide that shareholders who hold shares representing more than a specific percentage of the company's aggregate share capital must disclose their holding to the company. However, no disclosure threshold may be lower than 0.5 percent of the share capital of the company.⁴¹ By using low disclosure-thresholds a company may be able to identify potential "hostile" acquirors at a very early point. Such thresholds are used by, inter alia, Paribas and Saint Gobain, the former using a 0.5 percent threshold and the latter using a 1 percent threshold.

The use of cross-holdings ("participations réciproques") is also quite common in France.

A number of large French companies, including Peugeot and Bénédictine, have provisions in their charters that set forth that shareholders who have owned their shares for a specified period of time have double voting rights compared to shareholders with less "seniority". In this connection it should be noted that the period during which the voting rights are limited to 50 percent may not exceed 4 years.⁴²

It is also quite common to have charter provisions which stipulate the number of votes that each shareholder has, irrespective of the number of shares held by him in the company.⁴³

⁴⁰ See Section 6, Chapter 1, paragraphs 2 and 3, of the Yellow Book dealing with so-called "super class 1-transactions".

⁴¹ See Article 356-1 of the French Companies Act.

⁴² There are no statutory provisions which stipulate the 4 year period, but in 1987 the COB stated that the 50 percent reduction of the voting rights is not acceptable beyond a 4 year period, cf. Michel Cuéré, *French Poison Pills and Takeover Restrictions*, International Financial Law Review, p. 8 ff. at 11 (June 1988). Inter alia, Aussidat Rey, Pernod-Ricard and Peugeot use shares with voting rights that depend on the shareholders' seniority.

⁴³ For example, Pernod Ricard has a charter provision according to which no shareholder can have more than 30 percent of the total number of votes of the company.

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Management may prepare itself for a possible alliance with a third party ("chevalier blanc") by obtaining the authority from the shareholders to increase the share capital of the company without preemptive rights for the existing shareholders. As an alternative, management may be authorized to issue convertible bonds or warrants.⁴⁴

Another defensive means that has been used by many companies before the occurrence of a "hostile" bid is what is known as "certificats d'investissements". These certificates constitute a division of the rights attached to a share since the certificates only give their holders the right to dividends while the voting rights are attached to voting certificates held by the shareholders of the company.⁴⁵

Charter provisions according to which management must approve transfer of shares of a company are not used by French listed companies since the COB has refused to allow companies with such provisions in their charters to have their securities listed at the French stock exchanges.⁴⁶

A special concept that has been used in connection with the privatization in recent years of French government owned companies is based on the so-called "noyaux durs", i.e. groups of "stable", friendly shareholders, established on the basis of an initiative from the Ministry of Finance. Members of such groups may not dispose of their shares for a two year period and, even after the expiry of the two year period, are subject to a number of restrictions in their right to dispose of their shares.⁴⁷

The German business community, probably for cultural and historical reasons, is sceptical of transfers of corporate control which are not the result of a negotiation between the managements of the parties involved.

⁴⁴ These kinds of defensive techniques are discussed by Michel Cuéré, *French Poison Pills and Takeover Restrictions*, International Financial Law Review, p. 8 ff. (June 1988). Provided that the shareholders of both companies so decide, there is nothing to prevent a subsidiary from issuing convertible bonds giving the shareholders the right to acquire shares of the parent company.

⁴⁵ The aggregate amount for which certificats d'investissements are issued may not exceed 25 percent of the share capital of a company, cf. Article 283-1 of the Companies Act.

⁴⁶ See Gérard Mazet, *La Defense Anti-OPA*, Revue des Droits des Affaires Internationales, 1988, p. 333 ff. at p. 349.

⁴⁷ See Michel Cuéré, *French Poison Pills and Takeover Restrictions*, International Financial Law Review, p. 8 ff. at 9 (June 1988). A thorough discussion of the defenses available under French law may be found in Jean-Pierre Bertrel & Michel Jeantin, *Acquisitions et Fusions des Sociétés Commerciales* p. 132 ff.

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Due to this and due to the role played by German banks one would expect that there is a limited need only for defensive devices.⁴⁸

However, it is frequently seen that companies limit the voting rights of shareholders or issue non-voting preferred stock.⁴⁹

For a long time the boards of Dutch listed companies have shown a high degree of innovativeness in terms of taking the initiative to have defenses adopted.

Among the defenses thus used by Dutch companies is the issue of preferred stock to a trust established for the purposes of ensuring the companies' independence in the event of a contested takeover attempt. When facing such an attempt the board often uses authorities granted by the shareholders in advance to issue preferred stock to allocate the new shares to the trust.

Also, it is frequently seen how the rights to vote on the shares and the rights to receive dividend payments are divided. By means of the so-called "Administratiekantoor"- concept a special trust becomes the owner of the shares of a company. The trust then issues certificates to the investors who will be those entitled to receive dividend payments in connection with the shares allocated to the trust. The voting rights, however, will be exercised by the trustees of the trust (who will typically be in favor of incumbent management of the company).

Dutch companies often limit the voting rights of the shareholders by stipulating a "ceiling" which applies to the total number of votes that each shareholder may cast irrespective of the size of his stockholding.

Many Dutch production companies, including Philips and the Heineken Breweries, are not listed on the stock exchange but are owned by listed holding companies. Consequently, even if an acquiror acquires a controlling influence in the holding company, this does not automatically lead to control over the production company. This is particularly true in cases where the production company is large and has a supervisory board which exercises a number of the powers that would otherwise be vested in the shareholders.

⁴⁸ Defenses available under German law are discussed by Dr. Christophe Hauschka & Thomas Roth, in *Übernahmeangebote und deren Abwehr in deutschem Recht*, Die Aktiengesellschaft 7/1988, p. 181 ff.

⁴⁹ The German Stock Corporation Act allows limitation of voting rights and issue of non-voting preferred stock, see § 134 and § 139 of the Act where certain restrictions in this regard are set forth. See the discussion of the former issue by Theodor Baums, *Höchststimmrechte*, Die Aktiengesellschaft 6/1990, p. 221 ff.

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A number of the Netherlands' largest financial institutions have established a special "white knight trust" for the purpose of acquiring shares of companies that are threatened by "hostile" acquirors and where the bid made for the company's shares is too low, in the opinion of the trust. The trust only intervenes in a takeover battle at the request of the target-company.⁵⁰

In 1987 a discussion was initiated in the Netherlands about the desirability of Dutch companies being "takeover-proof". The Amsterdam Stock Exchange prepared a report which expressed a desire on the part of the Stock Exchange to introduce restrictions on the right for listed companies to adopt defenses.⁵¹ Many listed companies opposed the plans of the Stock Exchange and after extensive negotiations with the association of listed companies ("Vereniging van Effecten Uitgevende Ondernemingen", VEUO) a compromise was reached and announced on January 5, 1989.

The compromise led to a change of the Stock Exchange Rules stipulating, inter alia, that only two out of five defenses defined in the Rules may be used. Also, preferred shares may constitute no more than 50 percent of the total share capital of a listed company.⁵²

5.3. Some further reflections. As we have seen, the use of defenses by companies creates a very varied picture when we compare the different jurisdictions.

In the U.S. the innovativeness in terms of developing defenses has been considerable but the U.S. courts have developed in their decisions a number of restrictions in the right to adopt and administrate defenses.

British companies are by and large characterized by their use of comparatively few defensive means.

⁵⁰ The trust, known under the name of the "Winter Palace", is commented on in Financial Times, November 14, 1988, p. 6.

⁵¹ See *Rapport van de Vereniging voor de Effectenhandel inzake de toepassing van beschermingsconstructies*, dated March 4, 1987. A summary of this report is published in Nederlands Juristenblad 1988, p. 380.

⁵² The background for the change in the Stock Exchange Rules is discussed by J.M.M. Maeijer in *Beursoverval op Beschermingsconstructies*, Nederlands Juristenblad, 1988, p. 517 ff. See also E.J.J.C. van Groenigen, *Bescherming tegen overvallen: Zakelijk nodig*, de naamloze vennootschap 67/6, June 1989, p. 139 ff. The final compromise is discussed by A.G. van Solinge, *Aanpassing van het Fondsenreglement met Betrekking tot Beschermingsconstructies*, de naamloze vennootschap 67/3, March 1989, p. 60 ff.

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By contrast, companies in France, Germany and the Netherlands frequently have in their charters provisions that inhibit or prevent takeovers.

In this context Denmark seems to be closer to the Continental European countries than to the Anglo-Saxon countries. The massive use of defensive devices makes the majority of Danish listed companies “corporate fortresses”.

It is difficult to determine exactly how much defenses “weigh” in the total “basket” of factors that determine the market for takeovers. There is no doubt, however, that the widespread use of defenses by Danish companies has a very substantial impact on the access to Danish listed companies.

6. Some concluding thoughts on the Danish market for takeovers viewed comparatively

Is the Danish market for takeovers more or less open for such activity than similar markets of other countries?

One of the points made in the Booz Allen-report is that “strong family control still prevails in Denmark”. The report adds that due to family ownership Danish listed companies are still on an average of a relatively small size (only two Danish companies are among the 500 largest companies in Europe).⁵³

The report also points out that the possibility of setting up foundations has made it easier for Danish companies to transfer ownership with a reduced tax burden.⁵⁴

Finally, the report indicates that the use of A- and B-shares has allowed companies to raise funds by means of public offerings while at the same time maintaining control. The public thus receives the low-vote B-shares whereas high-vote A-shares are owned by e.g. a foundation. A-shares are frequently listed in very small portions only.⁵⁵

The Booz Allen-report classifies obstacles to takeovers in two categories, regulatory and structural impediments, respectively.⁵⁶

The term “regulatory” is used in the report in a very broad sense and thus not only focuses on what has been referred to as regulatory in this

⁵³ See p. 30 of the Booz-Allen report.

⁵⁴ See p. 30 of the Booz-Allen report.

⁵⁵ See p. 31 of the Booz Allen-report (see the statistics on this under 5.1.)

⁵⁶ See p. 21 of the Booz Allen-report.

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book, but includes, in addition to the traditional concept of regulation, what has been referred to here as “shark repellents”.

Taking these factors into consideration, the report ends up with stating that Belgium and Great Britain should be considered “liberal” in terms of regulation, whereas Denmark, Spain and Italy are labelled as “moderately restrictive”. The Federal Republic of Germany, the Netherlands, and France are referred to as “highly restrictive”.⁵⁷

Moreover, the Booz Allen-report sums up that the British economy has the “highest relative structural accessibility” (see page 33 of the report).

Incidentally, the British government, probably suspecting that British companies due to the differences in, inter alia, structure of ownership and legal regulation are much easier to take over than e.g. German companies, commissioned Coopers & Lybrand to find out the facts about barriers to takeovers in the EC⁵⁸. Not surprisingly, the Coopers & Lybrand-report, among other things, concludes that Great Britain is far more open for corporate acquisitions than the other EC countries.⁵⁹

There is little doubt that a substantial number of barriers exist to contested takeovers in Denmark. The very extensive use of charter provisions and other means which deter acquirors from attempting to acquire control is definitely one of the largest obstacles to takeovers. However, even the features of the Danish stock market as well as regulation pertaining to the financing of takeovers and tax laws are likely to lead to an inhibited activity.

Whether Denmark in this respect can be said to create more obstacles than the other Continental European countries or whether it is the other way round is hard to tell, since, as we have seen, a number of factors that are difficult to measure affect the market for takeovers. On an overall view of all the factors that create obstacles to takeovers, it seems, however, as if Denmark could very well deserve to be labelled as “highly restrictive” in line with countries like the Federal Republic of Germany, France and the Netherlands.

Whether or not one agrees to this conclusion it remains a fact that the Danish market for companies is characterized by a number of factors

⁵⁷ See the report p. 52, Exhibit 34. The analysis in the report regarding Ireland, Luxembourg, Portugal and Greece is not conclusive, see p. 52 of the report.

⁵⁸ See the Coopers & Lybrand-report dated October 27, 1989, and referred to as “*Barriers to Takeovers in the European Community*”.

⁵⁹ See Volume 1 of the report, p. 43.

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which substantially inhibit changes of corporate control, including contested takeovers.

It is important that we deal with these obstacles at an early point to ensure the competitiveness of Danish companies in the years to come. The fact that some of the Continental European countries may have barriers in their corporate markets to the same degree as Denmark, or perhaps even higher, is not a very good reason for just leaning back.

We need to reconsider several issues in connection with the present regulation of contested takeovers, and, as we have seen, the EC-initiatives, including the Draft Takeover Directive, at least in its present form, contain elements which will not create a desirable basis for regulating contested takeovers.

Sammenfatning på dansk

Denne afhandling indeholder en samlet fremstilling af det fænomen, der er kendt navnlig i angelsaksiske lande som “contested takeovers” eller, i noget omskrevet form, “ledelsesfjendtlige” virksomhedsovertagelser. Som det fremgår af afhandlingens titel, er genstanden for analysen den retlige regulering af ledelsesfjendtlige overtagelser i Danmark.

Afhandlingen søger at bidrage til retsudviklingen, dels på det metodiske plan, og dels på det materielle plan.

For så vidt angår det metodiske introducerer afhandlingen “law and economics” eller “retsøkonomi”, d.v.s. anvendelse af mikroøkonomisk analyse ved vurdering af juridiske problemstillinger.

Den nævnte metode anvendes bl.a. til at beskrive og vurdere de økonomiske virkninger af ledelsesfjendtlige virksomhedsovertagelser. På tilsvarende måde – og her mødes den økonomiske og den juridiske metode – foretages en vurdering af forsøg på at undgå overtagelser af virksomheder, ligesom der foretages en vurdering af de eksisterende retlige rammer for virksomhedsovertagelser i Danmark.

Den retlige regulering af disse spørgsmål her i landet er sparsom. Hertil kommer, at der har været en meget beskeden saglig debat om ledelsesfjendtlige virksomhedsovertagelser, idet fænomenet overvejende har været behandlet i dagspressen, og uden at dyberegående analyser har fundet sted. Af disse grunde er det fundet hensigtsmæssigt at inddrage de retsregler og den erfaring vedrørende ledelsesfjendtlige overtagelser, der findes i andre, herunder navnlig de angelsaksiske, lande.

Afhandlingen er begrænset til børsnoterede selskaber, ligesom den alene beskæftiger sig med virksomhedsovertagelser, der er ledelsesfjendtlige i den forstand, at ledelsen i det selskab, der søges overtaget, forsøger at modsætte sig overtagelsesforsøget.

Der er ikke gjort forsøg på udtømmende at beskrive enhver overtagelsesteknik eller ethvert defensivt skridt, men afhandlingen fokuserer på de metoder, som må siges at være typiske eller karakteristiske for området.

Vægten i afhandlingen er lagt på selskabsretlige aspekter. Andre juridiske discipliner, herunder skatteret og kontrol med virksomhedsovertagelser, er kun inddraget i det omfang, det er nødvendigt for at forstå den sammenhæng, hvori ledelsesfjendtlige virksomhedsovertagelser optræder.

En kort oversigt over afhandlingens kapitler ser således ud:

Systematisk indledes afhandlingen med et metodisk kapitel, kapitel I, som introducerer anvendelsen af økonomisk analyse i forbindelse med retlige problemstillinger og begrundet valget af denne metode.

Herefter følger kapitel II, der belyser den historiske baggrund for ledelsesfjendtlige overtagelser samt de teknikker, som sædvanligvis er set anvendt i forbindelse hermed.

Dernæst findes 3 kapitler, der hver udgør en brik i den mosaik, der søger at give svar på, om ledelsesfjendtlige overtagelser, samfundsmæssigt set, er ønskelige eller ej. Kapitel III redegør således for samfundets interesse i et organiseret aktiemarked, kapitel IV belyser de økonomiske virkninger af denne virksomhedsovertagelsesform, medens kapitel V indeholder en samlet redegørelse for de motiverende faktorer og mekanismer, der er centrale for en besvarelse af, om ledelsesfjendtlige overtagelser er samfundsmæssigt gavnlige.

Baggrunden for, at disse tre relativt generelle kapitler findes tidligt i afhandlingen, er, at afhandlingen indeholder en række retspolitiske elementer, som alene kan behandles, når selve spørgsmålet om ledelsesfjendtlige overtagelser ønskelighed, samfundsmæssigt set, er afklaret.

Kapitel VI indeholder en gennemgang af de retskilder, der er relevante i forbindelse med virksomhedsovertagelser.

Herefter fokuseres der i kapitel VII på de retlige rammer, der gælder for køb af aktier i Danmark. Der foretages en vurdering heraf samt en undersøgelse af behovet for ændringer, bl.a. på baggrund af angelsaksisk og kontinentaleuropæisk ret.

De særlige problemer, der rejser sig i forbindelse med beskyttelse af minoritetsaktionærer i det overtagne selskab (herefter benævnt "mål-selskab"), behandles i kapitel VIII.

De finansielle og skattemæssige forhold i forbindelse med ledelsesfjendtlige virksomhedsovertagelser belyses i kapitel IX.

De følgende to kapitler, kapitel X og XI, beskæftiger sig med, hvilken rolle ledelse og aktionærer indtager i forbindelse med forsøg på overtagelse af en virksomhed. Kapitel X søger at fastlægge, hvilke principper der gælder for ledelsens dispositioner i disse situationer, medens kapitel XI gennemgår og vurderer en række såkaldte "forsvarstiltag", set i lyset af den tidligere dragne konklusion om ønskeligheden af ledelsesfjendtlige virksomhedsovertagelser.

Herefter følger kapitel XII, hvis formål er kort at belyse den konkurrenceretlige regulering af virksomhedsovertagelser.

Endelig afsluttes afhandlingen med kapitel XIII, der belyser det danske "marked" for ledelsesfjendtlige virksomhedsovertagelser.

KAPITEL I introducerer disciplinen kendt fra bl.a. USA, "law and economics", eller retsøkonomi.

Kapitlet redegør bl.a. for en række grundlæggende økonomiske begreber. Økonomi beskæftiger sig med fordeling af goder efter rationelle principper i en verden, hvor ressourcer er begrænsede. Økonomisk analyse kan således bidrage til en afgørelse af spørgsmålet om, hvorledes ressourcer skal fordeles til dækning af de forskellige behov, og hvorledes prioritering kan ske mellem disse behov.

Efter præsentationen af de økonomiske grundbegreber drøftes spørgsmålet om, hvorvidt økonomi er et egnet redskab til at analysere juridiske problemstillinger.

Medens økonomen ud fra generelle modeller og i forvejen fastsatte antagelser om individets handlings- eller adfærdsmønster søger at forklare, hvorledes individet vil reagere på bestemte påvirkninger, beskæftiger juristen sig primært med konkret retsanvendelse.

Økonomen ser individet som en rationel person, medens juristen typisk betragter individet som en fornuftig person (bonus pater).

Disse forskelle betyder imidlertid ikke, at økonomi ikke er et egnet redskab til at bistå juristen. Økonomens modelanvendelse er – uanset modellernes generelle karakter – et nyttigt redskab til at vurdere sandsynlige reaktioner eller handlingsmønstre.

Der er ikke kongruens mellem økonomens syn på individet som en rationel person og juristens bonus pater-standard. Heller ikke dette gør imidlertid økonomien uanvendelig, idet der er grund til at antage, at individer i forskelligt omfang handler rationelt, d.v.s. på en hensigtsmæssig måde søger at opnå deres mål.

Der har blandt teoretikere været en betydelig debat om forholdet mellem effektivitet og retfærdighed, idet visse teoretikere bl.a. har gjort gældende, at der er et indbygget modsætningsforhold mellem de to begreber. Denne debat videreføres i afhandlingen.

For at føre en meningsfyldt diskussion om disse spørgsmål, er det nødvendigt at fastlægge begrebet "retfærdighed".

Vælges Alf Ross' retfærdighedsprincip, således som det foreslås i kapitlet, er der ikke grundlag for at konkludere, at der nødvendigvis er et mod-

sætningsforhold mellem effektivitet og retfærdighed. På den anden side er der næppe heller tvivl om, at de situationer, som lovgivningen behandler "ens", ikke altid er forenelige med et ønske om maksimal effektivitet.

Det konkluderes i afhandlingen, at det er hensigtsmæssigt at kombinere juridisk og økonomisk metode. Dette betyder ikke, at udfaldet af økonomisk analyse skal diktere, hvorledes retsregler skal udformes. Men økonomien kan være egnet til at undersøge, hvilke økonomiske følger de eksisterende retsregler må antages at have, og hvilke konsekvenser ændringer i retsreglerne må forventes at få. Vi kan på denne måde bl.a. undersøge, hvilken "pris" et krav om retfærdighed har. Da et samfunds ressourcer er begrænsede, vil enhver anvendelse af ressourcer være udtryk for en prioritering. Ressourcer, der anvendes til ét formål, kan ikke anvendes til et andet. Dette må betyde, at der er en samfundsmæssig interesse knyttet ikke alene til retfærdighed, men også til de økonomiske virkninger af retfærdighed.

Den her beskrevne kombination af jura og økonomi er en af grundstene i afhandlingen. Det er dog væsentligt at bemærke, at økonomisk metode alene supplerer og ikke erstatter traditionel juridisk metode.

I **KAPITEL II** findes dels en redegørelse for den historiske baggrund for ledelsesfjendtlige virksomhedsovertagelser og dels en beskrivelse af den typiske måde, hvorpå sådanne transaktioner struktureres.

Med få undtagelser fandt de første ledelsesfjendtlige virksomhedsovertagelser sted i Storbritannien, hvor fænomenet navnlig i løbet af 1950'erne vandt stor udbredelse. Omkring midten af 1960'erne bredte fænomenet sig til USA, hvor en meget betydelig aktivitet har fundet sted, ikke mindst siden begyndelsen af 1980'erne.

Siden begyndelsen af 1980'erne har der også i de vesteuropæiske lande kunnet konstateres en betydelig udvikling i antallet af virksomhedsovertagelser. Indtil videre har antallet af ledelsesfjendtlige overtagelser – bortset fra i Storbritannien – været begrænset, men meget tyder på, at billedet er ved at skifte, også for så vidt angår Danmark.

Det må forventes, at den typiske ledelsesfjendtlige overtagelse i Danmark vil finde sted gennem et til samme formål etableret selskab ("acquisition vehicle"). Når køberen har opnået kontrol, vil han antagelig i visse tilfælde ønske at indløse minoritetsaktionærerne, undertiden i forbindelse med en fusion mellem acquisition- og mål-selskabet.

Med henblik på at skabe grundlag for en vurdering af samfundets interesse i ledelsesfjendtlige virksomhedsovertagelser er det nødvendigt først at se på den samfundsmæssige interesse i et organiseret aktiemarked. Dette gøres i **KAPITEL III**, som bl.a. redegør for, hvorledes investorernes in-

teresser primært er knyttet til at have et aktiemarked, der kan tilbyde aktier og hvor aktier kan sælges så let og så billigt som muligt. Hertil kommer, at investorer vil lægge vægt på, at der gælder et sæt "spilleregler", som klart fastlægger, hvad der gælder for investorer, der optræder i markedet.

Investorer og børsnoterede selskaber har i denne forbindelse en sammenfaldende interesse. Selskaberne på deres side ønsker nemlig, at så mange investorer som muligt tiltrækkes af aktiemarkedet, idet dette – alt andet lige – vil føre til højere aktiepriser og dermed billigere kapital for selskaberne.

Set fra samfundets side er der en interesse knyttet til at have et aktiemarked, som sikrer en ubesværet handel med aktier, idet der herved skabes mulighed for, at ressourcerne, der investeres i aktiemarkedet, anvendes så effektivt som muligt.

Samfundet har tillige en interesse i, at danske børsnoterede virksomheder vokser og bliver eller forbliver konkurrencedygtige, idet dette er en forudsætning for, at virksomhederne kan bidrage til samfundsøkonomien ved skabelsen af arbejdspladser, skattebetalinger m.v. samt fremstilling af produkter og serviceydelser. Der er imidlertid også en samfundsmæssig interesse knyttet til at undgå manipulationer og urimelige spekulationer i aktier.

I **KAPITEL IV** bevæger vi os væk fra den generelle debat om aktiemarkedet og hen imod en vurdering af ledelsesfjendtlige overtagelser som sådanne.

Kapitlet beskæftiger sig dels med de empiriske studier, der er foretaget med henblik på at afklare virkningerne af ledelsesfjendtlige overtagelser, og dels den debat, der har været ført blandt amerikanske jurister og økonomer.

Det empiriske materiale viser, at aktionærene i mål-selskabet nyder fordel af ledelsesfjendtlige overtagelser. Derimod viser undersøgelserne af virkningerne på aktionærene i det købende selskab ikke et klart billede. En del undersøgelser peger på, at disse aktionærer har fordel af ledelsesfjendtlige overtagelser, medens andre peger i modsat retning.

Der er ligeledes tvivl om, hvorvidt en positiv virkning på produktiviteten er knyttet til en virksomhedsovertagelse. En meget omfattende undersøgelse tyder på dette, medens andre undersøgelser giver et andet billede.

Navnlig i lyset af den tvivl, der hersker med hensyn til det empiriske materiale, er den debat, der har fundet sted i USA, af særlig interesse.

Det er karakteristisk for såvel debatten som de stillede reformforslag, at de fleste teoretikere er enige om, at virksomhedsovertagelser, der er genstand for en hensigtsmæssig regulering, er en fordel for et samfund. De

fleste er således enige om, at aktionærerne i et selskab, som ikke ledes tilfredsstillende, skal have mulighed for at udskifte ledelsen. I modsat fald ville ledelsen være isoleret mod aktionærernes kontrol. De fleste er også enige om, at ledelsesfjendtlige overtagelser kan motivere ledelsen til at følge aktionærernes interesser snarere end ledelsens egne i det omfang, disse ikke måtte være sammenfaldende. Flertallet af teoretikere vil være enige i, at det bør være aktionærerne og ingen andre, der bestemmer, om aktierne i mål-selskabet skal sælges eller ej.

Uenigheden koncentrerer sig om virkningen af den høje gældsætning, der typisk har været følgen af overtagelser i USA, ligesom der er delte meninger om, hvorvidt en konstant trussel om en overtagelse fører til, at ledelsen fokuserer på kortsigtet planlægning og anvender tid og penge på at undgå overtagelser. Endelig har mange, ikke mindst tidligere, fremhævet, at visse overtagelsesteknikker fører til en urimelig behandling af mål-selskabers aktionærer.

En vigtig konklusion er imidlertid, at ledelsesfjendtlige overtagelser synes at indeholde elementer, der har en gunstig, motiverende virkning på selskabers ledelser. Dette taler for, at vægten bør lægges på at skabe en hensigtsmæssig regulering af denne overtagelsesform snarere end på at opretholde eller etablere retsregler, som udelukker den.

På baggrund af den nævnte konklusion indeholder **KAPITEL V** en yderligere analyse af de virkninger, som ledelsesfjendtlige virksomheds- overtagelser har eller må forventes at få.

Udgangspunktet for analysen er den omstændighed, at aktionærerne i de fleste børsnoterede selskaber er passive. Der er grund til at tro, at en af de væsentlige årsager til dette er, at mange selskaber i deres vedtægter har indsat bestemmelser, der fraviger den fordeling af beføjelser, som aktieselskabsloven fastlægger, ved at begrænse aktionærernes ret til indflydelse.

Det er forudsat i afhandlingen, at det typisk vil være i aktionærernes interesse at maksimere værdien af deres investering i selskabet. Direktionen vil formentlig, bl.a. på grund af karrieremæssige og aflønningsmæssige forhold, i højere grad være tilbøjelig til at lægge vægt på en vækst af virksomheden, og dette selv om væksten fører til, at selskabets kapital ikke anvendes optimalt, set fra et aktionærssynspunkt. En anden grund til, at direktionen vil lægge særlig vægt på vækst, er det forhold, at den på grund af risikoen for at blive draget personligt til ansvar for sin ledelse af selskabet er mere "sårbar" over for virksomhedens økonomiske sammenbrud end aktionærerne.

Det er væsentligt at undersøge direktionens interesser i forhold til aktionærernes, fordi direktionen i mange selskaber ikke alene forestår den

daglige drift af virksomheden, men tillige tager initiativer vedrørende mere overordnede anliggender. Dette skyldes navnlig, at direktionen er knyttet til virksomheden på fuldtids basis, medens bestyrelsen typisk alene mødes nogle få gange i løbet af året. Hertil kommer, at direktionen i et vist omfang kan kontrollere de oplysninger, der tilflyder bestyrelsen.

Så længe bestyrelsen reelt kontrollerer og overvåger direktionen, er der ikke anledning til de store bekymringer i forbindelse med de nævnte fordele for direktionen.

Problemet opstår imidlertid, hvis bestyrelsens kontrol med direktionen bliver mangelfuld eller helt forsvinder.

Interessemæssigt befinder bestyrelsen sig mellem direktionen og aktionærerne. Bestyrelsen er ikke karrieremæssigt så tæt knyttet til selskabet som direktionen. På den anden side må det antages, at også bestyrelsen er "risikofølsom". Netop fordi bestyrelsens og direktionens interesser ikke er sammenfaldende, er det hensigtsmæssigt, at bestyrelsen effektivt kontrollerer og følger med i direktionens arbejde.

Det følger heraf, at aktionærerne har en interesse i, at bestyrelsen er aktiv og kritisk over for direktionen. Aktionærerne bør imidlertid samtidig erkende, at bestyrelsen ikke altid kan forventes at følge aktionærernes interesser. Vækst må fortsat forventes at spille en større rolle for bestyrelsen end for aktionærerne.

Spørgsmålet er derfor, om aktionærerne har en interesse i at overlade deres indflydelse til bestyrelsen, eller om de bør forblive aktive. Vælges den førstnævnte løsning, vil resultatet bl.a. blive, at bestyrelsen – og ikke aktionærerne – afgør, om selskabets aktier skal sælges og ledelsen udskiftes, når en "fjendtligt" indstillet køber viser sig. Vælges den anden løsning, bliver det aktionærerne, der bestemmer, om deres aktier skal sælges eller ej, samt om ledelsen skal skiftes ud.

Meget – og ikke mindst de synspunkter, der har været fremme i den amerikanske debat – tyder på, at det er for snævert blot at vurdere den enkelte aktionærs frihed til at være passiv, f.eks. ved at købe aktier, der kun giver en begrænset indflydelse. Det er væsentligt at inddrage den samlede virkning, som aktionærpassivitet fører til.

Det, der umiddelbart forekommer en tiltalende løsning for den enkelte aktionær – at sælge sine aktier, hvis man er uenig med ledelsen – fører til det såkaldte "freerider"-problem, hvis denne holdning spreder sig blandt aktionærer. Hvis alle aktionærer er passive, har ledelsen ingen at være ansvarlig over for.

En latent stående trussel om, at ledelsen bliver afsat i forbindelse med en overtagelse af selskabet, er en tungtvejende – ofte måske den mest

tungtvejende – grund til, at ledelsen holdes til ilden og motiveres til at gøre sit bedste. Set på denne baggrund er ledelsesfjendtlige overtagelser en mekanisme, som medvirker til, at ledelser forbliver aktive. Den bedste måde at undgå en overtagelse på er at sikre, at selskabets aktier handles til en realistisk pris, som ikke indeholder “skjulte” reserver, der kan give anledning til, at en potentiel køber ønsker at overtage selskabet.

Ikke alene aktionærerne selv, men også samfundet har en interesse i, at aktionærer forbliver aktive. Samfundets interesse er, som berørt ovenfor, at sikre, at virksomheder er konkurrencedygtige. Konkurrencedygtighed forudsætter en evne til at tilpasse sig nye krav, herunder øget konkurrence. Disse krav kan alene imødekommes, såfremt ledelsen stedse arbejder i aktionærernes interesse. I det øjeblik, ledelsen viser sig ineffektiv, bør aktionærerne kunne udskifte denne og dermed sikre selskabets fremtid.

Da aktionærernes og samfundets interesse i denne sammenhæng er sammenfaldende, kan man betragte aktionærerne som “vogtere”, ikke alene af deres egne midler, men også af den interesse, som samfundet har i bevarelse af virksomheden.

Ledelsesfjendtlige overtagelser kan imidlertid, i lighed med enhver anden form for virksomhedsovertagelse, føre til lukning af virksomheder, afskedigelse af medarbejdere og monopoldannelser.

Dette forhold er dog ikke alene kendetegnende for ledelsesfjendtlige overtagelser. Der lukkes dagligt virksomheder, afskediges medarbejdere m.v. på basis af køb af virksomheder, der aftales mellem de respektive virksomheders ledelser. Der vil med andre ord altid være brådne kar, uanset virksomhedsovertagelsens form.

KAPITEL VI indleder analysen af dansk ret ved at beskrive og vurdere retskilderne. Det er karakteristisk for reguleringen på dette område, at de væsentligste regler er udstedt af bestyrelsen for Københavns Fondsbørs, der tillige påser overholdelsen af reglerne. Det er ligeledes karakteristisk, at brud på reglerne sanktioneres indirekte (gennem Finanstilsynet), samt at brud foretaget af andre end børsnoterede selskaber og børsrådgivningselskaber ikke kan sanktioneres juridisk.

I lyset af en gennemgang af reguleringen af virksomhedsovertagelser i en række lande redegøres der for den retlige karakter af de funktioner, som Københavns Fondsbørs har. Dette indbefatter en stillingtagen til arten af de regler, som bestyrelsen for Københavns Fondsbørs har udstedt, samt de beslutninger, som bestyrelsen træffer.

Det konkluderes bl.a., at det nuværende system, hvorefter regler fastsættes af Fondsbørsens bestyrelse på baggrund af bemyndigelser i Fondsbørsloven, giver en høj grad af fleksibilitet. På tilsvarende måde konclu-

deres det, at den nuværende reguleringsform heller ikke udelukker anvendelsen af forvaltningsretlige principper eller forhindrer etableringen af et mere effektivt sanktionssystem.

I KAPITEL VII finder en gennemgang sted af de eksisterende danske regler vedrørende aktiekøb.

Bortset fra bestemmelsen i de Børsetiske Reglers regel 4 om tilbudspligt angår de eksisterende bestemmelser alene oplysningsforpligtelser vedrørende køb og salg af aktier.

Efter en gennemgang af reguleringen af aktiekøb i USA, herunder en belysning af henholdsvis "tender offers" og andre aktiekøb, redegøres der for, hvilke faktorer der må tages i betragtning ved en regulering af området. Ud over at økonomiske betragtninger må indgå i overvejelserne, fremhæves det, at der må ske en sondring mellem aktiekøb, der finder sted gennem forhandling mellem køber og sælger, og offentlige købstilbud, der fremsættes over for en række ubekendte, potentielle sælgere.

Baseret på disse betragtninger – og bl.a. inspireret af tilsvarende regulering i andre lande – indeholder den resterende del af kapitlet en række drøftelser og forslag til såvel regler, der bør gælde for alle aktiekøb, som regler, der særligt bør gælde for offentlige købstilbud.

KAPITEL VIII beskæftiger sig med de særlige problemer, der vedrører minoritetsaktionærerne i et mål-selskab.

I kapitlet gennemgås aktieselskabslovens bestemmelser, der beskytter minoritetsaktionærer. Herefter finder der bl.a. en belysning sted af bestemmelsen i regel 4 i de Børsetiske Regler om tilbudspligt ved overdragelse af kontrollerende aktieposter. De parallelle regler i henholdsvis britisk og fransk ret samt i EF-kommissionens udkast til direktiv om overtagestilbud belyses.

Herefter foretages der en kritisk vurdering af, om tilbudspligt ved aktiekøb i det hele taget er ønskelig. Økonomisk set er en sådan regel vanskelig at forene med et ønske om effektivitet, og det er samtidig tvivlsomt, om bestemmelsen kan forsvares ud fra den lighedsgrundsætning, som bestemmelsen angiveligt hviler på.

Inspireret af de forsøg på at beskytte minoritetsaktionærer, der er set i andre lande, indeholder kapitlet en vurdering af alternative beskyttelsesformer.

Kapitlet afsluttes med en diskussion af behovet for minoritetsbeskyttelse, idet vægten lægges på de forskellige faser i overtagelsesprocessen, henholdsvis situationen hvor køberen køber aktier i markedet og (endnu) ikke har forsøgt på at overtage kontrol, situationen hvor køberen gennem private handler eller ved fremsættelsen af et offentligt købstilbud forsøger at

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opnå kontrol, samt situationen hvor køberen har opnået kontrol og anvender sin indflydelse i selskabet.

De finansielle og skattemæssige forhold i forbindelse med ledelsesfjendtlige overtagelser er behandlet i **KAPITEL IX**.

Kapitlet består af to dele: den ene vedrørende forbuddet i aktieselskabslovens § 115, stk. 2, og den anden angående skat.

I forbindelse med gennemgangen af bestemmelsen om forbuddet mod, at et selskab medvirker til finansiering af køb af dets egne aktier, påpeges det, at den nuværende formulering af reglen er unødigt vidtgående. Ikke alene tilfælde, hvor der sker en forringelse af mål-selskabets økonomiske struktur, men tillige situationer, hvor det er hensigtsmæssigt og forsvarligt at anvende mål-selskabets aktiver til finansieringen, rammes af forbuddet. Økonomisk er dette uheldigt, idet § 115, stk. 2, skaber barrierer for virksomhedsovertagelser, som ellers vil være ønskelige.

Skattedelen af kapitlet beskæftiger sig bl.a. med sambeskatning af køber og mål-selskab, beskatning af mål-selskabets aktionærer og den skattemæssige behandling af fusioner.

I forbindelse med redegørelsen for de skattemæssige forhold inddrages tillige de sandsynlige økonomiske virkninger af de forskellige skatteregler, ligesom der drages paralleller til amerikansk skatteret.

I **KAPITEL X** fokuseres der på de retlige standarder, der gælder for ledelsen i et selskab, der søges overtaget.

Kapitlet indledes med en diskussion af ledelsens forpligtelser i lyset af de generelle regler om ledelsesansvar samt på basis af den meget sparsomme retspraktis vedrørende ledelsesfjendtlige virksomhedsovertagelser.

De få sager, der har drejet sig om ledelsens – og navnlig bestyrelsens – forpligtelser i overtagelsessammenhæng, synes at indikere, at ledelsen har en betydelig grad af frihed til at imødegå en uønsket overtagelse af virksomheden. Culpa-reglen, der danner grundlaget for en vurdering af ledelsens handlinger, er imidlertid en standard af meget generel og vag karakter.

I den resterende del af kapitlet undersøges det derfor, om der er basis for at supplere culpa-reglen med andre retlige standarder, der giver en større klarhed med hensyn til ledelsens rolle.

Dette indledes med en analyse af henholdsvis amerikansk og britisk ret, herunder en redegørelse for henholdsvis den fra amerikansk ret kendte "business judgment rule" og den i britisk ret udviklede "proper purpose test".

Det kan undertiden være vanskeligt at drage grænserne for, hvornår ledelsen har forfulgt et lovligt formål, således som det er forudsat i the pro-

per purpose test, der forekommer at være en hensigtsmæssig standard. Dette fører naturligt til en diskussion af, hvilke interesser ledelsen kan og skal forfølge. Skal den alene tage hensyn til aktionærinteresser, eller bør andre interesser tillige varetages?

Der er megen inspiration at hente i forbindelse med dette spørgsmål fra den angelsaksiske debat, som – i modsætning til, hvad nogle forfattere gør gældende – reflekterer synspunkter, som i hvert fald i vidt omfang er sammenfaldende med de betragtninger, der har vundet udbredelse herhjemme. Det søges således påvist i afhandlingen, at en pligt til maksimering af værdien af aktionærernes investering (med visse modifikationer) er en egnet standard også for danske selskabsledelser. Dette betyder ikke, at ledelser skal bortse fra andre interesser, men at de primært bør sigte på at øge værdien af aktionærernes investering i selskabet.

Det må erkendes, at andre persongrupper, herunder medarbejdere, samt samfundet har en interesse i selskabet og dets fremtid. Disse interesser bør imidlertid ikke fremmes ved, at ledelsen gives meget brede beføjelser til at forfølge sådanne andre interesser uafhængigt af aktionærernes interesser. I stedet bør det – som det allerede sker i vidt omfang idag – primært gøres til et lovgivningsanliggende at sikre varetagelsen af andre interesser end aktionærernes.

Da ledelsens interesser ikke altid er sammenfaldende med aktionærernes, opstår der særlige problemer, når en ledelse står over for et overtagelsesforsøg.

Medens der sædvanligvis ikke gives – og heller ikke bør gives – aktionærerne ret til at intervenere i konkrete beslutninger, der træffes af bestyrelse og direktion, er forholdet et andet, når der er tale om en mulig overtagelse af virksomheden. Der bør således foretages en sondring mellem ledelsesmæssige beslutninger og beslutninger vedrørende skift i kontrol over selskabet. Beslutninger af den sidstnævnte art bør træffes af aktionærerne og ikke af ledelsen.

Til støtte for den nævnte sondring henvises til bestemmelserne i kapitel 14 og 15 i aktieselskabsloven vedrørende henholdsvis likvidationer og fusioner. Bestemmelserne i disse kapitler forudsætter, at beslutninger af helt særlig betydning for aktionærernes investering skal træffes af aktionærerne og ingen andre.

På denne baggrund foreslås det i kapitlet, at ledelsen i mål-selskabet bør være afskåret fra på egen hånd at imødegå et overtagelsesforsøg.

Ledelsen har en række forpligtelser, bl.a. til at rådgive mål-selskabets aktionærer, men må ikke anvende sin indflydelse til at fratage aktionær-

erne valget mellem at sælge deres aktier eller forblive aktionærer i selskabet.

De specifikke defensive tiltag og strategier er gjort til genstand for en undersøgelse i **KAPITEL XI**. Kapitlet er bygget op således, at de enkelte metoder forklares og illustreres med udgangspunkt i amerikansk ret, hvorefter de tilsvarende spørgsmål i dansk ret drøftes. I det omfang, der foreligger undersøgelser af de økonomiske konsekvenser af defensive tiltag og planlægning, er der redegjort herfor.

Herudover er der i dette kapitel en diskussion af, hvorvidt det er nødvendigt at ændre adgangen til at foretage forsvarstiltag i tilknytning til børsnoterede selskaber.

Økonomisk set betyder forsvarstiltag, at den proces, hvorved et aktiv skifter hænder fra en sælger, for hvem aktivet har en bestemt værdi, til en køber, for hvem det har en højere værdi, vanskeliggøres. De nævnte tiltag er således en hæmsko i henseende til opnåelse af maksimal effektivitet.

På den anden side vil der være tilfælde, hvor vi er indstillet på at give afkald på ønsket om effektivitet, fordi der eksisterer andre, og efter omstændighederne mere tungvejende, hensyn.

For så vidt angår brugen af A- og B-aktier, begrænsning af aktionærernes stemmeret samt ejerskabsbegrænsninger og samtykkeklausuler gælder det, at ledelsen opnår større indflydelse på aktionærernes bekostning. Dette betyder, at ledelsen på egen hånd vil kunne imødegå selskabets overtagelse og dermed forhindre, at kapitalen, der er investeret i aktiemarkedet, flyder hen, hvor den anvendes mest effektivt.

Netop da de nævnte tiltag alle er karakteriseret ved, at ledelsen isoleres fra aktionærernes kontrol, er det vanskeligt at se berettigelsen af at opretholde sådanne bestemmelser i forbindelse med børsnoterede selskaber.

For så vidt angår øvrige defensive tiltag, danner der sig et andet billede. Selv om de vanskeligt kan forenes med et ønske om effektivitet, udgør denne kategori af forsvarstiltag en række forskellige bestemmelser og arrangementer, der i visse tilfælde vil kunne gavne aktionærerne. Der er således næppe basis for at konkludere, at også brugen af disse mekanismer bør udelukkes.

I **KAPITEL XII** findes en redegørelse for den kontrol med virksomhedsovertagelser, der er relevant for ledelsesfjendtlige overtagelser i Danmark.

Medens der ikke findes en egentlig regulering af selskabsovertagelser i den danske konkurrencelov, findes der på EF-plan en forordning, der regulerer området. På grund af de anvendte beløbsmæssige grænser for, hvor-

når en overtagelse er omfattet af forordningen, har den imidlertid begrænset praktisk interesse her i landet.

Kapitlet indeholder herudover en sammenligning af dansk ret med den tilsvarende regulering i andre lande.

De foregående kapitler i afhandlingen har alle med hver deres facet bidraget til det samlede billede af fænomenet ledelsesfjendtlige virksomhedsovertagelser. I **KAPITEL XIII** suppleres disse kapitler med en redegørelse for, hvad der kan betegnes som det danske "marked" for sådanne virksomhedsovertagelser. Grunden til, at denne undersøgelse foretages, er at belyse omfanget af forhindringer for virksomhedsovertagelser og dermed give et indtryk af problemets omfang. Hertil kommer, at det er af interesse at vide, om Danmark i denne sammenhæng er mere restriktiv end de lande, som vi sædvanligvis sammenligner os med.

I kapitlet gennemgås – på komparativ basis – ejerstrukturen i danske børsnoterede selskaber, kapitaliseringen og "likviditeten" på Københavns Fondsbørs, lovgivningsmæssige begrænsninger samt udbredelsen af forsvarsmekanismer.

Der peges bl.a. på, at der i Danmark – i lighed med en række andre lande – er en tendens til, at de institutionelle investorer repræsenterer større og større aktiebesiddelser. Et andet forhold, der påkalder sig interesse, er den omstændighed, at næsten 3/4 af alle danske selskaber på Københavns Fondsbørs har vedtægtsbestemmelser, der væsentligt vanskeliggør, og nogle gange umuliggør, en overtagelse.

Sammenfattende konkluderes det, at Danmark, i lighed med bl.a. Vesttyskland, repræsenterer et meget "tyndt" marked for virksomhedsovertagelser, forstået således, at der eksisterer mange og meget omfattende barrierer for overtagelser.

I lyset af de fordele, der er forbundet med ledelsesfjendtlige overtagelser, bør det overvejes, om denne tingenes tilstand er ønskelig.

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