The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock

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1 Introduction

In order to achieve its vision of a free right of establishment within the European Union, the EU Commission has undertaken an extensive effort to harmonise European company law. Through proposals for harmonisation directives, the Commission has tried to create a minimum standard of sorts in the area of company law among member states.

As part of these harmonisation efforts, the Commission in the early 1970s presented for the first time a draft directive on takeovers.[1] Little did the Commission know then that it would be one of its most controversial directive proposals ever and that, thirty years later, it would still be fighting to get the directive adopted.[2]

This article focuses on the recently discussed idea of introducing a "breakthrough" rule in the directive, aimed at "breaking through" different kinds of pre-bid obstacles to takeovers, among them systems of dual class stock (two or more classes of common stock with different voting rights). It starts with a brief outline of the history of the directive proposal (sec. 2) and the way the proposal deals with takeover defences (sec. 3). Special attention is here given to the "breakthrough" rule. It goes on to describe how dual class stock became an accepted financing device in modern industry (sec. 4). The article then presents empirical data on the use of dual class stock among Swedish listed companies (sec. 5) and provides an overview of takeover activity in Sweden, especially with regard to the existence of dual class stock (sec. 6). The last section concludes that the assumption underlying the idea of introducing a

1 Report on Takeovers and other Bids, COM Doc. XI/56/74.

2 For an overview of the directive proposal's development, *see*, e.g., Skog, R., *The takeover directive – an endless saga?* European Business Law Review 4/2002 and Hopt, K., *Takeover regulation in Europe – The battle for the 13th directive on takeovers*, Australian Journal of Corporate Law 1/2002.

"breakthrough" aimed at "breaking through" systems of dual class stock is theoretically as well as empirically false (sec 7).

2 The History of the Proposed Directive

When the first draft of the takeover directive was presented, only one member state had any experience with takeovers – the UK. Takeovers had been an accepted part of the British business scene since the 1950's. In contrast, they were practically nonexistent in other member states. The UK had also developed a detailed set of regulations on takeovers, The City Code on Takeovers and Mergers, while other member states for obvious reasons saw no need for such rules.

Thus, the prospects for the Commission's directive were poor from the start, and the draft was shelved after an initial round of consultations among member states. Ten years later, the plans materialised again, this time in the White Paper on the internal market presented by the Commission in 1985.[3] At that point several Continental European member states had managed to gain some experience with takeovers and even introduced rules in the area. As a result, the climate for a takeover directive was in some sense more favourable than at the time of the previous attempt. When the Commission in 1989 issued its first formal directive proposal[4], it turned out, however, that member states disagreed widely whether such a directive was needed at all, as well as on its substantive content and degree of detail. The Commission revised its proposal on certain points, but still did not manage to placate member states.[5] Not until 1996, after a more extensive reworking, was the Commission able to present the Council and the European Parliament with what can be said to be the basis of the directive proposal that is currently the focus of discussions in Brussels.[6]

A couple of years of negotiations on the directive proposal in the Council and Parliament culminated in the spring of 2001 in a conciliation process between the two co-deciding bodies.[7] A compromise was reached in early June but was rejected by a one-vote margin when presented to Parliament for a final vote in a

3 COM Doc. (85) 310, 14.6.1985.

4 COM Doc. (88) 823, 16.2.1989; OJ C64/8.

5 COM Doc. (90) 416, 10.9.1990; OJ C240/7.

6 COM Doc. (95) 655 2.7.1996; OJ C162/5, revised in COM Doc. (97) 565 2.7.1996; OJ 378/10.

7 Underlying the proposed directive is the co-decision procedure laid down in Article 251 (former Article 189b) in the EC Treaty. The procedure entails two readings in the European Parliament and the Council, with a conciliation procedure in the event of disagreement. In cases where the Council is not able to approve all the Parliament's amendments of the second reading, a Conciliation Committee has to be convoked by the president of the Council in agreement with the president of the Parliament. The Committee is made up of fifteen members of the Council or their representatives and an equal number of representatives from Parliament. The Committee has 6 weeks (may be extended to 8 weeks) to find a compromise. The "joint text" is submitted to Parliament and the Council for approval in a third reading, without any possibility of amendment. If either of the two institutions fails to approve the text, it is considered rejected.

plenary session a month later.[8] Due to heavy German lobbying Parliament refused to accept the Council's (and Commission's) restrictive stance on the use of defensive measures against takeovers.

The rebuff by Parliament was a blow to the Commission. Only once before had the Parliament rejected a conciliation agreement.[9] The Commission refused to give up, though. In accordance with previously drafted plans, it appointed the High Level Group of Company Law Experts ("the Winter Group") in the summer of 2001 to propose an approach to continued company law harmonisation efforts. The Winter Group was asked first and foremost to propose amendments to the takeover directive to placate Parliament.

Based on the Winter Group's recommendations, which were presented in early 2002[10], the Commission in October of that year offered a new directive proposal[11] and started what has since proved at times to be a rancorous debate on what are and are not defensive measures against takeovers – a debate that to a large extent has focused on the possibilities available to Swedish, as well as Finnish and Danish, companies to issue multiple classes of common shares carrying different voting rights ("dual class common stock").

3 Takeovers and Defensive Measures

In a takeover bid, a company publicly asks shareholders in another company (the target company) to tender their shares on generally stipulated terms. Takeover bids, by definition, pertain to target companies with many shareholders and, in practice, almost always to publicly listed companies.

The fact that a company has many shareholders and is publicly listed does not prevent it from having a controlling shareholder. In companies where this is the case, a takeover bid is usually preceded by negotiations between the offeror and the controlling shareholder to acquire the latter's shares. If the parties reach an agreement, a similar offer is then made to the other shareholders. If the parties cannot agree, there is normally no point in making an offer to the other shareholders, although it may happen. If there is no controlling shareholder in the target company, the takeover bid is made directly to all shareholders.

The ownership structures of listed European companies differ from one company to the next. But there are also certain more or less systematic differences between countries. In terms of the concentration in ownership of individual companies, there is a clear distinction between the UK and

8 The outcome of the voting was 273 votes in favour and 273 votes against the proposal. Hence, one more vote in favour would have been enough to approve the directive.

9 The conciliation agreement on the proposal for a Directive on the legal protection of biotechnological inventions, COM (1988) 496, was rejected by the European Parliament in 1995.

10 Report of The High Level Group of Company Law Experts on issues related to takeover bids, Brussels, 10 January 2002. The Group's final report on future harmonisation work was published in November 2002; *see Report of The High Level Group of Company Law Experts on a modern regulatory framework for company law in Europ*e, Brussels, 4 November 2002.

11 Doc. COM (2002) 534, 2.10.2002.

Continental Europe. In the UK, most listed companies have a widely dispersed ownership structure without controlling shareholders. Among Continental European companies, the structure is more concentrated.[12] Many of the latter companies have a controlling shareholder or shareholder group. Against this backdrop, it is not surprising that takeover bids in the UK are often presented without any prior negotiations with shareholders in the target company, while takeover bids in Continental Europe – in countries where such bids occur at all – are frequently preceded by such negotiations.

Still, no matter what the country, offerors normally have an interest in obtaining the advance support for a bid from the target company's board of directors. According to takeover regulations in most countries, the board must make a recommendation to the shareholders whether or not to accept the bid. Obviously it is an advantage for the offeror to have a positive recommendation from the board before the bid is announced.

With any bid that does not have the support of the board of the target company, there is a risk that the board or management will see it as a threat to their position. If this happens, the board/management may deem the bid as "hostile" and try to "defend" the company against the offeror.

Defensive measures against takeovers can be divided into two categories: post-bid measures, which are taken to complicate or preclude the implementation of a takeover bid that has already been presented, and pre-bid measures, which are taken in advance to prevent or complicate future takeover bids.

In line with the overall aim of facilitating takeovers, the proposed takeover directive from the very beginning contained a provision designed to prevent the board of a target company from taking *post-bid defensive measures* that could jeopardize the interests of shareholders. This is also the case in the current directive proposal, which states in Article 9 that the target company's board may not take any measures that can result in the frustration of the bid without the approval, after the bid has been presented, of the shareholders at a general meeting.

The directive's treatment of post-bid defensive measures is modelled on British takeover regulations.[13] Similar approaches are now taken in most other member states as well. Germany stands apart, however. German takeover regulations allow the supervisory board (Aufsichtsrat) of the target company to take measures to complicate or preclude the implementation of a bid on the basis of the previous authorisation of the general meeting. In other words, there is no requirement that the general meeting's approval has to be obtained *after* a bid has been presented and shareholders know what they are defending against. German law also permits the Aufsichtsrat to authorise the management board (Vorstand) to take certain defensive measures.[14] Against this backdrop, Germany opposed the Council's conciliation agreement with Parliament in 2001, and the

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12 *See*, e.g., Becht, M. & C. Mayer, *Introduction*, in Barca, F. & M. Becht (eds.), The Control of Corporate Europe, 2001, at 1 ff.

13 General Principle 7 and Rule 21, City Code on Takeovers and Mergers.

14 § 33 Wertpapiererwerbs- und Übernahmegesetz (WpÜG).

German position was decisive to the Parliament's eventual refusal to approve the conciliation agreement.

The original directive proposal did not contain any provisions on *pre-bid defences*. Nor did the conciliation agreement. Influential members of Parliament, including the rapporteur in this case, Klaus-Heiner Lehne (German MEP, member of the PPE-DE group), felt that the directive as such would give an unfair advantage to companies in member states that offered more leeway with pre-bid defences. The directive, in their opinion, would not create a true "level playing field" for takeovers in Europe.

The Winter Group, which supported the Commission's restrictive stance toward post-bid measures, felt that the Commission should try to thwart certain pre-bid defences through a "breakthrough" rule in a new directive proposal.[15]

Based on the Winter Group's proposal, but without following it in detail, the Commission – in Article 11 of a new directive proposal in the autumn of 2002 – introduced a rule whereby an offeror who had obtained a specific percentage of the votes in a target company after a takeover bid could call a general meeting in the target company to decide, for example, to appoint a new board - without being hindered by provisions in the company's articles of association that give special rights to certain shares or shareholders in terms of appointing the board or provisions that limit how many votes each shareholder can cast at the general meeting. Provided that the offeror has successfully obtained enough votes in the target company to amend the articles of association, such provisions should "cease to have effect" at the first general meeting after the bid is completed.[16]

The idea behind the Commission's proposed "breakthrough" rule was to "break through" pre-bid defences that risk isolating a company, and thus its board and management, from the will of shareholders in a takeover situation. The proposal did not cover dual class shares. In the view of the Commission, the existence of such shares did not cause "management entrenchment" and there was no proof that they rendered takeover bids impossible.

Sweden announced its support in principle for the Commission's proposal, but objected to the "breakthrough" rule from a technical legal point of view. Sweden felt the rule had to be revised by the Commission in its continued work.[17] This was also the view of Denmark and Finland.

The Commission's new position on defensive measures was not shared by Germany, however, which proposed in part that Article 9 on post-bid defensive measures should be made less restrictive and allow the German model with authorisation to take defensive measures against future takeover bids, and in part that the "breakthrough" rule in Article 11 should be expanded to include shares with different voting rights. Similar signals were given by the rapporteur in the Parliament in late 2002.

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15 *Report of The High Level Group of Company Law Experts on issues related to takeover bids*, Brussels, 10 January 2002, at 29 ff.

16 COM (2002) 534 2.10.2002.

17 The model for the "breakthrough" rule is to a certain extent to be found in Art 212 of the Italian Consolidated Act on Securities Legislation. The rule also shares similarities with certain French rules. For other member states, the "breakthrough" rule is a completely new concept.

After listening to Germany and other member states, Greece, which took over the semi-annual rotating presidency of the Council at the start of 2003, came to the conclusion that the Commission's directive proposal would neither gain the support of a large enough majority in the Council nor be accepted by Parliament. In March 2003 the presidency therefore presented a revised directive proposal in which Article 9 was unchanged but Article 11, now in complete conformity with the Winter Group's proposal, was expanded to include dual class common stock. According to this proposal, an offeror who, through a takeover bid, obtains a shareholding representing at least 75 per cent of the capital in the target company could call a general meeting in the target company to decide, for example, to appoint a new board - without being limited by provisions in the articles of association that give special rights to certain shares or shareholders when it comes to appointing directors, that limit how many votes each shareholder can cast at the general meeting or *that assign certain shares more votes than others*. Basically a "one share, one vote" principle would apply at such general meetings.[18]

Sweden, together with Denmark and Finland, opposed this extension of the "breakthrough" rule for several reasons. First of all, the right of companies to issue dual class stock is an important part of their right to determine their own financial structure. This right should, according to the Swedish position, not be limited without very strong grounds. The directive proposal does not offer any such grounds. Still, the extended "breakthrough" rule would create considerable uncertainty as to the value of an investment in high vote shares and thereby in practice limit the opportunities available to companies to issue multiple classes of shares with unequal voting rights.

Secondly, Sweden argued, the proposal negates efforts to maintain effective corporate governance regimes in companies that are so large that they have to turn to the stock market for risk capital. The fundamental corporate governance problem in these companies is to maintain shareholders' active ownership (monitoring) function despite the dispersed ownership base. The possibility to issue multiple classes of shares with different voting rights offers an opportunity to resolve this problem. Hence a "breakthrough" rule aimed against differentiated voting rights would also be detrimental to the corporate governance system, and promote rather than restrain management entrenchment.

A third reason for the Swedish, and Nordic, opposition to the extension of the "breakthrough" rule was that the proposal is based on a theoretically incorrect view of takeovers and defensive measures. The basic problem in a takeover situation is that the board/management of the target company may, to protect its own position, try to prevent or complicate the implementation of the bid and that this might conflict with shareholders' interests. This is, as noted above, the reason why Article 9 in the proposed directive requires that post-bid defensive measures are approved by the shareholders. The problem isn't any different when it comes to pre-bid defences. The "breakthrough" rule should therefore, as the Commission correctly proposed in its October 2002 proposal, focus on breaking through defensive measures that could be used for the purpose of management entrenchment, such as voting caps, while leaving measures that

18 Doc. 6024/03 DRS 10 CODEC 119.

strengthen shareholder influence, such as dual class stock, unaffected.[19] In the presidency's proposal for an expanded "breakthrough" rule, there was no hint of such a view.

Fourthly the proposal lacked empirical support. Takeover activity in the Swedish business sector is higher than in most European countries, and available empirical material does not give evidence of takeover activity being adversely affected by the existence of multiple classes of shares carrying different voting rights.

Last but not least, Sweden together with Denmark and Finland argued, the "breakthrough" rule would encroach on the property rights of the owners of high vote shares and give rise to complicated questions of compensation.

4 Dual Class Common Stock - one of Many Financing Devices in Modern Business

The basic purpose of the limited liability company is to offer businesses a practical structure to procure risk capital. History shows that the limited liability company has fulfilled this role well. The concept of the company as an independent legal entity, in combination with the absence of personal liability, separation of the company's equity into freely transferable shares and rules to protect shareholders, has facilitated capital procurement of tremendous scope by businesses around the world.

Back when the limited liability company was in its infancy, the company's financial structure was simple. Businesses were financed with debt capital from banks and other lenders, and with risk capital contributed by shareholders. The boundary between debt financing and risk capital was clear. Lenders were entitled to a predetermined rate of interest, while shareholders were entitled only to future profits. All shares were of the same class and had the same financial rights.

As far back as the late 19th century, however, when American railroad companies began issuing multiple classes of shares with different financial rights, this boundary between debt capital and risk capital began to dissolve. The first hybrid instrument, the preferred share, was introduced.

Over a century later hybrid instruments are standard fare in the business world. There are debt instruments that confer the right to share in the company's profit, debt instruments that will or can be converted to shares, debt instruments that confer the right to subscribe for shares, etc. There are also shares with different rights to the company's assets or profit, shares whose financial rights are related only to a certain part of the company's operations, shares that can be converted from one class to another, etc.

In the same way, the importance of an instrument's control rights has changed over time. Companies and investors have learned to create and price instruments that differ not only financially but also in terms of control rights.

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19 For a discussion concerning the distinction between voting caps and dual class stock in the context of takeovers, *see* Gilson, R., *The Political Ecology of Takeovers*, in Hopt, K. & E. Wymeersch (eds.) European Takeovers – Law and Practice, 1992.

Modern businesses utilise a number of different debt instruments that give lenders a direct influence on the company's operations as well as shares that provide little or no influence at all. There are shares that confer no votes, shares with limited voting rights, shares with voting rights only on certain issues, shares with voting rights only under certain conditions, shares with higher voting rights if held by the same investor for a certain minimum amount of time, etc.

In other words, in business today there is no longer a sharp dividing line between debt capital and risk capital. There are, in theory, an unlimited number of instruments whose financial rights and control rights can be adapted to companies' individual needs. Dual class common stock is just one of many such instruments. In principle, there is no difference between dual class stock and other hybrid instruments.[20]

In a sophisticated capital market, professional investors price financial instruments based on the combination of risk and return they offer. There is essentially no difference between different types of instruments in this respect, either.

5 The use of Dual Classes of Shares Among Swedish Companies

Almost all large Swedish companies are listed on the Stockholm Stock Exchange. In January 2003 there were 279 listed Swedish companies with a total market capitalisation of SEK 1,600 billion (EUR 170 billion).[21]

The presumption in the Swedish Companies Act (1975:1385) ("CA") is that each share confers the same right in the company. In its articles of association, however, a company can prescribe that it shall have or can issue shares of different classes with different rights in the company.[22] This means that a Swedish company can, for example, issue shares of different classes that are distinguished by their voting power. The maximum voting ratio between high vote and low vote shares could, however, not exceed 1 to 10.[23] [24]

20 This trend toward an increasing diffuse boundary between debt capital and risk capital is clearly reflected in the IAS 32 definition of financial instruments, recognising that while substance and legal form are commonly consistent, in some cases they are not. Therefore, financial instruments which are legally referred to as equity instruments (e.g. preference shares) may be classified or partly classified as liabilities.

21 Figures do not include other, significantly smaller marketplaces for shares. The total value of the shares listed on these marketplaces is negligible in relation to the market value of the Stockholm Stock Exchange.

22 Chap. 3 Sec. 1 CA.

23 Chap. 3 Sec. 1 CA. The act originally did not contain any provisions that limited the size difference in voting rights. The limitation was introduced in the 1944 version of the Companies Act, which entered into force on 1 January 1948. Companies that had already issued shares with differences greater than 1 to 10 were permitted to retain these shares and continue to issue shares with such a large differentiation in voting rights. Sweden has never permitted companies to issue non-voting shares.

24 Shareholders' right to influence the company's business is exercised at the general meeting (Chap. 9 Sec. 1 CA). Every shareholder has the right to participate in the meeting and have an issue brought up before the meeting, regardless of the size of his or her shareholding (Chap. 9 Secs. 1, 2 & 11 CA).

The system of dual class common stock is widely used among the listed companies. The listing requirements of the stock exchange do not include any restrictions on dual class stock. At the beginning of the 1990s around 85 per cent of the listed companies had multiple classes of shares carrying different voting rights. Due to, above all, initial public offerings by companies having only one class of shares the system is less frequent today.[25] Still more than half of the listed companies, 53 per cent, have two or more classes of common shares with different voting rights.[26] Almost without exception, the voting ratio is 1 to 10. Due to the grandfather clause in the law, two companies have larger differences.

A company having two classes of shares can choose to list both classes or just one. In 25 per cent of the companies listed on the Stockholm Stock Exchange that have dual class shares, both classes are listed, while in 75 per cent of the companies only low vote shares are listed.

As in most Continental European countries, individuals and families with large holdings traditionally have dominated the ownership structure of most Swedish listed companies. Despite the fact that the collectivisation of savings and investments in recent decades has led to a substantial increase in institutional ownership (above 80 per cent), many listed companies still have controlling owners.[27] In listed companies with only one class of shares, the

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The rules in the Companies Act on decision making at the general meeting are based on the majority principle. The basic rule is that a proposal passes if it wins more than half of the votes cast (Chap. 9 Sec. 28 CA). In board elections, a closely related but not quite identical rule applies, i.e. that the winner is the person who has garnered the most votes (Chap. 9 Sec. 29 CA). Hence, a shareholder with enough shares – high or low vote – to hold a majority at the general meeting can decide himself on the board's composition. The act has no rules on minority representation for shareholders on the board. In listed companies, however, the board must have at least two directors who are independent of any shareholder who holds more than ten per cent of the shares or votes in the company (Stockholm Stock Exchange Listing requirements, 1 September 2003).

A decision to amend a company's articles generally is valid only if supported by both two thirds of the votes cast and two thirds of the shares represented at the general meeting (Chap. 9 Sec. 30 CA). In addition, the decision-making rule is designed in such a way that the more sweeping an amendment to the articles of association typically is for individual shareholders, the higher the majority requirement (Chap. 9 Secs. 30-33 CA). If the amendment will, for example, change the legal relationship between various shares, the decision will carry only if supported by all shareholders present or represented at the general meeting, who together must represent at least nine tenths of all shares in the company. In this instance, any differences in the voting power of the shares are irrelevant.

The requirement of a majority of both two thirds of the votes cast and two thirds of the shares represented at the general meeting also applies to decisions on new share issues that deviate from current shareholders' pre-emptive rights or involve reductions in share capital, share repurchases or mergers.

Last but not least, Swedish company law expressly states that neither the general meeting, board of directors nor managing director may take a decision that may give an undue advantage to one shareholder or other party to the detriment of the company or another shareholder (the principle of equal treatment") (Chap. 9 Sec. 37 and Chap. 8 Sec. 34 CA).

25 During the period 1990-2002 a total of 268 initial public offerings were made on the Stockholm Stock Exchange. In 122 of these companies, 46 per cent, there were dual classes of shares with different voting rights.

26 The figure refers to the situation in January 2003.

27 During the 1960s roughly 80 per cent of the market capitalisation of the Stockholm Stock Exchange was in the hands of private investors, while 20 per cent was held by institutions.

largest shareholder or shareholder group holds an average of 25 per cent of the capital and votes. In listed companies with dual class common stock, the largest shareholder or shareholder group also holds an average of 25 per cent of the capital but 41 per cent of the votes.[28 29]

The structure of ownership is fully transparent. All companies must maintain a register of their shares and shareholders. The register is made public, so that anyone, at any time, can gain access to information on the ownership structure of a certain company.[30]

6 Takeover Activity in Sweden

Takeovers are common in Sweden. During the years 1990 – 2002 there were 280 takeover bids in the Swedish stock market; 245 bids, or an average of about 19 bids per year, were successful. On average 8 per cent of the total number of listed companies were acquired through a public takeover bid each year.

By comparison, one can look at the UK market, which is generally considered to be the most open in Europe. During the same period (1990 – 2002) 1.494 takeovers were completed in the UK. Looked at in relation to the total number of listed companies, the annual number of successful takeovers corresponds to only 5 per cent of the listed companies each year, i.e. significantly less than in Sweden.[31]

Today the percentages are reversed. Pension funds, mutual funds, insurance companies and other portfolio intermediaries have gradually assumed a more dominant role in providing risk capital. However, since institutional investors, to minimize their risks, typically have very large share portfolios with limited holdings in each company and invest in low vote shares, there is still room for those willing to take on a large firm specific risk to become a controlling owner of the company.

28 Listed companies vary greatly in size. The market capitalisation of the largest companies is more than 10,000 times that of the smallest companies. However, when broken down in terms of size, the numbers show that the use of dual class stock is fairly evenly divided. In total there were 103 companies with a market capitalisation of least SEK 1 billion at the time. Slightly over half of these companies (51 per cent), accounting for 96 per cent of the total market capitalisation, had dual class common stock. The largest shareholder held 27 per cent of the capital and 44 per cent of the votes. In the group without dual class stock, the largest shareholder held 25 per cent of the capital and votes.

29 The extent to which a shareholder can obtain a larger percentage of the votes than the capital in a particular company depends not only on the voting ratio between high and low vote shares but on the numerical ratio between high and low vote shares as well; *see*, e.g., Bebchuk, L., Kraakman, R. & G. Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity*, in Morck, R. (ed.) Concentrated Corporate Ownership, 2000 at 297 f. This aspect has not been taken into consideration here; *see*, however, *Ägande och inflytande i svenskt näringsliv*, SOU 1988:38 at 72 ff.

30 Chap. 3 Secs. 7 & 13 CA. Based on this information, a privately financed and widely referenced compilation of the ownership structure in listed Swedish companies is published each year: Fristedt, D., Sundin, A. & S-I Sundquist, *Owners and Power in Sweden's Listed Companies* (Latest ed: 2003).

31 Total number of successful bids involving control according to the Takeover Panel's annual reports in relation to the total number of listed companies at the London Stock Exchange (incl. AIM) each year.

Takeover activity in Sweden is also high when looked at in terms of value. During the five-year period 1998 – 2002 cash bids for listed Swedish companies totalled approximately SEK 200 billion.[32] This corresponds to slightly over 7 per cent of the average market capitalisation during the entire period.

An underlying theme in the discussion on the takeover directive is that takeovers are important to the restructuring of European business. Various obstacles to cross-border takeovers must therefore be removed. A review of all 245 successful takeovers in the Swedish stock market during the period 1990 – 2002 shows that foreign buyers accounted for 68 bids, or 28 per cent of the total number of bids.[33] In seven of the ten largest cash takeovers during the period 1998 – 2002, the buyer was from outside Sweden. The largest was Linde of Germany, which acquired AGA for SEK 30 billion, and the second largest E.On, also of Germany, which took over Sydkraft for SEK 23 billion. In 35 cases, or more than half of these 68 takeovers, the buyer was a company from another EU country. In 20 cases the buyer was a US company.

The strong increase in foreign takeovers of Swedish listed companies coincides with an overall increase in foreign ownership in Sweden. After having remained at around 5 per cent until the early 1990's, foreign ownership today accounts for around 33 per cent of the market value of all listed Swedish companies.[34]

As noted above, if a takeover bid is opposed by the board/management of the target company, the offer is sometimes deemed "hostile". Depending on differences in the ownership structure, it is hard to make an accurate comparison of the number of "hostile" offers between countries. In those where companies tend to have a dispersed ownership structure, takeover bids, as also noted above, are often presented without prior negotiations between the offeror and the company's owners. It is hardly surprising that in such situations the board/management of the target company in certain cases will oppose the bid and deem it as "hostile".

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32 The amount does not include takeovers through an exchange of shares, such as Stora – Enso and Astra – Zeneca.

33 Among major Swedish companies acquired in this manner by foreign buyers are: *Esselte* – acquired by the US company J W Childs in 2002; *Svedala* – acquired by Finland's Metso in 2001; *Sydkraft* – acquired by Germany's E.On in 2001; *Enator* – acquired by Finland's Tieto in 2000; *BT Industries* – acquired by Japan's Toyoda in 2000; *AGA* – acquired by Germany's Linde in 1999; *ASG* – acquired by Germany's Danzas in 1999; *Bilspedition* – acquired by Germany's Stinnes in 1999; *Scancem* – acquired by Germany's Heidelberger Cement in 1999; *PLM* – acquired by Rexam of the UK in 1998; *Linjebuss* – acquired by France's CGEA in 1997; *Nobel Industries* – acquired by the Dutch company Akzo in 1994; *Esab* – acquired by Great Britain's Charter in 1994; and *Programator* – acquired by France's Cap Gemini in 1992.

The increase in foreign takeover activity in Sweden is also reflected in the number of major mergers that were implemented through takeovers and resulted in foreign ownership of Swedish companies, such as Pharmacia – Upjohn, Stora – Enso, Astra – Zeneca, Autoliv – Morton and Nordbanken – Merita – Unibank – Kreditkassen.

34 Fristedt, D., Sundin, A. & S-I Sundquist, *Owners and Power in Sweden's Listed Companies*, 2003, at 22. A few years ago foreign held shares represented almost 40 per cent of the market value.

In countries with concentrated ownership structures, where takeover bids are often preceded by negotiations with the controlling shareholder(s), there is less likelihood that a bid will be seen as "hostile". If the negotiations result in an agreement, the subsequent bid is practically by definition "friendly". The board of the target company then generally recommends that shareholders accept the bid. If the negotiations do not lead to an agreement, the bid may never be presented. Then the question of "hostile" or "friendly" is moot. Failed negotiations can, however, also force the offeror to go directly to the shareholders with its offer, and such offers may fall under the label of "hostile" by the board/management.

In the UK during the period 1990 – 2002, about 18 per cent of the total number of takeover bids were unrecommended by the board of the target company at the time the offer document was posted.[35] In Sweden, during the period 1995 – 2002 around 14 per cent of the total number of takeover bids were unrecommended.

If dual class stock with unequal voting rights were an obstacle to takeovers, one would expect such stock to be significantly less common among takeover targets than among listed companies in general. A review of data does not support this. Among the 245 Swedish listed companies that were taken over during the period 1990 – 2002, 157 companies, or 64 per cent, had multiple classes of common shares with unequal voting rights. This is not significantly lower than the frequency (69 per cent on average), of dual class stock among all listed companies during this period. Hence, the statistics do not give evidence that differentiated voting rights prevent takeovers or hamper takeover activity.

This conclusion is reinforced by a thorough review of failed bids. During the period 1990 – 2002 a total of 35 takeover bids for control of Swedish listed companies failed. In 22 (63 per cent) of these bids there were dual classes of shares in the target company. An examination of these bids indicates that around one third failed because a competing bid. Other reasons why bids were not successful were institutional investors' displeasure over the offer price, the price performance of the offeror's shares, financing difficulties for the offeror and the objection of competition authorities. In only one or two cases is there any indication that the reason why the bid failed had anything to do with the existence of differentiated voting rights.

7 Conclusions

The idea of introducing in the takeover directive a rule to "breakthrough" systems of dual class common stock is based on the assumption that the existence of such stock in listed companies is a major obstacle to takeovers. This article shows that this assumption lacks theoretical as well as empirical support. Dual class common stock is widely used among Swedish listed companies. Nonetheless, takeover activity in Sweden is higher than in the UK, which is generally considered to be the most active and open market for corporate control

35 Takeover Panel Annual reports 1990-1991 – 2002-2003.

in Europe. Statistics provide no evidence that differentiated voting rights prevent takeovers or hamper takeover activity.

In reality, there is good reason to claim that the existence of a controlling shareholder in the target company can facilitate a takeover. By reaching agreement with the controlling shareholder, the offeror sends an important signal to other shareholders that his bid is reasonable, which increases the chance of its successful implementation. Provided that the offeror is forced to offer all shareholders the same price for shares of the same class – a fundamental rule in all modern takeover regulations – the existence of a controlling shareholder can also allow shareholders of a target company to obtain a higher price for their shares. When confronted with a takeover bid, dispersed shareholders are unable to act collectively. This inability to coordinate makes it impossible for shareholders to negotiate with the offeror to obtain a better price. The existence of a controlling shareholder helps overcome this collective action problem. It forces the offeror to deal directly with the controlling owner, who in turn can negotiate on behalf of other shareholders.[36] Whether or not the controlling shareholder bases his control on high vote shares is beside the point in this context, as long as the takeover rules contain a provision that dictates the maximum price difference between shares with different voting rights in bid situations. This should in fact be the key issue when it comes to takeovers and dual class stock. It is not even mentioned, however, in the proposed takeover directive.

36 Cf., e.g., DeAngelo, H. & DeAngelo, L., *Managerial ownership of voting rights*, Journal of Financial Economics 14 (1985), at 33 (52); and Fischel, D., *Organized exchanges and the regulation of dual class common stock*, in Coffee, J., Lowenstein, L. & S. Rose-Ackerman (eds.) Knights, Raiders and Targets, 1988 (p. 509).