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The Dark Triad: Private Benefits of Control, Voting Caps and the Mandatory Takeover Rule

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Abstract

This paper takes as an example the intertwined relations between Grupo Espírito Santo and Portugal Telecom and the events surrounding the unpaid Rioforte loan to describe minority blockholders' strong incentives to protect the extraction of private benefits of control when a third party threatens a company takeover. This paper argues that the combination of the extraction of private benefits of control, the takeover protection granted by a statutory voting rights ceiling provision and the existence of a mandatory takeover rule create a vicious circle with an unintended outcome. Although a mandatory takeover rule should protect minority shareholders, it instead works in favour of the blockholder extracting private benefits of control, which is the exact opposite of its original intent.

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Introduction

In listed companies with highly concentrated voting rights, the market for corporate control naturally functions rather ineffectively.[1] If more than 50% of the voting shares are in one shareholder's hands, a transfer of control can only take place if the incumbent controller agrees to sell the shares in a private bilateral negotiation. This is typically the case for companies listed in continental Europe,[2] and with the growing popularity of multiple voting rights shares, it is increasingly becoming the case for companies listed in the United States.

The reverse generally occurs in companies with widespread voting dispersion. In these cases, the hostility of existing blockholders against a prospective acquisition will not be relevant if the sale price offered to non-blockholders incentivizes them to tender their shares (if there are no inefficiencies of a different nature) because the general acceptance of the takeover should be enough to make it successful and to transfer control to the bidder.[3]

Recent literature has suggested that the role played by minority blockholders in takeovers becomes more central if there are supermajority provisions in place (in particular, if they are combined with the unavailability of squeeze-out rights and ineffective breakthrough provisions).[4] If this is case, the role of a hostile blockholder becomes critical. This paper will show that this is especially true if a blockholder is

[1] Henry G Manne, *Mergers and the market for corporate control*, 73 JOURNAL OF POLITICAL ECONOMY 110, 112 (1965). (*The market for corporate control was first described by Henry G Manne. The market for corporate control is often referred to as the takeover market*).

[2] Julian Franks & Colin Mayer, *Hostile takeovers and the correction of managerial failure*, 40 Journal of Financial Economics, 163, 165 (1996) (*defining European 'insider' systems, featuring a smaller number of listed companies, concentrated voting rights, particularly in the hands of families and other companies, and lower levels of takeover pressure*); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W Vishny, *Legal determinants of external finance*, 52 The Journal of Finance 1131 (1997) (*extending the concept to a larger number of countries).*

[3] Mike Burkart, Denis Gromb & Fausto Panunzi, *Minority blocks and takeover premia*, Journal of Institutional and Theoretical Economics (JITE)/Zeitschrift Für Die Gesamte Staatswissenschaft, (2006) (generally, even if the existence of blockholders may force a bidder to offer a higher price, either to secure the blockholder's support, or to attract to a larger extent small shareholders).

[4] Sergio Gilotta, *EU Takeover Law and the Powerful Anti-Takeover Force of Supermajority*, 26 COLUMBIA JOURNAL OF EUROPEAN LAW 1 (2019).

extracting high levels of private benefits of control and there are statutory voting rights ceilings in place. In this case, bylaw revision is a condition necessary for the acquisition, and the supermajority required for the resolution empowers the hostile blockholder with a de facto veto right. This is particularly damaging in a jurisdiction with a mandatory takeover rule in place such as the European Union countries.

Recent events offer clear examples of this problem and of the causal relation between minority blockholders' superpower and the defence of the extraction of private benefits. On 30 June 2014, Portugal Telecom ('PT'), by then the largest telco in Portugal, officially confirmed the rumoured existence of a financial investment in unsecured debt issued by Rioforte Investments S.A. ('Rioforte'), a Grupo Espírito Santo ('GES') company, in the amount of €897 million.[5] PT explained:

> the subscription of commercial paper of Rioforte is based on the 14-year long adequate experience in treasury applications of Banco Espírito Santo ('BES') and GES entities, in the context of the strategic partnership signed in April 2000 between both parties. This strategic partnership contemplated the cross shareholding between both entities as well as the designation of PT as a preferred supplier of telecommunications to BES Group and the designation of BES as preferred provider of financial services to PT.

The impact of the official disclosure was brutal. GES and BES had been in turmoil since the last quarter of 2013. In June 2014, scenarios that had once seemed impossible (such as the resolution of BES, one of the largest banks in the system, and the bankruptcy of several GES companies, including Rioforte) had become actual threats hanging over the head of the most powerful group in the country. BES was resolved by the Bank of Portugal about a month later, on 3 August 2014, splitting it into a 'bad bank' and a 'good bank' that retained its core operations.[6] Rioforte, a company

[5] Portugal Telecom: Clarifications regarding treasury investments, Portugal Telecom (June 30, 2014), available at: https://web3.cmvm.pt/sdi/emitentes/docs/FR51050.pdf. To put the materiality of the investment in perspective, the market capitalization of PT a week before the announcement was slightly above the €2,500 million threshold, which means the investment represented almost one-third of the company's market capitalization.

[6] The timing of the BES resolution was unique and made this an 'experimental' process while the new EC rules were under discussion/undergoing the approval process. The Banking Recovery and Resolution Directive had just been approved in May 2014 but had not yet been implemented, and the Single Resolution Board would only centralize resolution powers in January 2016. https://www.srb.europa.eu/en/node/360.

holding a significant portfolio of real estate, tourism and agriculture assets, would also file for creditor protection shortly thereafter. When the rumours started circulating, the word on the street was that the likelihood of Rioforte repaying its debt to PT was close to zero. As anticipated, Rioforte missed the payment deadline two weeks after the market announcement. Within less than 10 days, PT's market capitalization had dropped from around €2,600 million to below €1,800 million. By October, it was already below the €1,000 million threshold.

In June 2014, PT was halfway through a merger process with two Brazilian companies, Oi, S.A. ('Oi'), and Telemar Participações, S.A. ('Telemar').[7] The exchange ratio for the merger was fixed in the first quarter of 2014. They had agreed that for each PT share, shareholders would receive shares in CorpCo (the holding company that would head the future group) corresponding to a Brazilian reais amount equivalent to €1.9979, to which 0.6330 shares in CorpCo would be added. Subject to approval at the shareholders meeting, PT shareholders would also receive, prior to the merger's completion, a dividend of €0.10 per share. The imminent Rioforte default inevitably impacted the fixed exchange ratio.

On 2 July, Oi issued an official announcement stating that it had neither been aware of the €897 million financial investment nor participated in making the decisions that had led to its implementation but were now requesting additional clarification and would take the necessary action to protect its interests.[8] Red flags were being publicly waved. On 16 July, one day after the default, PT, Oi and Telemar announced the execution of a new memorandum of understanding adjusting the terms and conditions of the exchange ratio: PT would call back the Rioforte debt from Oi in exchange for Oi shares (representing 16.6%), which would be held as treasury shares, and PT would have a call option over a six-year period to repurchase the Oi shares. In

[7] The merger of PT, Oi and Telemar was not a legal merger but a series of transactions that would end up in a so-called 'combination of activities, business and shareholder bases of the three companies'. The outcome of the process (which was never concluded) would have been the incorporation of a single integrated Brazilian company, CorpCo, which would have owned all the assets involved in the transaction and would have been listed in New York, São Paulo and Lisbon. https://www.sec.gov/Archives/edgar/data/944747/000119312514060058/d680410dex1.htm.)

[8] Material fact disclosed by Oi, Portugal Telecom, (July 3, 2014), available at: https://web3.cmvm.pt/sdi/emitentes/docs/FR51116.pdf.

short, the risks of the non-performing debt would return to the shareholders of the Portuguese company, and the exchange ratio was adjusted accordingly.[9]

The final chapters of this story, although interesting, are not especially relevant for this paper. First, the merger was never completed (even though the activities and shareholder bases have been combined). Second, in 2015, Altice acquired PT Portugal (the Portuguese telco operation of PT) from Oi for €5,700 million, transforming PT (renamed Pharol S.A.) into a pure holding company owning Oi shares, the Rioforte loan and the Oi call option. Third, the market capitalization of Pharol is today below the €100 million threshold (in 2006, PT's market capitalization was above €10 billion), which makes these events a unique story of value destruction in Portuguese economic history.

It is interesting to note that in 2006/2007, PT was the target of a failed takeover bid. For that reason, the events surrounding this case are particularly interesting because they show us how damaging the superpower of the blockholder is in jurisdictions with high extraction of private benefits of control and a mandatory takeover rule. The fact is that the inside blockholder will not tender its shares and will do whatever it takes to make the takeover fail unless the takeover price compensates it for the loss of private benefits it would have expected to extract in the future. Under normal circumstances, the bidder will not be able to offer the desired price or will not be able to offer it to all shareholders.

This creates a problematic alignment of incentives that will be described in this paper: the smaller the blockholder or controlling position is, the more attractive it will be for the shareholder to create non-proportional distortions of the distribution of benefits; the more extensive the extraction of private benefits is, the larger the delta of divergence between the (theoretical) acceptance price for the inside blockholder and the minority shareholders will be. In takeovers where the target companies are subject to statutory voting rights ceilings, the inside blockholder is granted a de facto veto right to oppose bylaw revision, and it will use this veto right unless properly compensated for the lost future benefits. Where mandatory bid rules force the bidder to extend the same price to controlling and minority shareholders, one of two effects

[9] PT and Oi reaffirm their support for the business combination, Portugal Telecom (July 16, 2014), available at: https://web3.cmvm.pt/sdi/emitentes/docs/fsd30452.pdf. The Rioforte credit remains unpaid today, and the current expectation is that the creditors will receive about 5% of the nominal value of the unsecured credits in the bankruptcy proceedings.

will normally occur: either the unrealistic acceptance price will reduce takeover activity or the outcome of the takeover will depend on the blockholder's power to oppose it, which will cause most acquisitions to fail.

This paper is organized as follows. Section 2 delves deeper into the description of the shareholder structure and dynamics of PT and analyses the specific role of the GES/BES group and what allowed this group to play such a central role for so long without encountering shareholder contestability. Section 3 briefly explains why a controlling shareholder might be encouraged to use its dominant position to extract benefits that are not proportionally shared with other shareholders and analyses the extension of this problem in a peripheral jurisdiction like Portugal. Section 4 describes what seems to be the paradox of the non-existence of a positive correlation between the high extraction of private benefits of control by minority blockholders and the efficiency of the market for corporate control. Section 5 partially explains this paradox with the mechanics of voting rights ceilings, which is one of the most important control-enhancement mechanisms used in Iberia. Section 6 explains how the existence of a mandatory takeover rule serves as the last piece of the puzzle, creating the (im)perfect alignment of interests to make control contestability more difficult and ends up protecting the blockholder extracting private benefits of control. Section 7 concludes.

I. PT's shareholder structure and the role of BES/GES

PT was incorporated in 1994 through a legal merger of the then existing Portuguese telecom operators Telecom Portugal, Telefones de Lisboa e Porto and Teledifusão de Portugal. Its privatization—among the most iconic and important public-to-private transactions in the post-revolution (post 1974) period—was structured in five phases that took place between 1995 and 2000. The first phase (1995) involved the privatization of 27.26% of its share capital; the second (1996) involved the privatization of 21.74% of its share capital; the third (1997) involved the privatization of 26% of its share capital; the fourth (1999) involved the privatization of 13.5% of its share capital and a simultaneous rights issue (the state reduced its shareholding from 25.15% to close to 11%); and the fifth phase (2000) involved the privatization of the remaining state-owned shares, except for 500 shares that corresponded to an actively challenged golden share.[10] This golden share would eventually be cancelled in 2011 as part of the agreement concerning the Economic Adjustment Programme for Portugal, commonly referred to as the 'bailout programme'.

BES was an important PT shareholder from the earliest stages of the privatization process. After the second phase of privatization, BES owned a 5% shareholding, which soon increased to around 10% and would remain at between roughly 9% and 12%. However, anyone interacting with PT understood that BES/GES's actual role and importance in the dynamics of PT's decision-making process were not proportional to the group's 10% shareholding since it had always played a pivotal role in the company's management and operation.

Various factors led to the disproportionate power of BES/GES in PT. First was the fact that despite PT's shareholders often changing over the years, BES/GES remained a constant presence. Second, BES/GES had a gravitas of its own as the most important non-industrial private group in Portugal after the 1974 revolution. Third, BES/GES had always been prized by the political establishment as a vehicle for keeping the company in Portuguese hands and for being strategically aligned with the country's political will. Fourth, it had informal alliances with other shareholders; some were attracted to the national and international prestige of the BES/GES group and would rather follow its lead, while others were financially dependent on BES and would rather have it as a friend and ally. Finally, but especially relevant, were the statutory control-enhancement mechanisms in place to prevent other shareholders (such as Telefónica) from gaining control of the company. Article 5 of the bylaws set the Portuguese state's golden share; Article 9.1 regulated an ownership cap of 5%, applicable to competing shareholders (unless authorized by the shareholders meeting); and Article 12 regulated a general voting cap of 10%.

PT's other strategic shareholder was the Spanish telco Telefónica, but it was never given the same political treatment (rather the opposite is true) or an equivalent role in PT's strategic dynamics. PT signed a strategic agreement with Telefónica in 1997 when it was decided that the Spanish company would buy a 3.5% shareholding in the third phase of PT's privatization and that PT would acquire a 1% cross-shareholding in

[10] Maria Lurdes Castro Martins & Natália Monteiro, *Privatisation, Liberalisation and the Portuguese Telecommunications Sector: a Social Cost-benefit Analysis*, SEMINÁRIOS ANACOM, (2006), available at: https://repositorium.sdum.uminho.pt/bitstream/1822/7160/1/Monteiro_Martins_2006_Anacom.pdf.

Telefónica. Unsurprisingly, what had been designed as a balanced cross-shareholding agreement rapidly evolved into an unbalanced relationship: PT never increased its shareholding in Telefónica, but Telefónica increased its shareholding in PT—first to 4.8%, later to 8.2% and finally to almost 10% after receiving authorization from the PT shareholders meeting in April 2001 (such authorization was required because of the 5% ownership cap applicable to competing shareholders set by Article 9.1 of the bylaws).

In truth, PT was a perfect target for the fast-growing and aggressive Telefónica, not only because of their obvious geographical synergies but also because the two groups were 50/50 partners in Vivo,[11] a Brazilian company located in one of the world's most attractive markets in the early 2000s. It should be noted that Telefónica was simultaneously PT's partner in a 50/50 joint venture, a qualified shareholder, a member of its board of directors, a potential takeover bidder and its most important commercial competitor in different markets. It does not take much effort to understand why the problematic relation between the two Iberian players was never a peaceful one or why Telefónica was never able to increase its position in PT above the 10% threshold. In 2010, after a long battle involving the one and only exercise of the golden share by the Portuguese government, Telefónica ended up acquiring PT's shares in Vivo for almost $6 billion and selling its shares in PT.

After the collapse of the BES/GES group, a parliamentary inquiry was held in Portugal in 2014/2015. The final report's[12] conclusions painted a clear picture of the BES/GES group's actual level of influence in PT and revealed the magnitude of the relation by showing that the Rioforte exposure was not an exception: over the years, PT had frequently acquired BES/GES's debt, with a maximum exposure of €4,992 million at the end of 2010. Moreover, the relation between the two groups was rather promiscuous: the CFO of BES was simultaneously a non-executive board member of PT, there were other common directors, PT's investments in GES were not made in arm's-length market conditions (e.g., there was no due diligence or risk analysis, the

[11] Portugal Telecom, SGPS, S.A., Annual Report (Form 20-F) (Dec. 31, 2004). In 1998, Telebrás was privatized through the auction of 12 holding companies (with 26 regional telcos and one long-haul telco), and PT and Telefónica acquired the group's two most important companies: Telesp Celular and Tele Sudeste Celular. In 2002, PT and Telefónica agreed to incorporate a 50/50 joint venture (Vivo) and merge the Brazilian telco assets. Vivo remains today the market leader of wireless subscribers in Brazil. https://www.statista.com/statistics/758503/mobile-telephony-market-share-brazil-operator/.

[12] Comissão Parlamentar de Inquérito à Gestão do BES e do GES, Final Report (April 28, 2015).

formalities of the authorization process were not followed and information about the investments was not fully disclosed[13]) and BES (and BESI, the investment bank of the group) was usually the financial intermediary in relations with GES.

II. Private benefits of control

Some shareholders obtain and extract benefits that are not proportionally shared with minority/non-controlling/other shareholders[14] (the best example of proportionally shared benefits is dividend distribution). These benefits are varied and include benefits illegally extracted (such as any non-arm's-length transaction with a related party that overpays that party or underpays the company) and others that are legal but subject to special regulatory attention (e.g., access to privileged information through board representation or arm's-length transactions with related parties). Such benefits include pecuniary and non-pecuniary gains (e.g., the prestige of the controlling shareholder or the use of the controlling position to advance any agenda that does not concern the company). In some situations, the advantages for the controlling shareholder correspond to a reciprocal and equivalent loss for the company (e.g., the sale of underpriced assets or the acquisition of overpriced assets); in others, there are advantages for both the controlling shareholder and the company

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[13] The Rioforte investment was not referred to in PT's 2013 accounts as a 'related party transaction' with BES. In 2016, the Securities and Exchange Commission fined PT over its failure to disclose the credit risks of its investments in GES. In 2020, the Portuguese Comissão do Mercado de Valores Mobiliários would also fine the company and some of its directors for breaching their disclosure obligations. https://www.cmvm.pt/pt/Comunicados/Comunicados/Pages/20210628r.aspx.

[14] The extraction of private benefits always implies a certain level of influence and control. For these purposes, what qualifies as a *controlling position* or a *blockholder* will always depend on multiple variables, particularly the characteristics of the relevant market, the practices in relation to attendance at shareholders meetings and, of course, the level of ownership dispersion. Most papers that empirically analyse this topic take as a reference the holding of at least 5% of the share capital (the traditional threshold that triggers disclosure requirements in both the United States and Europe). *See* Alex Edmans, *Blockholders and corporate governance*, 6 ANNUAL REVIEW OF FINANCIAL ECONOMICS 23–50 (2014). In Europe—and particularly in Portugal—voting is more concentrated, and the minimum 'influence shareholding' is always much higher (since the participation of more than half of the voting rights will always qualify as a *controlling position*). Regardless of the size of the shareholding, the relevant consideration is whether a shareholder has a specific position of influence and control—or access to that position—and this can happen, depending on the shareholder context, with 5% or 25%. The case of BES/GES in PT is a good example.

(e.g., closing an agreement with a party closely related to the controlling shareholder that generates synergies for both parties).[15]

The reality is that when there is a controlling shareholder—especially one holding more than 50% of the voting rights—the impact of the minority shareholder vote in critical matters, such as the appointment of the board, is quite residual. It is typically either dependent on the existence and effectiveness of rules for the appointment of board members by minority shareholders[16] or entirely irrelevant. In such cases, as a winner-takes-all consequence of the formula for board appointments, the board members are all (or almost all) appointed by the controlling shareholder. Moreover, at least in most European jurisdictions, a controlling shareholder can also dismiss any director, at any time, with or without cause.[17] Unlike the typical agency problem, this

[15] Private benefits extracted with a reciprocal loss for the company and/or other shareholders are also referred to as *extracted private benefits*, while those that do not cause a reciprocal loss are referred to as *independently created private benefits*. *See* Jens Dammann, *Corporate ostracism: freezing out controlling shareholders*, 33 JOURNAL OF CORPORATE LAW 681 (2007); Edmans, Blockholders and corporate governance, 6 ANNUAL REVIEW OF FINANCIAL ECONOMICS, 23-50 (2014). In truth, these concepts are very vague and still unstable. Sometimes the extracted private benefits are referred to as *pecuniary benefits* since they imply an inequitable distribution of resources, while there is a correspondence between the independently created private benefits and the *non-pecuniary benefits* (which is not accurate in all cases). *See* Ronald J Gilson & Jeffrey N Gordon, *Controlling controlling shareholders*, 152 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 785, 787 (2003). Finally, some authors use the word *tunnelling* to refer to the extraction of pecuniary private benefits of control, but this conceptual appropriation incorrectly implies that all pecuniary benefits extracted are illegal. *See* Olaf Ehrhardt & Eric Nowak, *Private benefits and minority shareholder expropriation: Empirical evidence from IPOs of German family-owned firms*, CFS Working paper, No. 2001/10, (2001); Edmund Schuster, *Efficiency in private control sales–The case for mandatory bids* 8 (2010), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1610259.

[16] Rules concerning the appointment of board members by minority shareholders are quite different in most European jurisdictions, and some jurisdictions have no mandatory rules granting this right to minority shareholders. *See* Luca Enriques, Henry Hansmann & Reinier Kraakman, *The basic governance structure: the interests of shareholders as a class*, *in* THE ANATOMY OF CORPORATE LAW, Oxford UP (2009). Conversely, even in such cases where the rules exist, their effectiveness is far from perfect since they typically depend on the existence of a minority block with a certain materiality (typically not less than 10% and not more than 20%) that will vote against the prevailing proposal, which does not prevent artificial blocks from being gathered.

[17] Among the many material differences between European and American corporate regulations and the relations between directors and shareholders is the generalized European rule that allows a simple majority to dismiss directors. The principle of shareholder supervision of the board, which is generally accepted in Europe, does not exist in regulations in places such as Delaware. *See* Christopher M. Bruner, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER, Cambridge UP, 40 (2013); Enriques, Hansmann & Kraakman. 60–62 (2009); Lucian Arye

circumstance creates an environment in which controlling shareholders are encouraged to use their dominant position to extract benefits that are not proportionally shared, much to the detriment of other shareholders.[18]

The existence and appropriation of private benefits of control are intuitive but difficult to quantify. Unlike public benefits that are proportionally shared, such as dividends, private benefits are in most cases discreetly and privately extracted. Under normal circumstances, their economic value will be higher the more private and discreet they are (and the less efficient the legal environment for minority shareholder protection is) since this would normally mean other shareholders are unaware of such appropriation or are unable (or unwilling) to resort to court action or other mechanisms to constrain the controlling shareholder. Also, the incentive to appropriate private benefits will naturally be stronger the more invisible the extracted benefits are. Therefore, all methodologies for the quantification of private benefits of control are indirect.

Bebchuk, *The case for increasing shareholder power*, 118 HARVARD LAW REVIEW 833 (2004). This relationship has evolved over the past few years, not only because of pressure from authors such as Bebchuk but also because of new rules, such as the Dodd–Frank Act concerning directors' payment and the say-on-pay rule. *See* Paul Rose & Christopher J Walker, *Examining the SEC's Proxy Advisor Rule*, REPORT FOR US CHAMBER OF COMMERCE, 6 (November, 2020); Anna Faure, VERANTWORTUNG INSTITUTIONELLER AKTIONÄRE IM DEUTSCHEN AKTIENRECHT, Nomos Verlag, 22–23, (2019).

[18] Not all benefits generated by the company are supposed to be proportionally shared by all shareholders, but this is a general rule. In this sense, private benefits are the opposite of shared benefits—shared benefits are proportionally divided. The fair and equal treatment of shareholders (which means that each shareholder has the right to be treated in proportion to the share they own) is a general principle in most jurisdictions and has different implications. First, it implies that the shares of each class are homogeneous. Second, it implies that the legal position of each shareholder in relation to each class of shares is equivalent—shareholders cannot be arbitrarily discriminated against (*Untersagt ist nur die willkürliche*). Nonetheless, this principle does not mean that all shares, regardless of the class, must be equal. This is quite clear in Germany, where the general equality rule of § 53a of the Aktiengesetz has several exceptions, such as shares issued with special rights in accordance with §§ 11, 12i and 23III4 of the Aktiengesetz. Furthermore, this principle applies to relations between the company and the shareholders but not necessarily to relations between the shareholders themselves. This is again quite clear in jurisdictions such as Germany (in accordance with § 53a of the AktG) but is generally implied in most jurisdictions. *See* Michael Hoffmann-Becking, MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS 4, CH Beck, 123–125, (2020); Tim Drygala, Marco Staake & Stephan Szalai, KAPITALGESELLSCHAFTSRECHT: MIT GRUNDZÜGEN DES KONZERN UND UMWANDLUNGSRECHTS, Springer, 538–539 (2012); Yves de Cordt, L'ÉGALITÉ ENTRE ACTIONNAIRES, Bruylant, 297 (2004).

With some variations, there are two main methodologies for quantifying private benefits. The first was applied in the work of Barclay and Holderness and compares the prices of block trades, which are typically priced at substantial premiums, with the post-announcement price of the same shares in the stock exchange.[19] The premise is that the premium is the 'price' the blockholder is willing to pay for the private benefits to which it will have access. The second was applied by Zingales, Rydqvist and Modigliani and Perotti in their respective studies and compares the premium attributed to voting shares and that of multiple classes of shares with different voting rights.[20]

There are no reliable figures for the level of appropriation of private benefits of control in the Portuguese market, but it seems reasonable to assume that this level is high. First, this is the conclusion drawn in existing international comparative empirical studies.[21] Second, the value of control (measured by the amounts paid for the control premium) is, on average, higher in civil law countries than in common law countries, and among civil law countries, the value of control is higher in jurisdictions with less efficient judicial systems (and a lack of investor protection) than in more efficient ones, such as Scandinavian countries or Germany.[22] If this is the case when analysing a country like France, for example, it is fair to infer that the same conclusion can be

[19] See Michael J Barclay & Clifford G Holderness, *Private benefits from control of public corporations*, JOURNAL OF FINANCIAL ECONOMICS, (1989).

[20] See Luigi Zingales, *The value of the voting right: A study of the Milan stock exchange experience*, 7 THE REVIEW OF FINANCIAL STUDIES 125-148 (1994); Kristian Rydqvist, *Takeover bids and the relative prices of shares that differ in their voting rights*, 20 JOURNAL OF BANKING & FINANCE 1407 (1996); Franco Modigliani & Enrico Perotti, *Protection of minority interest and the development of security markets*, 18 MANAGERIAL AND DECISION ECONOMICS 519 (1997). In any case, it is generally understood that the private benefits of control are only one reason for the payment of a premium above-market price. Other reasons include, for example, the benefit of improving the company's management to increase future cash flows, the cost and profit synergies generated after the acquisition of control and liquidity discounts in large block transactions.

[21] Such studies are not representative because the sample of information concerning Portugal is very limited. We refer to Alexander Dyck & Luigi Zingales, *Private benefits of control: An international comparison*, 59 JOURNAL OF FINANCE 537 (2004), Table 2; T Nenova, 68 *The value of corporate votes and control benefits: A cross-country analysis. Harvard University*, ECONOMICS, WORKING PAPER 325(2000), Table 3; Craig Doidge, *US cross-listings and the private benefits of control: evidence from dual-class firms*, 72 JOURNAL OF FINANCIAL ECONOMICS 519 (2004), Table 2. The first study contemplates two samples from Portugal, the second contemplates three samples and the third four samples (over different periods).

[22] Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate ownership around the world*, 54 JOURNAL OF FINANCE 471 (1999).

drawn for Portugal. Third, the extremely high concentration of ownership is in itself an indication of the large value of control.[23]

III. The Sonae takeover

On 6 February 2006, Sonae, one of the largest conglomerates in Portugal, announced that it was launching a takeover bid for all of PT's shares, paying €9.50 per share. Compared with the previous day's share price, this represented a premium of 20.1%. The bid was dependent upon meeting several conditions, including the amendment of PT's bylaws to eliminate the voting and ownership caps.[24]

[23] Ownership concentration, especially in cases when a single shareholder owns shares representing more than 50% of the voting rights, is an instrument that grants control over the company (and serves to defend against external hostile bidders). Eleven of the eighteen companies represented in the PSI (the most representative index of the Portuguese stock exchange)—Altri, Corticeira Amorim, EDP Renováveis, Ibersol, Jerónimo Martins, Mota-Engil, Navigator, NOS, Semapa, SONAE Capital and Sonae SGPS—have a *de jure* controlling shareholder. In the remaining seven companies represented in the index, there is still a strong concentration of ownership. In Millennium, Fosun and Sonangol together own 47% of the share capital (27.25% + 19.49%); in EDP, China Three Gorges controls 21.4% of the share capital; in Galp, Amorim Energia controls 33.34% of the share capital; in Novabase, HNB controls 33.34% of the share capital; and in REN, State Grid owns 25% of the share capital. This means that in only two companies represented in the index—CTT and Pharol—the largest shareholder owns less than 20% of the shares and voting rights. Notably, Portugal has the highest share of companies with a controlling shareholder in Europe, since more than half of the listed companies in Portugal have a single controlling shareholder. *See* Mobilising Portuguese Capital Markets for Investment and Growth, OECD (2020), available at: https://www.oecd.org/corporate/ca/OECD-Capital-Market-Review-Portugal-2020.pdf. In each of these cases, the shareholder regards concentrated ownership as the best way to organize their investment. Consequently, the shareholder is willing to accept the capital cost of this option, comprising the immobilization of the investment (whether equity or debt, but more clearly the latter) and a portfolio diversification cost, as the concentration limits the scope for other investments. It is reasonable to assume that if the shareholder could (with equivalent efficiency and marginal utility) organize their investment with less concentration of capital, that is what the shareholder would rationally do. *See* Zingales, The value of the voting right: A study of the Milan stock exchange experience, 7 THE REVIEW OF FINANCIAL STUDIES 125, 126 (1994).

[24] PRELIMINARY ANNOUNCEMENT FOR THE LAUNCH OF A GENERAL TENDER OFFER FOR THE ACQUISITION OF SHARES REPRESENTING THE SHARE CAPITAL OF PORTUGAL TELECOM, SGPS, S.A. SONAECOM (February 6, 2006), available at: https://web3.cmvm.pt/english/sdi/emitentes/docs/FR8141.pdf.

For more than a year, PT (and BES/GES, as a practical leader of the hostile shareholders) fought fiercely in different arenas against Sonae's offer. About two weeks before PT's shareholders meeting that would decide the outcome of the takeover by voting on the proposed bylaw amendments, the takeover price was revised to €10.50 per share, but it did not make a difference. About 800 of PT's shareholders, in one of the most crowded shareholders meetings in Portuguese economic history, decided to reject the proposal with a 52% majority. The takeover failed.

Sonae's failed bid to take over PT is merely one example in a long list of unsuccessful hostile takeovers in the otherwise uneventful history of Portuguese capital markets. Almost simultaneously, Banco Comercial Português announced a hostile takeover of Banco Português de Investimento (BPI). In April 2007, BPI's shareholders rejected the bylaw amendments on which the takeover was conditional, causing the takeover to fail. These remain the two largest takeover attempts made in Portugal, but other failed takeover attempts have followed suit.[25]

The general existence of a positive correlation between the high extraction of private benefits of control and the efficiency of the market for corporate control seems logical.[26] The extensive expropriation of benefits by a controlling blockholder directly

[25] More recently, in 2019, at EDP's shareholders meeting, 56.6% of shareholders voted against amending the bylaws to remove the voting cap, which was a condition of the takeover announced by China Three Gorges, already the largest shareholder of the company, about one year before. *See* Operações passadas, CMVM (2020), available at: https://www.cmvm.pt/pt/AreadoInvestidor/rec_oper/Operacoes/opaedp2018/Pages/opa_edp_edpr.aspx. In 2015, BPI's shareholders meeting did not approve the revision of the bylaws to eliminate the voting ceiling, which was a condition of the takeover proposed by CaixaBank (52% of shareholders voted in favour of the amendment, but the resolution required a supermajority of 75%). *See* Facto relevante, CaixaBank (June 18, 2015), available at: https://web3.cmvm.pt/sdi/emitentes/docs/fsd64947.pdf.

[26] This applies in cases where no shareholder (or group of shareholders) controls more than 50% of the voting rights. When a shareholder owns more than 50% of the voting rights, or close to that, it is virtually impossible for a non-friendly third party to take control of the company. This is the case in most listed companies in Portugal and continental Europe. Some scholars have defended the existence of a positive correlation between the low protection of minority shareholders (and the associated risk of extraction of private benefits of control) and the high concentration of capital, contending that a greater concentration of share ownership in a company makes it less rewarding for the controlling shareholder to create non-proportional distortions of the distribution of benefits. The extraction of private benefits involves costs, risks etc., and its marginal value will be reduced. *See* La Porta, Lopez-

impacts the pre-appropriation valuation of a company since external shareholder payoffs are reduced in proportion to the expropriations, which necessarily impacts the company's valuation.[27] If a third party is willing to make a valuation of the company and offer a price that does not discount such benefit extractions (even though they are usually invisible) and also proposes a control premium that will be shared by all shareholders, this would plausibly present an attractive proposal for all non-blockholders and could easily trigger a change in control; this is definitely the case if the largest blockholders own up to 10% or 15%. In these circumstances, an outside party able to improve the value of the company would bid for its control and replace the incumbent management.[28] However, the long history of failed takeover attempts over recent decades points to the opposite being true in Portugal.

There are many inefficiencies in the functioning of the market for corporate control, particularly in terms of the concentration of capital,[29] the free-rider problem caused

de-Silanes & Shleifer, Corporate ownership around the world, 54 JOURNAL OF FINANCE 471-517 (1999); Morten Bennedsen & Daniel Wolfenzon, 58 *The balance of power in closely held corporations*, JOURNAL OF FINANCIAL ECONOMICS 113-39 (2000); Igor Filatotchev, Rostislav Kapelyushnikov, Natalya Dyomina & Sergey Aukutsionek, *The effects of ownership concentration on investment and performance in privatized firms in Russia*, 22 MANAGERIAL AND DECISION ECONOMICS 299-313 (2001). Conversely, the existence of majority blockholders extracting private benefits will deter other blockholders since they will not be able to extract private benefits unless they are able to replace the incumbent blockholder. *See* Jeffrey Zwiebel, *Block investment and partial benefits of corporate control*, 62 THE REVIEW OF ECONOMIC STUDIES 161 (1995).

[27] The extraction of private benefits by the controlling shareholder also reduces their incentive to maximize shareholder value and, to a certain extent, may conflict with that goal. Conversely, a controlled company may face an excessive cost of capital if potential shareholders cannot quantify the value of private benefits. *See* Ronald J Gilson & Alan Schwartz, *Contracting about private benefits of control*, COLUMBIA LAW AND ECONOMICS RESEARCH PAPER, 436, 436–7 (2013).

[28] The idea that listed companies should be owned and managed by those parties that are able and willing to maximize their value is the central proposal behind the concept of the market for corporate control. *See* Henry G Manne, *Mergers and the market for corporate control*, 73 J. OF POLITICAL ECONOMY 110, 119 (1965); *See also* Michael C Jensen & Richard S Ruback, *The market for corporate control: The scientific evidence*, 11 JOURNAL OF FINANCIAL ECONOMICS 5-50 (1983).

[29] If more than 50% of the votes are not dispersedly held, a transfer of control can only take place with the controlling shareholder's consent through a bilateral negotiation. Controlling blocks may not be owned by the more efficient party, and the owners of controlling blocks may not be willing to sell their shares, regardless of the control premium that is offered (this is particularly true in the context of family-owned businesses).

by extreme shareholder dispersion,[30] information asymmetry and private benefits of control. The following sections demonstrate how the conjugation of private benefits with voting ceilings and a mandatory general takeover context provokes a particularly relevant inefficiency.

IV. Voting rights ceilings

Statutory voting ceilings are generally accepted in Europe[31] and have been the most popular control-enhancement mechanism in Portugal.[32] In most listed companies in Portugal, there is either a shareholder with more than 50% of the voting rights or a voting cap in place. Today, 11 of the 18 companies in the PSI, Euronext Lisbon's most important index, have a shareholder, or a group of shareholders, controlling more than 50% of the voting rights; four of the remaining seven companies (Millennium, EDP, REN and Pharol) have statutory voting caps.[33]

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[30] *See* Sanford J Grossman & Oliver D Hart, *Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation*, 11 THE BELL JOURNAL OF ECONOMICS 42 (1980).

[31] There are a few exceptions, such as the short-lived rule in Article 515 of the Real Decreto Legislativo 1/2010 in Spain (revoked in 2011) and, more remarkably, the German rule in § 134.1(1) of the Aktiengesetz that does not allow voting caps in listed companies. *See* Grigoleit & Herrler, *AktG § 134 Rn. 4, 5*, (2020); Thomas Raiser & Rüdiger Veil, RECHT DER KAPITALGESELLSCHAFTEN, Verlag München, 254 (2015).

[32] Dual-class structures are typical deviations from the one share, one vote rule, commonly referred to as control-enhancement mechanisms. However, there are other mechanisms that do not affect the economical proportionality between cash flow rights and voting rights but undermine the spirit of the principle, one of which is the voting ceiling. Voting ceilings are the most popular control-enhancement mechanism in not only Portugal but also in Iberia. *See* ISS-Shearman Sterling-ECGI, REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION, Ref. Ares, Shearman & Sterling LLP, (May 18, 2007); Jeremy Grant & Thomas Kirchmaier, *Corporate control in Europe*, 2 CORPORATE OWNERSHIP AND CONTROL 65, 72-73 (2005). The number of Spanish companies resorting to statutory voting rights ceilings increased after the publication of the 2007 ISS report. However, at a European level, the most popular mechanisms for separating control from ownership are shares with differentiated voting power, pyramiding and crossholdings. *See* Morten Bennedsen & Kasper Meisner Nielsen, *The impact of a break-through rule on European firms*, 17 EUROPEAN JOURNAL OF LAW AND ECONOMICS 259-283 (2004); Erik Berglöf & Mike Burkart, 18 *European takeover regulation*, ECONOMIC POLICY 171-213 (2003); Mara Faccio & Larry HP Lang, *The ultimate ownership of Western European corporations*, 65 JOURNAL OF FINANCIAL ECONOMICS 365-395 (2002).

[33] The popularity of voting caps was even higher in the past. Between 2014 and 2019, the Portuguese stock exchange lost companies such as BPI, BES, ZON and PT, all with statutory voting caps (ZON

A voting cap prohibits shareholders from voting above a certain threshold, irrespective of the number of voting shares they hold, and is typically expressed as a percentage of the voting rights.[34] If a shareholder is not allowed to vote above a certain threshold, this creates an incentive—but not a legal prohibition—to inhibit the acquisition of shares above that threshold.[35] If the shareholder buys more shares, doing so will increase the shareholder's economic interest, or cash-flow rights, but will not elevate the shareholder's capped voting power.

This statutory formulation mainly serves two purposes. First, it is an equalizer among shareholders that prevents dominant positions, which may be particularly relevant in cases where shareholders have differentiated acquisition powers and want to prevent the possibility of a controlling shareholder emerging.[36] Second, it works as an effective

eliminated its voting cap in 2012 and BPI eliminated its voting cap in 2016). *See* Jorge Brito Pereira, *Voting caps e OPA obrigatória*, *in* ESTUDOS EM HONRA DE JOÃO SOARES DA SILVA (2021).

[34] There are no legally mandated minimum or maximum values for such limits, and the existing voting caps vary between Pharol's 10% and Millennium's 30%. Voting caps are typically established below the mandatory takeover threshold (which is 33.33% in Portugal) and above a minimum blockholder shareholding (between 5% and 10%). The existing voting cap in Article 14 of EDP's bylaws is a typical formulation. In accordance with Article 14, number 3: 'votes cast by a shareholder, on its own account or on behalf of another shareholder, that exceed 25% of the votes corresponding to the share capital, shall not be taken into account'. In accordance with number 4 of the same Article, 'for the purpose of this Article, [votes] shall be treated as cast by the same shareholder the voting rights, whenever so considered under the terms of Article 20, paragraph 1 of the Securities Code, or any provision that modifies or replaces it, that are chargeable to them'. Article 20 of the Securities Code is the voting aggregation rule relevant for threshold disclosures and mandatory takeovers.

[35] A more complex alternative would be to stipulate the threshold as a percentage of the votes cast at each meeting. Its effects would also be more random and unstable since shareholders would be unaware of their effective voting power until the moment the votes were cast and because the effective voting power of each shareholder would vary from meeting to meeting, depending on which shareholders attended. Another alternative would be to stipulate the voting power of the shareholders progressively, with different thresholds depending on the percentage of shares. These are scaled voting rights provisions or clauses of *voto scaglionato*. This formula was very popular in Europe and the United States in the nineteenth century. *See* Eric Hilt, *When did ownership separate from control? Corporate governance in the early nineteenth century*, 68 THE JOURNAL OF ECONOMIC HISTORY 645-85 (2008); Siddharth Ranade, *Separation of Voting Rights from Cash-Flow Rights in Corporate Law: In Search of the Optimal*, WARWICK SCHOOL OF LAW (July 2013); Henry Hansmann & Mariana Pargendler, *Voting Restrictions in 19th Century Corporations: Investor Protection or Consumer Protection?*, Work. Pap.,YALE LAW SCH. (May 2010).

[36] The decision on whether to include a voting rights ceiling is an issue for the bylaws and thus lies in the hands of the shareholders. Nonetheless, this decision affects the dynamics of the relationship

anti-takeover formula, since an external shareholder will not be interested in launching a takeover and acquiring shares above the voting rights threshold unless the bylaws are revised before the acquisition, which may suffice to restrain opportunistic acquisition projects.

In practical terms, this makes the successful outcome of a takeover dependent on the supermajority required for revising the bylaws (which is 66.6% in most European jurisdictions, sometimes reaching as high as 75%). Put differently, if one-third of the voting shareholders represented at the shareholders meeting decide against revising the bylaws, they can veto a proposed takeover despite not controlling the absolute majority of the voting rights. It should be noted that under Portuguese law, as under most European laws, the supermajority required to approve an amendment resolution is calculated based on the number of votes cast in the meeting. Therefore, the two-thirds required to approve the resolution does not mean two-thirds of the existing voting shares but two-thirds of the voting shares of those in attendance at the meeting. More importantly, and for the same reason, the minority that can veto the resolution may hold less than one-third of the existing voting rights (for listed companies, shareholder attendance at meetings never reaches a figure close to 100%).

Nonetheless, voting caps do not make hostile takeovers impossible. It is always possible to revise the bylaws and revoke the voting cap before the acquisition[37] or to acquire more shares than the outstanding share capital. With a 10% voting cap, a shareholder owning 91% owns more than 50% of the voting rights because the outstanding shares amount to less than the shareholder's limited voting power. However, a voting cap clearly makes it more difficult for the bidder because the bidder will have to convince a larger group and will be subject to an effective opposition group of shareholders. Without a voting ceiling, a takeover's success typically hinges on the absolute majority of voting shareholders agreeing to it (and, if applicable, on outbidding competing offers). With a voting rights ceiling in place, the successful outcome of the takeover depends on convincing the required supermajority (usually two-thirds) of shareholders represented at the shareholders meeting. That is why the takeovers of target companies with statutory voting caps are always conditional on

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between shareholders and the board, and in certain cases, the proposal to include a voting rights ceiling may be induced by the board.

[37] The voting cap will apply in that case. There are a few exceptions to this rule, one of which is the rule of DL 20/2016. *See* Jorge Brito Pereira, *O Decreto-Lei nº 20/2016, de 20 de Abril*, *in* O NOVO DIREITO DOS VALORES MOBILIÁRIOS, Almedina (2017).

bylaw amendments to remove the voting limitation.[38] This affects not only the gains the bidder expects to collect from the takeover but also, and more importantly, the frequency of takeover activity.[39]

V. Mandatory all-shares takeover rule

Article 5.1 of the Takeover Directive[40] stipulates the following:

> [W] here a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4.

In accordance with Article 5.3, 'the percentage of voting rights which confers control for the purposes of paragraph 1 and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office'. In most EU Member States, the percentage of voting rights that confers control of the company under this article has been set at around 30%. In Portugal, in accordance with Article 187.1 of the Securities Code, the relevant threshold is one-third of the

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[38] This is what happened in the Sonae/PT takeover in 2006 (section 10 of the Preliminary Announcement), the BCP/BPI takeover in 2006 (number 10 of the Preliminary Announcement) and the CTG/EDP takeover in 2018 (number 13 of the Preliminary Announcement). The theoretical alternative would be to acquire the majority of voting shares and to keep limited decision-making power over corporate affairs. *See* Sergio Gilotta, *EU Takeover Law and the Powerful Anti-Takeover Force of Supermajority*, COLUM. J. EUR. L. Vol. 25, No. 3 (January 23, 2019).

[39] Elevating the success threshold from 50% + 1 to 66.6% (even if the percentages are calculated differently) inevitably makes life harder for the takeover bidder. *See* John Pound, *The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence*, 30 J. L. & ECON. 353 (1987).

[40] Directive 2004/25/EC of the European Parliament and of the Council of 21 april 2004 on takeover bids, EUR-Lex, (July 02, 2014), available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32004L0025.

voting rights: 'any entity with a listed company holding that exceeds, directly or in accordance with Article 20(1), one third or a half of the voting rights attributable to the share capital, takes on the obligation of launching a takeover bid for the totality of shares and other securities issued by the company that granted the right to their subscription or acquisition. '

The mandatory takeover rule (MTR) is probably the most important piece of harmonization in the Takeover Directive because there are two different yet coexisting regulatory systems. In some countries, such as the United States, the seller or sellers of the controlling stake receive the control premium in full, and the acquirer of control is free to decide whether to propose acquiring the other shareholders' shares (and, assuming they propose to acquire the other shareholders' shares, is free to decide under what terms and conditions the proposal is set).[41] This system is often designated as a market rule system or a private negotiation rule system. In other countries, such as the European countries where the Takeover Directive applies, the shareholder acquiring a controlling stake in a company must offer to purchase the shares of all other shareholders under the same terms and conditions. This system is designated as a sharing rule system.[42]

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[41] In the United States, the extension of the offer to all shareholders is not imposed by law. However, the bylaws may require that an equal and fair price is paid for each share in a merger. Although unusual, this is the so-called 'fair price amendment', which works as an anti-takeover measure. *See* Jesse A Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L. J. 291 (1984); Pound, The effects of antitakeover amendments on takeover activity: Some direct evidence, 30 THE JOURNAL OF LAW AND ECONOMICS, 353, 353–354 (1987); Brett W King, *Use of supermajority voting rules in corporate america: Majority rule, corporate legitimacy, and minority shareholder protection*, 21 DELAWARE JOURNAL OF CORPORATE LAW, 895, 931–40 (1996).

[42] The MTR system designed by the Directive was clearly inspired by the English framework after the 1970s. Even if this matter was discussed in the United States in the 1960s and 1970s, no similar understanding was ever adopted by federal legislation. *See* William D Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV., 505 (1965); Edmund Schuster, *Efficiency in private control sales – The case for mandatory bids*, LSE LEGAL STUDIES WORKING PAPER (2010); Paul Davies & Klaus Hopt, *Control transactions*, *in* THE ANATOMY OF CORPORATE LAW, Oxford UP, 256–60 (2004); John Armour & David A Skeel Jr, *Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation*, 95 GEORGETOWN LAW JOURNAL 1727 (2006). There is considerable geographical variation in the strictness of the MTR rule (even within European Members States subject to the Takeover Directive). While some countries apply a hard MTR, others (such as Brazil) have a lighter version, only sharing 80% of the controlling shareholder's price and only being applicable to transactions of transfer of control. *See* Paulo Eduardo Penna, ALIENAÇÃO DE CONTROLE DE COMPANHIA ABERTA, Editora Quartier Latin do Brasil, 32 (2012); Pedro Cordelli Alves, *A oferta pública de aquisição*

The existence of an MTR works to both protect the equal treatment of shareholders and give other shareholders an exit option when control is transferred, even when no control premium was paid and control was not transferred from a shareholder or group of shareholders but instead built by a series of acquisitions.[43] However, the European harmonization of takeover rules goes beyond these objectives by aiming to promote a more effective market of corporate control in Europe and stronger protection of minority shareholders. The underlying assumption is that takeovers lead to more restructuring,[44] which is good for the market. As stated in the 'Winter Report on Issues Related to Takeover Bids[45]':

> in the light of available economic evidence, the Group holds the view that the availability of a mechanism for takeover bids is basically beneficial. Takeovers are a means to create wealth by exploiting synergies and to discipline the management of listed companies with dispersed ownership, which in the long

obrigatória nos ordenamentos jurídicos brasileiros e português, DIREITO DAS SOCIEDADES EM REVISTA 201–04, Vol. XIV, (2015). The debate about the extension of the MTR—if the rule should be restricted to share acquisitions or generally to any control changes—is still alive in Europe. *See* Eddy Wymeersch, *A New look at the Debate about the Takeover Directive*, *in* FESTSCHRIFT FÜR PETER HOMMELHOFF, Verlag Dr. Otto Schmidt (2012).

[43] Equal treatment of shareholders and minority shareholders protection, in particular through the granting of an exit option (in the same terms and conditions of the controlling shareholder's exit) are the most important reasons for the MTR. But there are other reasons as well, such as the creation of a level playing fields in the stock exchange and the integration of European capital markets.

[44] In the 'Report of the High-Level Group of Company Law Experts on Issues Related to Takeover Bids', the most important instrument proposed for this purpose was the breakthrough rule. This would have allowed any offeror acquiring 75% (or more) of the shares to override, for the purposes of voting in a shareholders meeting, any provisions in the target company's bylaws and other constitutional documents deviating from the principle of one share, one vote. The proposal was controversial from the start, and Article 11 of the Directive ultimately adopted a watered-down version that depends on an 'opt-out' mechanism (implemented by most companies) and/or an 'opt-in' mechanism (implemented by almost no companies). *See* Maria Isabel Sáez Lacave, *Control Enhancing Mechanisms, Minority Control, and One-Share-One Rule (Blindajes, Control Minoritario y la Regla Una Acción-Un Voto)*, INDRET, (2011), available at: https://ssrn.com/abstract=1762792; Peter O Mülbert, *Make it or break it: the break-through rule as a break-through for the European takeover Directive?*, 13 ECGI-LAW WORKING PAPER 6–11 (2003). In any case, the goal of facilitating takeover activity becomes clear in light of the EC Treaty (particularly Articles 43, 2 and 3) and the declaration of the 2000 Lisbon Council.

[45] Jaap W Winter et al., *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union*, REFORMING COMPANY AND TAKEOVER LAW IN EUROPE, G. FERRARINI, KJ HOPT, J. WINTER, E. WYMEERSCH, EDS., ANNEX, 2, 825-924(2002).

term is in the best interests of all stakeholders, and society at large. These views also form the basis for the Directive.

At the same time, the harmonization is intended to protect the holders of securities, particularly those with minority holdings, when control of their companies has been acquired. This is achieved 'by obliging the person who has acquired control of a company to make an offer to all the holders of that company's securities for all of their holdings at an equitable price in accordance with a common definition'.

Evidently, the two most important objectives of the harmonization of takeover regulations conflict.[46] The stronger the minority shareholder protection is, the less effective the market for corporate control will be because the more 'equalitarian' the MTR is, the more discouraging the project will be for the bidder since they will be obliged to bid for all shares, and not only the targeted shares, at the highest pre-bid price.[47] In fact, in a market rule system, the control premium is agreed upon by the seller and the acquirer and is fully received by the seller of the relevant shares. In a sharing rule system, the control premium is divided among all the shareholders who are willing to sell their shares. Thus, a market rule system is more flexible and promotes the efficiency of the market for corporate control for both the control seller and the control buyer, whereas a sharing rule system makes the acquisition of control a more expensive and burdensome process by forcing the bidder to share the control premium among, and extend their offer to, all other shareholders.

[46] The most common explanation for this conflict is that the Takeover Directive's mechanics were designed assuming the paradigm of the dispersed ownership company. See Ronald J Gilson, *Controlling shareholders and corporate governance: Complicating the comparative taxonomy*, HARVARD LAW REVIEW, 1643-44, 1647-48 (2005).

[47] To the extent that shareholder protection increases the target shareholder's share of the takeover gains, it diminishes the bidder's private benefits, thereby resulting in a less active market for corporate control. On the contrary, less shareholder protection improves the bidder's profit prospects and thereby increases the likelihood that shareholders will collect a takeover premium. *See* Berglöf & Burkart, (insert article title here), (insert volume number) ECONOMIC POLICY, 181–183 (2003); Jesper Lau Hansen, *The Mandatory Bid Rule: Unnecessary, Unjustifiable and Inefficient*, NORDIC & EUROPEAN COMPANY LAW WORKING PAPER, 18-01, 16–17 (2018), available at: http://dx.doi.org/10.2139/ssrn.3112100; Christophe Clerc, Fabrice Demarigny, Mirzha de Manuel & Diego Valiante, A LEGAL AND ECONOMIC ASSESSMENT OF EUROPEAN TAKEOVER REGULATION, CEPS Paperbacks, 37, 52, 55, 88, 122, 154-55, 202, 224-25 (2012), available at: https://ssrn.com/abstract=2187837.

The underlying rationale of a sharing rule system and the MTR is that shareholders should be treated equally in case of a change of control, and thus the control premium, if existent, should be divided among all shareholders. This is also the rationale behind the rule of the UK Takeover Code that inspired the Takeover Directive. This means that in a sharing rule system, under normal circumstances, the premium proposed by the bidder to non-blockholders should provide the shareholders of the target company with compensation that is more generous than the expected net benefits from keeping the shares post takeover since the market price of the shares pre-takeover does not incorporate this shared premium.

The expectations of the inside blockholder are different, and the delta between the inside blockholder's acceptance price and that of the remaining shareholders will increase in keeping with the private benefits extracted (and the expectation of future extraction).[48] Mandatory bid rules, however, force the bidder to extend the same price to controlling, blockholder and minority shareholders, thus adding to the costs of acquiring the shares of the minority. If it is also necessary to convince the blockholder to tender its shares, the price may have to be increased too. One of two outcomes will normally occur: the blockholder will find the price acceptable but the cost of a control transfer will become too high since the bidder must pay the same premium on all shares, thus reducing takeover activity;[49] alternatively, the minority shareholders will find the price acceptable but not the blockholder, in which case the takeover's success will depend on the blockholder's power to oppose it. This power is particularly intense when that shareholder has a de facto veto right because of the supermajority required for a bylaw revision.

An alternative strategy would be for the prospective acquirer to aggregate a block that is larger than that of the incumbent blockholder but still below the MTR threshold (either 30% or 33.33% of the voting rights, in most jurisdictions) and smaller than, or in line with, the voting rights ceiling. However, this strategy is risky, and in most cases it would not be viable. First, it depends on the simultaneous acquisition of large blocks of shares because otherwise the disclosure thresholds will make it transparent, which will give the existing blockholder time to craft a defence strategy. Second, because having a voting caps rule in place (again perfectly exemplified by PT) means that the

[48] Michael C Jensen & William H Meckling, *Theory of the firm: Managerial behavior, agency costs, and ownership structure*, 3 ECONOMICS SOCIAL INSTITUTIONS 305-60 (1979).

[49] Marcel Kahan, *Sales of corporate control*, 9 J. L. ECON. & ORG. 368 (1993).

incumbent blockholder typically holds a voting position already in line with the statutory rule, the contesting shareholder can only match and never surpass the existing blockholder. Third, because the incumbent blockholder is always in a position that is stronger than the challenging blockholder, the latter will not typically be able to initiate a strategy that may have to be abandoned halfway.

Conclusion

This paper finds that there is a vicious circle between the extraction of private benefits of control, the 360º effects of statutory voting rights ceiling provisions and the existence of an MTR. Shareholders with larger stakes have more incentive to monitor managerial actions, and their interests are generally aligned with those of the other shareholders. However, their interests diverge once a blockholder uses its position to extract private benefits from the company (the smaller the blockholder position is, the more attractive it will be for the shareholder to create non-proportional distortions of the distribution of benefits).

The general existence of a positive correlation between the high extraction of private benefits of control and the efficiency of the market for corporate control seems logical. However, the long history of failed takeover attempts in recent decades points to the opposite being true in Portugal where blockholders are empowered by voting caps provisions and able to use these provisions as a defence against hostile takeovers. This is more relevant when the acceptance prices for the inside blockholder, and the remaining minority shareholders cease to be the same. This divergence is not relevant in cases where the remaining shares are dispersed and there are no inefficiencies of a different nature. In such cases, the price offered, and the premium paid to the minority shareholders will be enough to convince them to tender their shares, and the generalized acceptance of the offer will be enough to make it successful, even if opposed by the blockholder. However, the opposite occurs in cases where the inside blockholder has a de facto veto right and opposes a revision of the bylaws. In this case, the inside blockholder will not accept a price that does not compensate it for the loss of private benefits it expects to extract in the future, and under normal circumstances the bidder will not be able to offer that price, especially not to all shareholders.

After the lengthy approval process of the Takeover Directive, the MTR now seems to be comfortably embedded in the European system, and there are no signs pointing to a reopening of the debate or a revision of the rule. This paper's intention was not to argue whether the rule is necessary, justifiable or even fair.[50] The reality is that the MTR, especially the sharing of the control premium among all shareholders, has the unintended effect of protecting an incumbent blockholder empowered with a de facto right to veto a takeover. The higher the extracted private benefits are, the greater the blockholder's hostility against the takeover will be, leading it to challenge the parties' actions, coordinate with other shareholders, acquire more shares or acquire voting rights by any other means. Therein lies the supreme irony: as a rule intended to protect minority shareholders, the MTR works in favour of the blockholder extracting private benefits of control.[51]

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[50] Since the interesting debates that were held before the approval of the Directive, opinion on the MTR is almost unanimous nowadays, which is strange considering the impact of the rule. However, there are some exceptions. *See* Hansen, NORDIC & EUROPEAN COMPANY LAW WORKING PAPER, (2018), available at: http://dx.doi.org/10.2139/ssrn.3112100.

[51] There are alternative solutions close to the proposed breakthrough rule, such as enhancing the squeeze-out rights of a bidder that acquires the absolute majority of voting shares or suspending the supermajority requirements in the same circumstances. *See* Sergio Gilotta, *EU Takeover Law and the Powerful Anti-Takeover Force of Supermajority*, 26 COLUM. J. EUR. L. 1 (2019).

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