Research Paper

Which antitakeover defences are really efficient?

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Abstract

Launching a hostile takeover bid is a way for companies to pursue external growth opportunities after friendly talks have aborted or even before any kind of negotiations has been engaged. To protect themselves against such hostile offers, managers but also sometimes shareholders decide to implement defence strategies aiming at deterring corporate raiders from initiating tender offers on their company's capital. These defence measures can be either preventative or reactive, depending on whether they are implemented before or after the bid is launched. These defence tools can be financial, legal or political and respectively aim at making the firm unaffordable, at making a takeover difficult to implement in practice or at setting legal and political obstacles to hostile takeovers. The goal of this paper is to explore the various possible defence strategies through an analysis of existing literature and through the development of real life case studies, in order to get a sense of which strategies are the most efficient when it comes to fending off a hostile raider's offer and to defend the best interests of shareholders.

Acknowledgement

I would like to thank **Pascal Hervé** for inspiring the subject of this paper and for sharing his knowledge with me and **Patrick Legland** for guiding me through the process of writing this paper and for supervising my work.

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I. Introduction

A. *Background for hostile takeovers*

a. Rationale for hostile takeovers

When a potential buyer is willing to acquire a listed company, launching a public tender offer on the share capital of the target company is the only option available. It would indeed be particularly inefficient to buy control of the company directly in the market as this would have a dramatic price impact and would make the acquisition extremely costly. As a consequence of this mere fact, a tender offer should be considered as the best technique to acquire any listed company and should not be regarded automatically as an aggressive move from the potential buyer.

A takeover bid can be either friendly or hostile, depending on whether the potential buyer received the approval of the management and/or the board of directors of the targeted company. However, in either case, a tender process is always a good opportunity for current shareholders to challenge the incumbent management and to get a good valuation out of their shares. Takeover bids should thus not always be considered as aggressive moves, but should be called “hostile” if and only if they occur without the prior consent of the target’s incumbent management.

A potential buyer can decide to go hostile for two main reasons:

- First, a hostile takeover bid can be launched after initial negotiations with the management have failed to reach an agreement between the two parties. Indeed, there is often an issue of information asymmetry between the buyer and the target company. Managers have access to private information that allows them to judge whether an offer is adequate relatively to the perspectives of the company. It is the role of the management to reject any inadequate offer that would not create value for shareholders: this is their fiduciary duty. In addition to this first phenomenon, there might also be an “agency cost” issue, meaning that managers might be willing to reject any tender offer in order to retain their job position and the benefits that go along with it, regardless of their fiduciary duty to shareholders.
- Second, a hostile takeover bid can be launched prior to any negotiation with the management and/or the board of directors of the target. This can be a strategy aiming at avoiding lengthy negotiations with the incumbent management about the offer price and the terms of the buy-out. For example, it can be a way to set up a completely new management team instead of having to include some incumbent managers in the negotiations. It can also be a way to surprise the existing management and to launch the tender offer before the target’s management can implement any additional takeover defence mechanism.

Let’s now see which companies have a suitable profile for a takeover bid.

b. Profile of targeted companies

From a legal standpoint, any listed company can potentially become the target of a hostile takeover. However, most hostile takeover targets share some common characteristics that make them more attractive than other companies. Takeover bids are risky in a sense that the final outcome of the process is unknown, even when the terms of the offer have been negotiated with the incumbent management. Each shareholder has indeed the power to tender its shares to the offer or not, and can thus influence largely on the ability of the buyer to reach the contemplated share ownership. In this context, corporate raiders must have strong incentives to acquire the company to overcome the riskiness of the process.

As in any common acquisition, potential buyers are reasoning in terms of value creation at the level of the shareholders of the acquiring firm. Three main value creation drivers are looked upon when it comes to launching a takeover bid on a listed company:

- The target company must have an excellent strategic fit with the potential buyer. This strategic fit represents the most important incentive to gain control over the target, in an attempt to realise additional top line growth thanks to a business combination. This strategic fit is also what will generate future cost synergies within the combined entity, synergies that in turn justify paying a control premium for the target, premium without which it would not be possible to delist the company if it is correctly valued by the market on a standalone basis.
- The second most important characteristic of a hostile takeover target is a mild financial performance in terms of returns to shareholders. Indeed, a potential buyer would have no incentive to pay a premium for a target if it thinks that the target is perfectly well managed and that there is no room for improvement. As a consequence of this, a company with a high ROE (return on equity) would not be a suitable candidate for a takeover, as the buyer would not be able to extract additional value from the firm by better managing it. Thus, an important characteristic of hostile takeover targets is a mild financial performance, which often goes hand in hand with a low perceived quality of incumbent management team.
- Another characteristic shared by takeover targets is poor market performance. A potential buyer will indeed have a stronger incentive to buy a target if it is currently undervalued by the market. However, this undervaluation is not regarded in itself as a value creation driver as the value adjustment is more often than not included in the offer price finally agreed upon.

In addition to these three main value creation drivers, takeover targets also tend to have low to negative net debt on their balance sheet. Indeed, low to negative indebtedness allows managers to run the company not so efficiently and to accept low return projects, which results in poor financial performance. In addition to this, this type of company gives headroom to the acquirer by allowing it to take on additional debt for other projects or to adjust the capital structure of the new entity without being constrained by existing debt.

B. Most common processes of hostile takeovers

a. Bear hug

In the context of hostile takeovers, the bear hug strategy refers to a situation in which corporate raiders give formal notice to the target of their willingness to launch a tender offer on its capital. Usually, raiders prefer not to disclose their intention before the actual launch of a tender offer, in order to prevent the target's management from implementing takeover defence strategies that would hinder the raider's ability to obtain the control of the target.

However, in some particular cases, it happens that raiders have a strong belief that their offer will get support from the target's shareholders. In such circumstances, making the terms of the offer public will put pressure on managers. Indeed, management has a legal duty to act in the best interest of shareholders. As a consequence, if it is made public that a potential buyer is offering a much higher price than the current valuation of the company, the management will be forced to consider this offer and will have difficulty in implementing takeover defences as it would obviously not be in the best interest of the shareholders.

Bear hug schemes thus tend to arise when there is reasonable anticipations that the management will be reluctant to envisage a sale process while in the same time shareholders are anticipated to be supportive of the contemplated tender offer. The bear hug strategy is in those particular cases a good way to force the management to acknowledge the potential tender offer as a good opportunity for the company.

b. Tender offer

The potential buyer of the target can also launch an official tender offer without giving prior notice to the target's management or board of directors. The offer is in this case directly aimed at current shareholders, that will appreciate independently whether the offer price is sufficient for them to abandon their stake in the company or not.

The tender bid has to offer a given price for each share of the company's capital and must also stipulate a time limit after which the offer will expire. The potential buyer can offer cash or shares or a mix of both cash and shares to the shareholders of the targeted company. However, it is compulsory to tender for 100% of the share capital in most jurisdictions. Nevertheless, if the tender offer was not legally compulsory, for example in the case of the potential buyer exceeding the 30% threshold in the share capital, then it is legally possible to set up a minimum threshold under which the tender offer will not be validated. This threshold can in most jurisdictions go up to two thirds of the share capital, which means that the buyer will actually acquire the tendered shares if and only if at least two thirds of the share capital has been tendered to the offer.

Launching a tender offer without getting the prior consent of the management and/or the board of directors is a way for hostile corporate raiders to bypass the management of the target and to reach directly shareholders.

c. Proxy fight

A tender offer can be made more difficult through all the takeover defence mechanisms implemented by the management within the targeted firm. It is thus often useful for the potential acquirer to have a toehold in the company in order to influence the management.

In modern corporate structures, shareholders indeed elect the directors, who then choose the managers. The designated managers have then the power to set up antitakeover defences that will prevent raiders from gaining control of the company and that will allow managers to retain their position in the firm. As a consequence of this organisation, corporate raiders have interest in acquiring a stake in the target, which will enable them to use their voting rights to change the board of directors and eventually choose managers that will be in favour of the contemplated tender offer, thus turning a hostile offer into a friendly one. In the case where the potential buyer does not have the majority of voting rights, having a toehold in the company can also help the buyer convince other shareholders that a buy-out is a good opportunity, thus facilitating a change in management. As a consequence of this, holding a stake in the target company is always a good way for corporate raiders to facilitate a tender offer by cancelling antitakeover defence mechanisms and by controlling the firm's communication around the offer.

C. Stakeholders willing to prevent takeovers

a. Managers

From a legal standpoint, managers have a fiduciary duty towards shareholders, meaning that they should always make decisions in the best interest of the shareholders, which have mandated them to run the business on a daily basis. In the context of a potential takeover, managers should thus benefit from the asymmetry of information in order to assess the adequacy of offers that are presented to the company. This means that managers should implement an adequate level of defence in order to be effectively able to reject inadequate offers that do not create value for shareholders. But it also means that they should be in a good position to accept offers that represent good opportunities for current shareholders.

However, there is often a mismatch between the interests of managers and shareholders. This mismatch is known as "agency cost" and refers to the tendency of managers to act in their own interest regardless of their fiduciary duty. Indeed, managers often have a strong incentive to protect themselves against their own poor performance by implementing antitakeover defences, for their job position often means high compensation, social status, perks, power and network. Managers thus have a strong incentive to set up a high level of defence that will allow them to reject any tender offer, be it adequate or not.

b. Block of shareholders

It can also be in the interest of a block of shareholders to avoid a takeover. Indeed, a block of shareholders can de facto control a company by owning the largest stake whereas the major

part of the capital is held by dispersed shareholders. In this case, the block of shareholders may not have a majority stake in the company but is still the main decision-maker.

Two main scenarios can be envisaged in which a block of shareholders will want to avoid a takeover bid to be launched:

- First, family shareholders that have founded the business and have later publicly listed the company for financing purposes will want to keep control of the business even if they no longer hold the majority of the shares. Indeed, they might still control the company with a limited share ownership because the remainder of the share capital is owned by a dispersed shareholder base. In this context, even if they do not tender their shares to the offer, they might still lose control of the company.
- Second, a group can buy a significant stake in a subsidiary without having the required financial resources to buy a majority stake. If the shareholder base is quite dispersed, the group will be in a position where it can largely influence the strategy of the subsidiary, even if it does not consolidate it in full. In this particular case also, it will be in the interest of this shareholder to avoid any takeover that would leave it with a minority stake not granting it a sufficient influence on the target to orientate its strategy in the group's interest.

In addition to this, employees can also gather a significant ownership stake in their company through employee participation plans. This kind of shareholder groups also has a strong incentive in fending off hostile offers from corporate raiders, as such transactions often bring about redundancies and cost-cutting plans, which are obviously not in the best interest of employees in general. Double voting rights granted to shares that have been held for more than two years are also a way to strengthen the ability of employees to vote against a takeover and to compensate for the relatively small amount of capital they hold.

c. Political leaders

The third category of stakeholders that might be willing to oppose a takeover is political leaders. In times of international competition and sluggish economic environment, national political leaders often see foreign corporate raiders as a threat to national flagships. They often consider legal defences against takeovers as a good way to avoid losing national champions, but also as a means to fight against relocation of jobs and assets abroad. It is also a matter of public opinion for politicians to be able to retain attractive assets within the country, even if it is often considered as a concealed form of protectionism.

A good example of this hostility of political leaders towards international takeovers is the set of anti-takeover measures discussed in France in 2006 and supported by the then Prime Minister Dominique de Villepin. These measures were aimed at defending the national champions against takeovers, for example by developing employee shareholding. These measures reflected the willingness of some countries to set up a legal framework allowing them to better control tender offers on their national gems.

II. Anti-takeover Defence Mechanisms: Literature Review

Before starting detailing the different antitakeover defence mechanisms that exist and have been used across corporate history, we would like to elaborate on the classification we use in this section. Indeed, we decided to split the antitakeover defence techniques into the three following categories:

- Financial defences, that aim at making a takeover unaffordable or uninteresting for the buyer, by increasing the price or by modifying the structure of the assets
- Legal defences, that aim at using both legal and statutory tools in order to make a takeover difficult to implement in practice
- Political defences, that aim at setting up both a legal framework and political barriers to international hostile takeover attempts

In addition to this first classification, we decided to subdivide each category into two subcategories:

- Pre-offer defence techniques, that are preventative defence mechanisms implemented before any takeover rumour and whose role is to deter potential raiders from launching an actual tender offer on the share capital of the company
- Post-offer defence techniques, that are active defence mechanisms implemented after a tender offer was launched on the capital of the company and whose role is to make the takeover process fail before shareholders tender their shares to the offer

A. *Financial defences: Making a takeover uninteresting or unaffordable for raiders*

a. *Pre-offer*

i. *Good financial performance*

We would like to start by emphasizing a simple but powerful fact: the best way to prevent a takeover is to avoid being a suitable takeover target. In other words, before even starting implementing complicated takeover defence techniques whose efficiency can sometimes be questioned, a company’s best defence against a takeover attempt is to avoid looking like a suitable takeover target in the eyes of corporate raiders.

As was explained in the introduction of this paper, one of the main characteristics of takeover targets is a low or mild financial performance. As a consequence of this, the best defence against a takeover is to keep an excellent track record over the long run, so that corporate raiders would not be able to extract additional value from the company, as it is already perfectly well managed internally and perfectly well priced by the market. In such circumstances, a takeover will not be able to deliver value creation for the shareholders of the buyer, except if an abnormally high level of synergies within the contemplated integrated entity can justify paying a premium for a company that has little to no headroom for operational improvement.

Franck Riboud, CEO of the French dairy multinational company Danone, explained his point of view on this subject in an interview given to Le Figaro in 2006: *"It is not my role as an entrepreneur to lock up Danone's capital. I don't believe in shareholders' agreement, core shareholders and poison pills. These are often delusional protections. We have recently seen that there is no real protection for capital when someone offers your shareholders a disproportionate premium to buy their shares. However, I would not recommend my board of directors to approve a takeover. I continuously explain this: good results over the long run are the best protection against shareholders. But this is not enough. What makes the strength and the success of Danone is its corporate culture, the quality of its people and the work methods they have created. No one would have anything to gain if they dilute this culture in a bigger group. If you dilute it, you break its growth model."*[1]

As a consequence, the best antitakeover defence for any company is to keep a high ROE over the long run. A high ROE makes current shareholders reluctant to tender their shares to an offer, as their shares give them better perspectives of return than the premium paid by the potential buyer. A high ROE also deters corporate raiders from launching a takeover, as they will have to pay too high a price to buy control of the company. However, it has to be noted that a high ROE plays the role of a powerful deterrent if and only if it is based on a high ROCE, which is the result of excellent operational performance, and on a moderate leverage, which increases the ROE without threatening the future perspectives of the firm.

ii. Poison pills

Poison pills have been invented in 1982 by Martin Lipton, the well-known takeover lawyer, in an attempt to protect El Paso Electric against General American Oil. Since their invention, poison pills have evolved a lot to make them easier to implement for the potential target and also more efficient in deterring raiders from launching hostile offers.

In "Mergers, Acquisitions and Corporate Restructurings", Patrick A. Gaughan defines poison pills as "*securities issued by a potential target to make the firm less valuable in the eyes of a hostile bidder*"[2]. Since 1982, the financial engineering around this type of securities has evolved a lot in order to integrate more comprehensive situations in which they effectively protect the capital of a company. As a consequence of this evolution, we can distinguish five versions of poison pills, having each their advantages and their shortcomings:

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[1] Originally in French: "*Depuis un an, qu'avez-vous fait pour protéger votre capital contre un raid hostile? En dehors du fait que ce n'est pas si simple à mettre en place, ce n'est pas mon rôle d'entrepreneur de verrouiller le capital de Danone. Je ne crois pas au pacte d'actionnaires, au noyau dur et aux pilules empoisonnées. Ce sont souvent des protections illusoires. On a vu récemment qu'il n'y a pas de protection capitalistique valable quand on propose à vos actionnaires une prime disproportionnée pour leur acheter leurs actions. En revanche, je ne recommanderai pas à mon conseil d'administration d'approuver une OPA. Je ne cesse de l'expliquer, des bons résultats dans la durée sont la meilleure protection vis-à-vis des actionnaires. Mais ce n'est pas suffisant. Ce qui fait la force et la réussite de Danone, c'est sa culture, la qualité de ses équipes et les modes de travail et de relations qu'elles ont créés. Personne n'aurait rien à gagner à diluer cette culture dans un grand groupe. Si on la dilue, on casse le modèle de croissance.*" Franck Riboud, interview with Le Figaro, 03/08/2006

[2] Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructurings*, fourth edition, p173

- Preferred Stock Plan: This first-generation poison pill consists in granting a dividend of preferred shares to all current shareholders of the potential target. These preferred shares are then convertible into shares of the bidder if the bidder manages to take over the target company. This first-generation poison pill is quite effective because it brings about a serious dilution for existing shareholders of the bidding company. However, this pill has a few shortcomings. Indeed, it cannot be redeemed before a long period of time, often more than ten years, and has a negative impact on the balance sheet of the target, as preferred shares are considered by analysts as financial debt and increase the leverage and the associated risk of the target.
- Flip-over Rights: This second-generation poison pill was designed to overcome the shortcomings of the preferred stock plan. This time, poison pills came in the form of rights offerings distributed to all shareholders as a dividend. These rights entitle their owner to buy shares of the bidding company at a low price compared to their market value. They act as a kind of call option on the bidder's capital. These rights are activated after a triggering event, for example the launch of a tender offer on more than 30% of the shares, and are exercisable once the bidder has effectively bought 100% of the target. This poison pill has thus a serious dilution impact for the shareholders of the bidder, but only if the bidder actually buys 100% of the shares. As a consequence, this protection is not effective if the bidding company acquires a controlling stake without buying out 100 percent of the outstanding capital.
- Flip-in Poison Pills: This third-generation poison pill was one more time designed to overcome the drawbacks of the previous one. In this poison pill plan, the rights given to the target's shareholders entitle them to buy new shares of the target at a low price, potentially down to the nominal value of the shares. The effect of this poison pill is to dilute the capital of the target regardless of the percentage stake acquired by the bidder. This makes the acquisition of a controlling stake particularly expensive for the corporate raider.
- Back-end Plans: This plan was initially designed against two-tiered offers. They give shareholders a rights dividend that can be exchanged along with one share of capital against cash or a senior security equal in price to a back-end price, set up by the board of directors above market price. These rights are exercisable after the bidder acquired a stipulated percentage stake in the targeted company and serve as a minimum price to buy back minority shareholders. However, as two-tiered offers tend to become uncommon, this poison pill is no longer commonly used by potential targets of a takeover.
- Voting Plans: This poison pill gives a dividend of preferred shares to all the shareholders of the target company. In case a bidder acquires a substantial percentage stake in the company, the holders of the preferred shares get super voting rights that make it impossible for the bidder to obtain the voting majority in the company. However, this plan is not commonly used as its legality has been questioned in court.

Nowadays, the two most commonly used poison pills are the flip-in and flip-over plans. With the consent of the board, but not necessarily of the shareholders, these pills are issued and allow the potential target to distribute to its shareholders a dividend of one right per share. After a first triggering event such as the announcement of a tender offer on a given stake of the target, the rights detach from the shares and become exercisable, but at too high an exercise price to be actually exercised by shareholders. After a second triggering event such as the closing on the purchase of shares by the bidder, rights become exercisable at a much lower exercise price, are thus exercised by shareholders and have their expected dilution effect either on the target or on the merged entity.

One interesting feature of these flip-in and flip-over rights is that they are redeemable after the first triggering event at a very low nominal price, which enables the target company to cancel the protection if an offer is considered adequate and interesting for shareholders. However, this feature can be used by raiders to cancel the pill once they have acquired significant voting rights. To avoid this, some companies have implemented dead-hand provisions, stipulating that only directors that were at the board when the pill was adopted or that have been appointed by the latter have the right to redeem the pill. Slow hand provisions limit the time period during which only prior directors can redeem the pill. No hand provisions limit the time frame during which the pill can be redeemed. Nevertheless, the legality of such mechanisms can be questioned in some states or countries, limiting their effectiveness.

Some researchers have investigated to determine whether these protections are really efficient in preventing takeovers or in increasing premiums paid by corporate raiders. Two studies by Georgeson and Company showed that pill-protected companies received higher premiums than non-protected companies: their first study released in 1988 showed a 69% higher premium on average for pill-protected company and their second study released in 1997 showed a 26% higher premium on average for deals between 1992 and 1996[3]. Academic studies have come to the same conclusion that poison pills bring about higher premiums, for example Comment and Schwert in "Poison or Placebo: Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures"[4].

However, the legality of poison pills and its impact on shareholders' wealth is sharply debated. Indeed, in many jurisdictions, shareholders holding the same class of shares should be treated the same way, which questions the legality of poison pills. More importantly, poison pills are said to foster "management entrenchment" which relates to the tendency of management to deter takeover attempts in order to keep their job position and the benefits that go along with it. In doing so, they reduce the wealth of shareholders, who see their shares rerated downward by the market following the adoption of such defensive measures.

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[3] Georgeson&Co, *Poison Pill and Shareholder Value 1992-1996*, Nov-1997

[4] Robert Comment and William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, Journal of Financial Economics, 39, Sep-1995

Many advocate the right of shareholders to be offered a premium for their stake and to change control of the company if they believe it is in their best interest. Poison pills are thus often regarded as a violation of the fiduciary responsibility of managers.[5] This is the reason why funds dedicated to maintaining high level of corporate governance standards (ISR and ESG norms in France for example) consistently vote against dispositions aiming at setting up this kind of antitakeover defences, considered as management entrenchment tools.

iii. Fair price mechanisms

Fair price mechanisms are corporate charter amendments that are activated when a bidder launches a tender offer on the target. This mechanism stipulates that the bidder has to offer a minimum fair price to minority shareholders of the targeted company. This minimum price can be defined either as a P/E multiple or as a stated price. In the first case, the P/E multiple can correspond to the historical P/E of the firm or to a blend between the latter and the industry average P/E ratio. In the second case, the minimum stated price usually corresponds to the maximum price paid by the bidder to acquire its stake.

In most countries, corporate laws already include fair price provisions for minority shareholders in the event of a takeover. In these countries, corporate charter amendments aim at consolidating and reinforcing the state's corporate law by setting up a higher minimum fair price to be paid to minority shareholders.

It has to be noted that fair price mechanisms are useful in the context of two-tiered offers. Indeed, the fact that minority shareholders have the right to receive a minimum fair price for their shares even if they do not tender their shares to the first tier of the offer relieves them from the pressure inherent to two-tiered offers. Fair price provisions thus mitigate the efficiency of two-tiered offers.

However, as previously stated, two-tiered offers are becoming quite rare, which mitigates the effect of this protection on shareholders' wealth. Indeed, Jarrell and Poulsen reported a small negative change in share prices after the implementation of such a protection scheme. This small negative change of -0.65% was however not statistically significant and they could therefore not conclude on a relationship between stock prices and fair price amendments.[6]

iv. Golden parachutes

Golden parachutes are defined as compensation agreements between the firm and its top managers. In the case of a change in control within the company, if the top manager leaves the company voluntarily or involuntarily within one year after the change in control, then he

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[5] D. L. Sunder, *The Controversial Poison Pill Takeover Defense: How valid are the Arguments in Support of it?*, NMIMS Management Review, Jan-2014

[6] Gregg A. Jarrell and Annette B. Poulsen, *Shark Repellents and Stock Prices: The Effects of Antitakeover Amendments Since 1980*, Journal of Financial Economics, 19(I), Sep-1987

or she is entitled to receive a lump-sum compensation usually corresponding to a multiple of his or her salary, incentives and bonuses, for a pre-stated number of years.

Golden parachutes, though they are not per se antitakeover defence measures, can have some antitakeover effects on potential takeover targets. Indeed, having to pay a disproportionate compensation to former managers can be a deterrent for corporate raiders and can make the target company less desirable. However, we have to keep in mind that this compensation package is often negligible compared to the price paid to gain control of the company. Golden parachutes are thus only a mild deterrent for potential bidders, and are efficient only if they are used along with other antitakeover protection schemes.

Nevertheless, research has proved that golden parachutes have a significant impact on premiums paid by bidding companies. Indeed, golden parachutes reduce the conflict of interest that arises between shareholders and managers when a takeover offer is launched. Managers have an incentive to stay with the company and fight alongside shareholders in order to get a higher premium, because they know their position is protected by the golden parachute. As a consequence of this, by reducing the tendency towards “management entrenchment”, golden parachutes help shareholders get a better valuation for their shares.[7] To support this statement, we can cite the study that was conducted on a sample of 146 firms that adopted golden parachutes between 1975 and 1988. This study showed a positive correlation between the amount of the golden parachute and the takeover premium offered to the shareholders of the target. It also showed that companies that had adopted golden parachutes received significantly more takeover offers than other firms.[8] However, the post-crisis debate about excessive compensation packages paid to managers, and in particular to inefficient ones, sets a limit to the use of such a defence device.

b. *Post-offer*

i. *Targeted repurchases & standstill agreement*

Targeted share repurchases, also known as “greenmail”, happen when a potential bidder has acquired a significant percentage ownership in the target and might be willing to benefit from its toehold to launch a takeover bid on the remaining capital of the target. In this kind of situations, the “greenmail” technique consists in offering the potential bidder to buy back his or her shares at a premium compared to their market value in exchange of an agreement that the bidder will not be able to launch a tender offer on the target for a pre-specified period of time. This agreement is called a “standstill agreement” and can cover periods of time of more than 5 years.

This reactive antitakeover protection is effective against bidders seeking for short-term profits. For example, in the early eighties, Hammermill Paper Corporation is reported to have

[7] Michael Jensen, *Takeovers : Causes and Consequences*, in Patrick A. Gaughan, ed. Readings in Mergers and Acquisitions (Oxford: Basil Blackwell, 1994), p15-43

[8] Judith Machlin, Hyuk Choe and James Miles, *The Effects of Golden Parachutes on Takeover Activity*, Journal of Law and Economics, 7, 1985, p179-203

paid 36 dollars for each shares of Carl Icahn, valued at 25 dollars by the market, against his ceasing to demand the liquidation of the company for its liquidation value was higher than its market value. Carl Icahn is said to have made a 9 million dollars profit out of a 20 million dollars investment.[9] This technique is therefore efficient to fend off short-term profit oriented raiders. However, it would not repel bidders looking to gain control of the target in order to generate synergies within an integrated group.

Furthermore, according to a study conducted by Dann and DeAngelo between 1977 and 1980, standstill agreements and negotiated share repurchases are correlated with negative returns for non-participating shareholders. This study thus shows that greenmail and standstill agreements favour "management entrenchment" and are not in the best interest of existing shareholders of the target.[10]

ii. Just say no & fairness opinion

In the "just say no" defence, the target management simply refuses the takeover bid and communicates to the bidder its willingness to keep activated all its poison pills and other antitakeover defence mechanisms already implemented. In this way, the target makes it clear to the bidder that it is ready to use all the defence protections available to turn down the tender offer. Managers simply reject the offer and take no other action against the bidder.

When using the "just say no defence", the management's best argument is to state that they currently have a long-term business plan for the company that should yield higher profits and benefits for the target than the premium offered by the potential acquirer. To support this statement, a current method is to appoint an independent financial adviser to carry out a "fairness opinion". This fairness opinion's role is to evaluate the business perspectives of the target in order to assess the adequacy of the premium offered by the potential acquirer. In most cases, managers rely on these supposed-to-be independent reports to support the idea that they reject the offer because it is inadequate compared to the growth prospects of the target on a standalone basis.

However, this technique has its own limitations, as managers will not always be able to argue that the offer is inadequate if the potential bidder decides to raise its offered premium. Indeed, at some point, the fairness opinion will be forced to recognize that the bidder offers an adequate price compared to the business plan of the target. In this case, managers will have more difficulty to "just say no" and keep poison pills activated, for this behaviour would not be consistent with the fiduciary duty of managers.[11]

iii. Capital restructuring

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[9] Jeff Madrick, *Taking America* (New York: Bantam, 1987), p242-243

[10] Larry D. Dann and Harry DeAngelo, *Standstill Agreements and Privately Negotiated Stock Repurchases and the Market for Corporate Control*, Journal of Financial Economics, Apr-1983, p275-300

[11] Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructurings*, fourth edition, p230-231

In order to become less attractive for the bidding company, a target can decide to restructure its capital. This is a rather drastic reactive measure that can be used in four ways:

- Dividend recapitalisation: The target can decide to pay an extraordinary dividend to its shareholders. This dividend is often financed through debt, so that this dividend recapitalisation has a major impact on the financial leverage of the target. Leveraged recapitalisations are often conducted along with a capital restructuring after which current shareholders receive a stock certificate called a stub. This certificate corresponds to their ownership in the new capital. According to two studies, total debt to total capitalisation ratios rise from 20% to 70% after such dividend recapitalisations[12], thus making the target less attractive for the bidding company. This strategy has also two major advantages. First, managers often end up with a larger voting control of the company following the issuance of stubs. And second, shareholders receive a high value for their shares thanks to the extraordinary dividend, which makes the tender offer uninteresting.
- Increase in financial debt: The target can also increase dramatically its leverage without using a dividend recapitalisation, either by issuing bonds or by taking on more bank debt. Indeed, a firm with low debt is attractive for raiders as the bidding company will be able to use the target's debt capacity to finance the acquisition or to tackle further projects. By issuing more debt, the target thus becomes less attractive. However, managers have to keep in mind the risk of bankruptcy that goes along with debt, and should not replace a risk of takeover by an even higher risk of going under.
- Issuance of more shares: Alternatively, the target can decide to increase its equity while keeping a stable debt level. Increasing the number of outstanding shares makes it more difficult and also more costly for the bidder to acquire control of the target. Indeed, if new shares are issued each time the acquirer comes close to owning a majority stake, the bidder will have to buy new shares to cross the majority threshold, which makes the process longer and more expensive. However, this technique cannot be used too extensively as it dilutes the target's equity and tends to have a negative impact on stock prices. Nevertheless, if managers want to implement this strategy, they can issue more shares via a general issue, or via a white squire scheme, thus granting new shares only to a friendly shareholder that has no intention to bring its shares to the corporate raider, or via an ESOP (employee stock option plan) thus granting shares to a stable employee shareholder base.
- Share buy-back: A share buy-back program can also be implemented via three main mechanisms. Either a general non targeted share repurchase program that buys back a certain number of shares regardless of who is currently holding them. Or a targeted share repurchase program that aims at buying back the shares of shareholders that may want to sell their shares to a potential hostile bidder. Or a self-tender offer in

[12] Atul Gupta and Leonard Rosenthal, *Ownership Structure, Leverage and Firm Value: The Case of Leveraged Recapitalizations*, Financial Management, 20, Autumn 1991, p69-83; and Punett Handa and A. R. Radhakrishnan, *An Empirical Investigation of Leveraged Recapitalizations With Case Payout as a Takeover Defense,* Financial Management, 20, Autumn 1991, p38-68

which the target launches a tender offer on its own shares. The main advantage of this strategy is that the shares that have been bought back are no longer available for the corporate raiders to acquire, and no longer available for arbitrageurs to buy and sell to raiders at a profit. The second main advantage of this strategy is that share buy-back programs use up the company's resources, for example its cash reserves. As a consequence, these resources are no longer available for the bidder, which is a strong deterrent if the bidder was planning to use these resources to finance the acquisition of the target.

iv. White knight & white squire

When a target company is facing a hostile bid from a corporate raider, it can choose to defend its capital by finding a "white knight" willing to buy the target instead of the hostile bidder. The "white knight" company is a firm considered by the target as a more suitable buyer. This preference can arise because the "white knight" offers a higher premium to current shareholders than the initial bidder, or because it offers better terms for current employees, or because it promises not to disassemble the company for example. Needless to say, finding a "white knight" is not an easy task for managers. Negotiations with potential "white knights" thus often include selling some of the target's assets at a low price to the buyer against the retention of some of the target's managers. However, it has to be noted that such differential treatment between bidders can be ruled out by the court if the target company has obviously granted favourable conditions to one of the bidder without valid business motives.

A similar strategy involves finding a "white squire" that will purchase a large block of shares in the target company. The biggest advantage of this defence technique is that it preserves the independence of the target as the "white squire" does not seek to acquire control of the target. The friendly company acting as the "white squire" can act alongside the managers of the target thanks to their large part of voting rights. In addition to this, the fact that the "white squire" is not willing to sell its shares to a hostile bidder is also reassuring for the management of the target. In practice, managers issue convertible preferred shares to the "white squire", which is made possible by the earlier approval of a blank check preferred stock amendment of the company's charter. However, this issuance might still require shareholder approval in some jurisdictions. In order to accept to endorse the role of the "white squire", the acquiring company can be given incentives such as a low price for shares, the promise of a high dividend or a seat of the board of directors.

An interesting fact to be highlighted is that shareholding is usually more concentrated in continental Europe than in the UK or in the USA. Indeed, a study by Franks and Mayer[13] showed that 80% of the largest listed firms in France and Germany had a single shareholder owning more than 25% of the shares. They found the same level of concentration of shares

[13] J. Franks and C. Mayer, *Ownership and Control*, in H. Siebert, ed. *Trends in Business Organization: Do Participation and Cooperation Increase Competitiveness?*, Coronet Books, 1995

and voting rights in other continental Europe countries whereas the median level of concentration in the UK and in the USA is lower than 10%. This high concentration plays the role of natural “white squires” for companies incorporated in these countries.

“White knight” and “white squire” strategies can be completed by the three following protection measures:

- Lock-up transactions: transaction in which the target company sells its most valuable assets to a friendly third party in case a tender offer is launched. This method can also exist in the form of lock-up options that give a third party the possibility to buy the target’s most valuable assets in case of a change in control
- Break-up, termination or topping fees: agreement to compensate a bidder if the target is eventually taken over by another bidder than the initial one. This agreement can be a deterrent for other bidders as they are liabilities on the target’s side.
- No-shop provisions: agreement between the “white knight” and the target according to which the target cannot enter into negotiations with other bidders than the “white knight”. This provision can be used by the target to justify refusing to negotiate with hostile bidders.

v. Asset restructuring

Corporate asset restructuring is another drastic measure potential targets can use to either deter potential bidders from launching an offer or give them an incentive to withdraw their offer. Corporate restructuring can be used both as a preventative and active measure. However, managers will generally have difficulty in justifying a corporate restructuring whose only motive would be to prevent a hostile takeover. As a consequence, corporate restructuring are more often than not active measures taken as a reaction to the launch of a hostile bid. The four following schemes can be contemplated by managers:

- Take the company private in a LBO: This technique allows managers to retain their job position. However, this strategy can be implemented only if it generates a higher premium for shareholders than competing bids, which is even more important if the company is taken private by managing directors of the target itself.
- Sell valued assets: This technique basically corresponds to a lock-up transaction. It is highly controversial because managers take too much liberty with shareholders’ wealth when they decide to sell the most valuable assets of the firm. As a consequence, this strategy can be implemented and is legal only if assets are sold at a fair and reasonable value and if it does not result in a change in the firm’s value. In other words, the consideration received for assets should counterbalance the loss of the said assets, otherwise shareholders can sue managers.
- Acquire other companies: This defence method can have two goals. First, the target company can hope that, by buying assets in the scope of business of the bidder, the bid will be rejected by antitrust authorities. However, if the bidder indicates in its offer that it plans to sell off these divisions after the acquisition is completed,

antitrust authorities will most probably accept the deal. Second, the target can decide to buy a less profitable business or a business in a sector that is of no interest for the bidding company. In addition to this, if the target decides to take on additional debt to finance the acquisition, it will be less desirable for the bidding company, which might withdraw its offer.

- Liquidate the company: In sluggish market conditions, it can happen that the target has a higher liquidation value than the premium offered by the bidder to shareholders. In such circumstances, the target can decide to sell all its assets on the market, pay back its financial liabilities and pay an extra-dividend to shareholders with what is left. If this dividend is higher than the value offered by the bidder, then it might be more profitable for shareholders to simply liquidate the business.

B. Legal defences: Using legal and statutory tools to make a takeover difficult to implement

a. Pre-offer

i. Staggered board

In most jurisdictions, directors sitting at the board are elected by the shareholders of the company and serve one-year terms. This is the legal default rule in most countries. However, companies often decide to implement an alternative mechanism to elect their directors, known as a "staggered board". In a staggered or "classified" board, directors serve multi-year terms and only a fraction of the directors sit for election each year. In the most common scheme used, directors are elected to serve a three-year term and a third of the directors actually sit for election each year.

Thanks to this staggering of the directors' elections, it becomes harder for a potential acquirer to remove poison pills or other antitakeover defence tools implemented by the target company. Indeed, a staggered board theoretically forces the would-be acquirer to wait for at least two election rounds before it can actually access the "ballot box safety valve".[14] However, some staggered boards do not prevent new shareholders from taking control of the board and from removing poison pills or other antitakeover protections as expected in a staggered board scheme. For example, some corporations allow their shareholders to replace directors without cause, which allows new shareholders to elect friendly directors at the board instead of the uncooperative ones. Some other corporations also allow shareholders to "pack the board" by adding new directors to the incumbent ones, thus allowing for a quicker change as well.

In order to be an efficient antitakeover protection tool, a staggered board should not be possibly eliminated or circumvented by new shareholders. Such a board is called an "effective staggered board" or "ESB" and does not allow new shareholders to remove incumbent directors before the end of their terms nor to add new directors.

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[14] Jordan M. Barry and John William Hatfield, *Pills and Partisans: Understanding Takeover Defenses*, University of Pennsylvania Law Review, Feb-2012, p645

In a study released in 2002, Bebchuk and al concluded that it was possible to pursue an acquisition when the target had a staggered board, but that it was completely foreclosed when the target had implemented an effective staggered board mechanism. In this study, they were indeed incapable of finding a single occurrence in which a bidder managed to use the ballot box so as to gain control of the target when the said target had chosen to use an effective staggered board.[15]

ii. Super majority

Usually, corporate charters require a 50 percent majority of voting rights to approve important decisions for the firm such as mergers. Super majority provisions require a higher percentage of voting rights to approve such decisions, usually two thirds or 80 percent of voting rights, but in some extreme cases up to 95 percent. These super majority provisions can also be worded in a way that the percentage required to approve the merger is set higher if the bidder already has an important stake in the company. In addition to this, super majority provisions are often accompanied by lock-in provisions that stipulate that a super majority is needed to cancel the super majority provisions.[16]

This antitakeover technique is particularly efficient when the management and potentially a group of shareholders loyal to managers hold a large ownership in the target company. Indeed, if the management and its allies hold more than 20 percent of the firm's capital and the super majority is defined at a 80 percent threshold, then a hostile bidder will never be able to get its project of merger approved.

However, super majority provisions often include escape clauses that allow managers to bypass the super majority provision if the merger is approved by the board of directors or if the merger involves a subsidiary of the firm for example. Once again, these clauses have to be carefully worded in order to exclude interested parties from the vote. Indeed, in case of a project of merger with a company that already holds a stake in the target and appoints a few directors at the board, the directors related to the bidding company are not allowed to vote, which prevent raiders from circumventing the super majority provision.

The efficiency of super majority provisions was demonstrated in 1987 in a study by Pound.[17] This study examined two groups of 100 companies: a protected group and a non protected group. It showed that 38 percent of companies that has neither supermajority provision nor staggered board received takeover bids whereas only 28 percent of companies protected by super majority provisions and staggered boards received some. It has nevertheless to be noted that these measures are less efficient when the offer aims at 100 percent of the firm.

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[15] Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV., 2002, p887-904

[16] Richard Ruback, *An Overview of Takeover Defenses*, in Alan J. Auerbach, ed., *Mergers and Acquisitions* (Chicago: National Bureau of Economics Research, University of Chicago Press, 1987), p49-67

[17] John Pound, *The Effectiveness of Antitakeover Amendments on Takeover Activity*, Journal of Law and Economics, 30, Oct-1987, p353-367

iii. Dual class recapitalisation

A dual class recapitalisation is a mechanism that allows firms to concentrate the voting rights in the hands of shareholders that are supportive of the management's decisions. Typically, the firm issues a new class of stock with larger voting rights than normal stock, hoping for a concentration of this new stock in the hands of managers or people likely to support the management of the firm. This mechanism allows managers to concentrate voting rights and thus to control important decisions such as mergers or removal of antitakeover protections.

In practice, a new class of shares with super voting rights is issued and distributed to all shareholders. Shareholders then have the choice between exchanging this stock against normal stock and keeping this stock. They more often than not decide to exchange this stock because of its low liquidity on the market or because it pays lower dividends compared to normal stock. Usually, only managers and shareholders willing to support the incumbent management keep the super voting rights, which results in a concentration of voting power in the hands of managers, which is even greater if the management already held a large stake in the company before the implementation of such a mechanism.

It however has to be noted that the implementation of this mechanism requires shareholder approval. In "Mergers, Acquisitions and Corporate Restructurings", Patrick A. Gaughan explains what the incentives are for incumbent shareholders to accept the issuance of a new class of shares: "*If the end result of such recapitalisations is to concentrate voting power in the hands of a small group who usually are insiders, one may wonder, why would shareholders willingly agree to such equity structures? The answer is straightforward – shareholders seek the financial gain from the higher dividends and may not value control that highly.*"[18]

Some studies have shown a significant negative abnormal return for firms having recently implemented a dual class equity structure, in general or at least when initial shareholders lost control without receiving a compensation for this loss.[19] However, a study by Bacon, Cornett and Davidson concluded that the market reaction to dual class recapitalisations depended on the number of independent directors sitting at the board.[20] Indeed, they found that the market reaction to dual class recapitalisations was positive when the majority of directors sitting at the board were independent directors. This result shows that the market believes that when such a dual class recapitalisation mechanism is implemented by an independent board of directors, then this protection does not correspond to any kind of "management entrenchment" and is actually in the best interest of incumbent shareholders of the potential target.

[18] Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructurings*, fourth edition, p189
[19] Gregg Jarrell and Annette Poulsen, *Dual Class Recapitalizations as Antitakeover Mechanisms*, Journal of Financial Economics, 20, January/March 1988, p129-152; and C. M. Shum, W. N. Davidson III, and J. L. Glascock, *Voting Rights and the Market's Reaction to Dual Class Common Stock*, Financial Review, 32(2), p275-288
[20] Curtis J. Bacon, Marcia M. Cornett, and Wallace N. Davidson III, *The Board of Directors and Dual Class Recapitalizations*, Financial Management, 26(3), 1997, p5-22

iv. Legal structure of shareholding

The legal structure of shareholding can be a powerful tool to prevent raiders from obtaining control of the target company. Three main structures can be implemented in order to restrain the raiders' ability to acquire control of the company.

First, shareholders of the target company can create a shareholder association whose goal is to preserve the independence of the company. Shareholders that are members of this association agree to always vote in favour of the incumbent management and are also legally obliged to offer to sell their shares to other members of the association or to pre-specified players before they can sell them freely on the market. This kind of shareholder blocks is particularly efficient in preventing shares from falling in the hands of corporate raiders. However, from a legal standpoint, if a shareholder does not respect this statutory constraint, the company can only ask for compensation, but cannot force the execution of the clause, which is the biggest limit of this defence tool.[21]

Alternatively, the group of shareholders willing to prevent a takeover can contribute their shares to a non-listed holding company. Usually, family shareholders or controlling shareholders use this method to make the disposal of shares more difficult for individual shareholders of the group, thus preventing the said group from losing control of the firm. This structure can be further consolidated by clauses stipulating to whom and under which conditions the shares can be sold. This structure also allows family shareholders to control a large part of the shares of the company by using leverage at the holding company level, sometimes by using a chain of subordinated holding companies. It however has to be noted that such a structure is particularly efficient when the group holds the majority of shares.[22]

In addition to these measures, some jurisdictions have created legal structures allowing dissociating the owners of the company from its executive managers. For example, the French "Société en Commandite par Actions" is a legal structure that differentiates three stakeholders: the "commanditaires", i.e. shareholders owning listed shares of the company, receiving dividends but playing no role in the management of the firm, the "commandités", i.e. shareholders designated in the company's charter that own non-listed shares of the company, nominate and revoke the management and approve the accounts, and the "gérant" who cannot be a "commanditaire" and who manages the company.[23] Thanks to this structure, a raider can gain control of the listed shares, but this will not grant it any power regarding the management of the company, unless it takes time to completely block the company, by refusing to approve the accounts for example, thus resulting in the nomination of a new "gérant", which can take years. As a consequence, this legal structure is particularly efficient to repel short-term oriented raiders willing to profit from a dismantling of the firm.

[21] Olivier Arnoux de Maison Rouge, *Les Stratégies de Défense en Matière d'OPA*, DEA de Droit des Affaires 2000-2001, Université Clermont 1
[22] Ibid
[23] Laura Restelli-Brizard, *La Commandite par Actions, « une citadelle imprenable ? »,* AGEFI, 09/12/2010

b. *Post-offer*

i. *Litigation*

Litigation is a common way for a takeover target to save time while it implements other antitakeover defensive measures. Martin Lipton and Erica Steinberger listed four main reasons why a target should use litigation:[24]

- To opt for a more favourable court
- To prevent the bidder from suing first
- To save time in order to find a white knight
- To help the management keep its spirits high

The main reason why litigation is used as an antitakeover defence is to save time. If the target manages to get an injunction from the court requiring the bidder to stop accumulating shares until the charges are examined, the target will have additional time to defend itself. This additional time allows managers to implement other more effective antitakeover protections or to find a white knight or even to develop a full bidding process. This additional time also allows the bidder to revise its offer and potentially to offer a higher premium if it believes the target would drop the charges following a higher offer.

Common forms of litigation include the following:

- Antitrust: The target company can file a case claiming that the combined entity would raise competition issues at a national level or at a supranational level.
- Inadequate disclosure: The target company can also claim that the bidder failed to provide full and complete disclosure of its intentions thus resulting in the target company being unable to provide full and complete information to its stockholders.
- Fraud: The target company can try to sue the bidder for fraud. However this charge is more serious and difficult to prove in practice.[25]

Regarding the efficiency of litigation as an antitakeover defence, a study by Jarrell found interesting results. First, this study showed that 62 percent of targeted firms that used litigation received competing offers, whereas only 11 percent of targeted firms that did not use litigation received competing bids. Second, this study found that firms having used litigation received an additional 17 percent above the first offer they received when an auction process was launched following the use of litigation. However, when the bidder decided to withdraw its offer following the use of litigation, this resulted in big losses for shareholders, including the loss of the premium and the cost of litigation.[26]

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[24] Martin Lipton and Erica H. Steinberger, *Takeovers and Freeze outs* (New York: Law Journal Seminar Press, 1987),p 6-144

[25] Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructurings*, fourth edition, p227-228

[26] Gregg Jarrell, *Wealth Effects of Litigating by Targets: Do Interests Diverge in a Merger?*, Journal of Law and Economics, 28, April 1985, p151-177

C. Political defences: Setting up legal and political obstacles to hostile takeovers

Before starting this section, we would like to summarize the main rules applicable to takeovers in some of the main countries in the world. These rules largely influence the ability of corporate raiders to take control of their target and also influence their capacity to fully consolidate the target after the offer was successfully launched. It is thus important to understand how each country favours and deters takeover attempts by setting up a corresponding legal framework. Here are the major rules applicable to takeovers:

Country	Regulator	Threshold for mandatory bid	Minimum percentage mandatory bid must encompass	Bid conditions allowed ?	Bid validity after approval	Squeeze-out possible?
China	China Securities Regulatory Commission	30%	5%	Usual suspects [1]	30 days	No. Minority shareholders have the right to sell to the buyer after an offer giving him at least 75% of shares, at the offer price
France	AMF, Autorité des Marchés Financiers	30% of shares or voting rights, 2% p.a. between 30% and 50% of shares or voting rights	100% of shares and equity-linked securities	Usual suspects [1]. None if bid mandatory	25-35 trading days	Yes if >95% of voting rights and shares
Germany	BAFin, Budesanstalt für Finanzdienstleistungsaufsicht	30% of voting rights	100%	Usual suspects [1]. None if bid mandatory	4-10 weeks	Yes if >95% of shares
India	Security and Exchange Board of India	15% of shares or voting rights	20% at least	Minimum acceptance	20 days	No
Italy	CONSOB, Commissione Nazionale per le Società e la Borsa	30% of shares , 3% p.a. beyond 30% up to 50%	100% of voting shares	Usual suspects [1]	15-40 trading days	Yes if >95% of voting rights and shares
Netherlands	AFM, Actoriteit Financiele Markten	30% of voting rights	100% of shares and equity-linked securities	Minimum acceptance	>23 trading days and >30 if hostile	Yes if >95%
Spain	CNMV, Comision Nacional de los Mercados de Valores	30% and 50% or less if right to nominate more than half of the directors or any increase of 5% between 30% and 50%	100%	Usual suspects [1]	4-11 weeks	Yes if >90% of voting rights
Switzerland	COPA, Commission des Offres Publiques d'Achat	33.3% of voting rights	100% of shares	Usual suspects [1]	20-40 trading days	Yes if >98% of voting rights
UK	Takeover Panel	30% of voting rights and any increase between 30% and 50%	100% of shares and all instruments convertible or exchangeable into shares	Usual suspects [1] and MAC clause that must be approved by regulator	21-60 trading days	Yes if >90% of the shares
USA	SEC, Security Exchange Commission	None	None	Usual suspects [1] and MAC clause	>20 trading days	Yes with normal or super majority

Source: Corporate Finance Theory and Practice, Third Edition, Pierre Vernimmen

a. *Pre-offer*

i. *Mandatory bid rules*

In “Europe M&A: The Evolving Takeover Landscape”, Corte and Simpson define the mandatory bid rule in the following terms: “*Intended to prevent creeping takeovers, the rule provides that when a person – acting individually or in concert with other persons – acquires shares in a company above a specified percentage of voting rights in that company, giving him/her control of that company, such person is required to make a bid for the entire company and offer the same terms to all shareholders.*”[27]

As such, the mandatory bid rule is one of the main statutory defence mechanisms that are made available to potential target companies. This rule indeed helps potential targets to defend themselves against shareholders that are willing to take control of the company without making an offer for the remaining share capital of the target. This rule forces corporate raiders to tender for all the shares of their target once they have accumulated a certain percentage stake in the company. This prevents creeping takeovers for companies that have a dispersed shareholder base and in which someone controlling a large minority stake can de facto gain control of the firm.

However, this rule can be made more efficient by national authorities in three ways:

- National authorities can choose the threshold that requires the acquiring company to launch a tender offer. In the European Union, this threshold is currently set between 30 and 33 percent. For comparison, other takeover defence mechanisms in the US are triggered at much lower thresholds, for example 15 to 20 percent for poison pills. In Europe, it is thus relatively easy for a shareholder or a block of shareholders to actually control a company by accumulating ownership of shares just below the mandatory bid threshold. This makes the mandatory bid rule inefficient for quite a large number of companies that are not able to defend themselves against creeping takeovers because of a too high threshold. As a consequence, lowering this threshold can be a way for national authorities to protect their companies against takeovers, as it would repel any company willing to take control but unwilling to tender for the whole capital of the company.
- The mandatory bid offer can be flawed in many jurisdictions because corporate raiders have found a way to bypass the rule. An acquiring company can indeed buy a stake in the target just below the mandatory bid threshold, then launch a voluntary offer on the target at a low price, thus crossing the threshold without having to make a mandatory offer for the remaining share capital. This technique allows bidders to cross the mandatory bid threshold without having to offer the same terms to all shareholders. The implementation of two rules makes the mandatory bid rule stronger: first the implementation of a minimum acceptance threshold of 50 percent

[27] Lorenzo Corte and Scott Simpson, *Europe M&A: The Evolving Takeover Landscape*, 2013 Insights, Skadden Arps Slate Meagher & Flom LLP, Jan-2013

for any voluntary tender offer and second the implementation of additional mandatory offers upon further accumulation of shares once the mandatory bid threshold has been passed.

- The definition of “acting in concert” can also be a way for national authorities to prevent creeping takeovers. Indeed, some local authorities prefer keeping the right to decide on a case-by-case basis whether shareholders are “acting in concert” or not. This allows these nations to prevent potential acquirers from acting together in such a way that they fall outside the written definition of “acting in concert”, whereas nations that have adopted a strict definition of this concept may have difficulty in preventing creeping takeovers when players do not “act in concert” from a legal standpoint according to the formal definition.

ii. Squeeze-out rules

The “squeeze-out” rule is one of the only ways for bidders to achieve full control of a target. This rule specifies that when a bidder has managed to accumulate shares of its target above a certain threshold, the bidder has the right to expropriate the minority shareholders that did not tender their shares to the offer. This rule is of great importance for corporate raiders as it provides them a statutory tool to achieve full control of the target, thus allowing them to benefit from 100 percent of the target’s cash flows and to achieve fiscal integration within the newly formed group.

In the European Union, the Takeover Directive indicates that this threshold must be between 90 and 95 percent.[28] Some countries like the UK opted for a 90 percent threshold, some others like France or Germany for a 95 percent threshold, and some countries outside of the European Union like Switzerland opted for a 98 percent threshold. The higher the threshold, the more difficult it is for bidders to achieve full control of the target. As a consequence, in jurisdictions with high squeeze-out thresholds, bidding companies willing to acquire 100 percent of their target have an incentive to offer a higher premium in order to cross the squeeze-out threshold and achieve full control, or simply abandon the idea of launching a takeover if they doubt in their capacity to squeeze-out minority shareholders after the voluntary tender offer has expired.

National authorities have an incentive to set up a high squeeze-out threshold in order to protect their national champions from international corporate raiders. However, it can be argued by some players that:

- A 90 percent threshold should be adopted as it already corresponds to a large majority ownership in the target
- Once a bidder has acquired a dominating ownership in the target, there should exist other mechanisms to cash-out minority shareholders

[28] Lorenzo Corte and Scott Simpson, *Europe M&A: The Evolving Takeover Landscape*, 2013 Insights, Skadden Arps Slate Meagher & Flom LLP, Jan-2013

b. *Post-offer*

i. *Attack the industrial logic of the deal*

When a national champion faces a takeover bid, national political leaders often react to the takeover attempt by questioning and challenging the rationale and the industrial logic of the bid. They try to discourage the bidder from acquiring the target by demonstrating a national reluctance to see a national champion integrated in a bigger group controlled by foreign investors.

In 1999, the German Chancellor Gerhard Schroeder opposed the biggest hostile takeover bid ever launched. This bid on the German conglomerate Mannesmann by Vodafone faced a national opposition in Germany on the ground that Vodafone would most probably dismantle the conglomerate to keep only the successful mobile telephony operations and get rid of the historical industrial divisions of the conglomerate, thus generating huge social losses for the country in terms of employment. Gerhard Schroeder publicly stated that: "*In an open economy, takeovers should be free, with just two restrictions. One: Hostile bids destroy the culture of the company. They damage the target but also, in the medium-term, the predator itself. Two: Those who launch such actions in Germany underestimate the virtues of co-determination*".[29]

The same national opposition arose when the Anglo-Dutch steel company Mittal launched a hostile takeover bid on its competitor, the French-Spanish-Luxembourg steel company Arcelor. In 2006, Thierry Breton, then Industry Minister in France, stated in the local press that Mittal was not able to tell him more about industrial projects, about the mix of corporate cultures or about governance. The Luxembourg government also shared its doubts regarding the ability of Mittal to maintain employment and investments in Europe. This opposition from national political leaders contributed to the communication battle that followed between the two companies in order to gain shareholder approval and to win the battle for control.[30]

By communicating on a large scale about the lack of industrial logic of a bid, political leaders try to convince shareholders not to tender their shares to the offer. Their arguments can either relate to the value destruction that would follow the integration of the target into a larger group or invoke national solidarity in terms of employment, investment and industrial power. However, in the two precedent examples, strong national opposition to the takeover attempt was not sufficient to deter shareholders from tendering their shares. However, this opposition can be one of the drivers of an increase of the offered premium, as the bidder feels it needs to overcome this negative context in order to convince shareholders to tender their shares.

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[29] John Schmid, *As Mannesmann Fights Takeover, Construction Company Seeks Bailout: Consensus in German Business Shaken Up*, New York Times, 20/11/1999

[30] *Levée de Boucliers des Politiques contre l'OPA sur Arcelor*, La Tribune, 31/01/2006

ii. Reactive measures

Following rumours of potential takeover bids on their national champions, political leaders also tend to announce protectionist measures aiming at deterring bidders from actually launching a tender offer.

A good example of this phenomenon is the reaction of the Italian government following the acquisition of a 29 percent stake in the Italian dairy producer Parmalat by the French company Lactalis.[31] This acquisition happened just after the acquisition of Bulgari by LVMH and while the French utility company EDF was negotiating a takeover on Edison. As a response to these attempts to gain control of their national champions, the Italian government immediately announced that it would enforce new laws fostering reciprocity of antitakeover measures with the bidder's home country and reinforcing a preference for Italian shareholders.

The main goal of this type of reactive measures against takeover attempts is to show potential bidders that the government is ready to fight alongside the management of the target in order to keep national flagship companies independent. However, we can doubt these measures are really efficient when the bidder is determined to acquire control of the target for strategic reasons.

[31] Julie de la Brosse, *Comment Lactalis réveille le protectionnisme italien,* L'Express L'Expansion, 22/03/2011

III. Case Studies

A. *Hilton-ITT: A successful use of financial defences in improving premium*

a. *Contextual elements*

i. *Presentation of ITT and Hilton*

1. *ITT Corp.*

ITT Corporation was created in 1995 after the old International Telephone and Telegraph conglomerate was split into three distinct companies whose shares were offered to the incumbent shareholders of the former conglomerate:

- ITT Corporation, one of the largest companies in the world operating in the gaming and lodging industry;
- ITT Hartford, a major insurance company that was later renamed The Hartford Financial Services Group;
- ITT Industries, a major industrial group gathering the old activities of the International Telephone and Telegraph conglomerate, that was renamed ITT Corporation in July 2006 following a shareholder vote.

In 1996, ITT Corporation generated revenues of approximately $6.6 billion and had assets of approximately $9.3 billion. Its main activities included the operation of ITT Sheraton, one of the largest hotel companies in the world with about 410 hotels and resorts in 60 countries, Caesars World, a leading company in the gaming and casino industry, but also other assets such as ITT Educational Services, ITT World Directories, and stakes in Madison Square Garden and in the television station WBIS+.[32]

2. *Hilton Corp.*

In 1996, Hilton Corporation was the seventh largest company in the world and the first company in the US operating in the hotel and lodging business segment, with revenues of $3.9 billion and assets of approximately $7.6 billion. Hilton Corporation's activities included the development, ownership, management and franchising of hotels, casinos, resorts, properties and vacation ownership resorts. The hotels were operated under the Hilton and Conrad brand names and were spread across 40 different countries.[33]

ii. *ITT's vulnerability to takeovers*

The major part of ITT's vulnerability to takeovers is linked to the nature of the gaming and lodging businesses. Indeed, in 1996, most hotel companies used to own the buildings of the hotels they operated. As a consequence, the hotel and lodging business was very capital intensive and organic growth in this sector used to require huge amounts of capital expenditures.

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[32] *The Hilton-ITT wars*, Darden Business Publishing, University of Virginia

[33] Ibid

It was thus much more frequent for hotel companies to support their development by acquiring competitors than by developing their business internally. As for the gaming industry, the high barriers to entry are explained by the long time required to get clients to recognise and trust a new gaming brand or a new chain of casinos. It was hence also more efficient for companies operating in the gaming sector to acquire their competitors instead of trying to develop new brands or concepts.

In addition to this sector-related vulnerability to takeovers, ITT Corporation also suffered from the fact that it was not a pure player in the gaming and lodging business. Even after the initial split-up of the former ITT conglomerate in 1995, ITT Corporation itself was a smaller conglomerate gathering gaming and lodging activities along with other activities such as education or telephone directories. This conglomerate structure played against ITT's management because of the modern financial theory statement that pure players are doing better in the markets than conglomerates.

The market is indeed supposed to apply a conglomerate discount to the sum of the parts of any conglomerate in order to reflect the blurred risk profile resulting from the mix of different industries. As a consequence of this, ITT Corporation can easily be the target of any bidder willing to offer a premium for the core business of the conglomerate, knowing that it will then divest the other divisions. This premium to current market price would indeed appear really attractive to the shareholders of the conglomerate, whereas in fact the premium only represents a rerating of the core business based on the current valuation of its pure player competitors.

iii. Description of Hilton's initial bid

Hilton Corporation surprised the market on 27 January 1997 when it launched its tender offer on ITT Corporation's share capital and announced its intention to engage into a proxy fight. Hilton Corporation's takeover bid offered $55 per share of ITT's share capital in both cash and stock, which represents an equity value of approximately $6.5 billion.

According to Hilton Corporation, this offer represented a 29% premium compared to the closing price of $42.65 observed the Monday before the offer was launched. Assuming the debt value of $4.0 billion, Hilton's offer represented a $10.5 billion valuation for ITT Corporation.[34]

When Hilton's Chairman Stephen Bollenbach informed the market of this transaction, he stated that this hostile offer followed talks that were initially friendly but during which the two parties failed to find an agreement. Bollenbach also announced that he would not hesitate to enter into a proxy fight and to go directly to ITT's shareholders in order to change the board of directors and eventually cancel the poison pill plan implemented by ITT.[35]

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[34] *Hilton bids for ITT*, CNN Money, 27/01/1997
[35] Ibid

Hilton Corporation also hinted that the group might want to sell some of ITT's non-gambling assets if the offer was successful. These assets include Madison Square Garden and the teams that play in this stadium, but also two other divisions of ITT: ITT Educational Services and ITT Directories. These disposals would aim at keeping only the core business of ITT Corporation, which is the gambling and lodging business.[36]

b. *The defence strategy implemented by ITT*

In order to fend off Hilton's offer, the management of ITT Corporation decided to engage into a real takeover battle and started to use every available defence tool in order to remain an independent player in the gaming and lodging industry. The main defence strategies that were used by ITT's management are described in the following sections.

i. *Asset restructuring*

1. *Implemented strategy*

In order to make ITT Corporation less attractive to Hilton Corporation, ITT's management started by a drastic restructuring of its assets. The strategy consisted in selling the crown jewels to other groups, but also to acquire new assets that were of a lesser interest to Hilton Corporation. In chronological order, ITT conducted the following transactions as part of its asset restructuring strategy:

- On 21 February 1997, ITT announced that it planned to bid for the Italian telephone directory publisher SEAT SpA, which the Italian state wanted to dispose of. According to ITT's executives, the goal of this acquisition was to reinforce ITT's World Directory division. This move was interpreted by the market and also by Hilton Corporation as being in contradiction with ITT's communicated strategy which involved selling non-core assets like the directory division. However, ITT's executives argued that this acquisition was in line with their strategy and that it would increase the value of the directory division, no matter if it were to be sold or to remain within the group. However, this move was all the same largely analysed as a hostile move from ITT aiming at fending off Hilton's hostile offer.[37]
- On 6 March 1997, ITT announced that it was selling its 50% stake in Madison Square Garden. This stake included the stadium but also the Knicks basketball team, the Rangers hockey team and a television network. This transaction represented an 81% profit over a two year time period. According to observers, the objective of this disposal was to boost ITT's share price in order to make Hilton's tender offer uninteresting for shareholders.[38]
- On 12 May 1997, ITT announced that it had sold WBIS+, the business news and sports programming TV channel it owned jointly with Dow Jones & Co to Paxson

[36] *MSG on the block again?*, CNN Money, 30/01/1997
[37] *ITT looks to take a SEAT*, CNN Money, 21/02/1997
[38] *ITT sells its half of MSG*, CNN Money, 06/03/1997

Communications. The goal of this transaction was to find additional capital that could be used to fend off Hilton's offer.[39]

- Finally, ITT sold five of its Sheraton hotels to Felcor Suite Hotels on 9 June 1997. This final move is the one that emphasises the most the asset restructuring strategy implemented by ITT. Indeed, by selling the crown jewels that were the Sheraton hotels, ITT disposed of some of the assets Hilton's was the most interested in, thus incentivising Hilton to withdraw its offer.[40]

2. *Hilton's reaction*

Following the announcement that ITT was looking to acquire the Italian directory publisher SEAT SpA, Hilton Corporation decided on 28 February 1997 to extend its offer until 28 March 1997. At that time, only 710,000 ITT shares had been tendered on a total number of shares of 122.7 million. Extending this offer gave ITT's shareholders more time to evaluate the adequacy of Hilton's offer and eventually allow them to tender their shares.

After the disposal of five Sheraton hotels, Hilton reacted more aggressively and Marc Grossman, the spokesman of Hilton Corporation, commented the transaction in the following words: "*This is another sign of an entrenched management willing to destroy the value of assets in order to keep their jobs.*" However, Hilton's executives confirmed that they would continue to pursue ITT Corporation despite the hostile asset restructuring strategy implemented by ITT's management.[41]

ii. *Comprehensive three-way break-up plan*

On 16 July 1997, ITT's management announced a "Comprehensive Plan" to fend off Hilton's hostile takeover attempt. This defence plan included four major phases:

- A three-way break-up plan;
- A poison pill;
- Corporate charter amendments;
- and a self-tender offer.

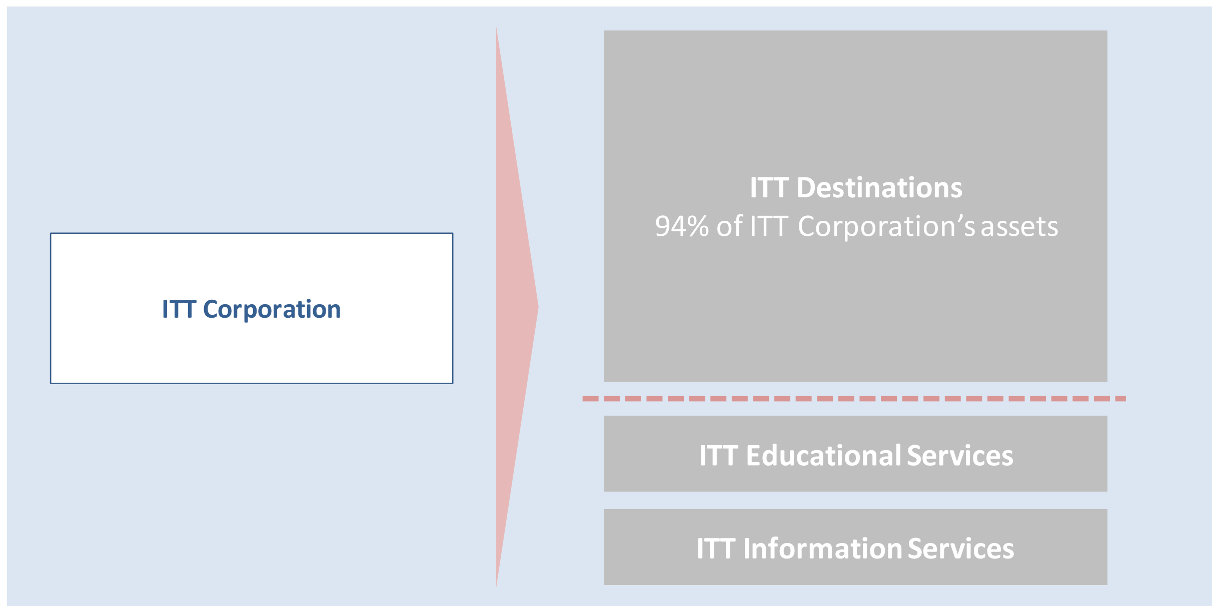
It has to be noted that this "Comprehensive Plan" was implemented before the annual shareholder's meeting, which had been delayed for months. As a consequence, ITT shareholders did not vote on these changes.

1. *Implemented strategy*

First, ITT's management announced its intention to split ITT Corporation into three distinct companies operating as pure players in their respective core businesses:

[39] *Paxson buys WBIS+*, CNN Money, 12/05/1997
[40] *ITT, FelCor reach pact*, CNN Money, 09/06/1997
[41] Ibid

- ITT Destinations, which would gather all the lodging and gaming activities of ITT Corporation, among which the Sheraton and Caesars brands, and which would concentrate 94% of ITT Corporation's assets;
- ITT Information Services, which would comprise the telephone directories;
- and ITT Educational Services, which would operate technical schools.



Under this scheme, each ITT shareholder would receive a share of ITT Destinations, a share of ITT Information Services and 0.25 shares of ITT Educational Services. This break-up plan, also called 'trivestiture", appeared as an attempt to create more value for shareholders thanks to a rerating of each individual company based on a pure player valuation.[42]

Second, it has to be noted that this three-way break-up plan was engineered in a way that made it completely tax-free. This tax feature served as the base for the creation of a poison pill linked to this three-way break-up plan. Indeed, if a bidder was to acquire the newly created ITT Destinations, this acquisition would question the tax-free status of the trivestiture and the acquirer of ITT Destinations would automatically be forced to pay 90% of a $1.4 billion tax liability.[43]

Third, as part of its "Comprehensive Plan", ITT used corporate charter amendments in order to strengthen and stabilise the board of directors. Indeed, ITT Corporation's management:
- voted in a staggered board with three classes re-elected in turn every three years;
- required an 80% majority to replace a director without cause;
- and required an 80% majority to remove this 80% majority requirement.[44]

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[42] *The Hilton-ITT wars*, Darden Business Publishing, University of Virginia
[43] http://www.casebriefs.com/blog/law/corporations/corporations-keyed-to-klein/mergers-acquisitions-and-takeovers/hilton-hotels-corp-v-itt-corp/
[44] Ibid

Finally, ITT's management decided to launch a self-tender offer for 30 million shares at a price of $70 per share. This represented about 25% of the outstanding shares. ITT also tendered for $2 billion of outstanding public debt, which represented about 50% of its outstanding debt. This final defence tool aimed at giving back money to shareholders by offering them a better price than the price stated in Hilton's takeover offer.[45]

2. Hilton's reaction

Hilton first reacted to this "Comprehensive Plan" by filing a case against ITT on 5 August 1997. Hilton indeed argued that putting up such defensive measures without a shareholder vote while a hostile takeover bid was going on was a way to entrench management and to deprive shareholders from their right to vote on important decisions.

Before implementing its three-way break-up plan, ITT needed the approval of three states: Mississippi, Nevada and New Jersey. On 18 September 1997, while Mississippi and Nevada had already approved the plan, the New Jersey casino regulator said it would delay its decision until it received word from Hilton.[46] The New Jersey casino regulator eventually approved the break-up plan on 26 September 1997, despite Hilton's efforts to convince the court to force ITT to call for a shareholder vote.[47] However, on 29 September 1997, a federal court judge in Nevada changed its ruling and decided that the issue must be put before a shareholder vote. Indeed, the judge considered that this "Comprehensive Plan" was a violation of shareholders' rights to vote. This plan could have been adopted without a vote if ITT had demonstrated that the potential acquirer would pursue a different corporate strategy or would represent a threat for the company, which was not the case for Hilton. Furthermore, the court found that the staggered board was implemented in order to intentionally entrench the management and deprive the shareholders from their right to vote. As a consequence, the Nevada court forced ITT to organise a shareholder vote, which was scheduled for 12 November 1997.[48]

Just one day after Hilton filed a case against ITT, Hilton also decided to raise its offer so as to match ITT's self-tender offer. Indeed, on 6 August 1997, Hilton raised its bid to $70 per share, which represented an $8.3 billion equity value and an $11.5 billion enterprise value with the assumption of ITT's debt. This new offer represented a 64% premium over the pre-rumour share price of January 1997. This new offer aimed at forcing ITT's management to consider Hilton's offer and to exercise its fiduciary duty to shareholders. Hilton stated that this was the final offer they would make and warned ITT's shareholders against a management that "*basically takes the assets and hides it from their shareholders*".[49]

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[45] *The Hilton-ITT wars*, Darden Business Publishing, University of Virginia
[46] *ITT fails to win N.J. okay*, CNN Money, 18/09/1997
[47] *ITT spinoff decision due*, CNN Money, 26/09/1997
[48] http://www.casebriefs.com/blog/law/corporations/corporations-keyed-to-klein/mergers-acquisitions-and-takeovers/hilton-hotels-corp-v-itt-corp/
[49] *ITT may be forced to talk,* CNN Money, 06/08/1997

Finally, after the Nevada federal court forced ITT to organise a shareholder vote, Hilton decided to extend its offer again and to leave shareholders until 10 October 1997 to decide whether they want to tender their shares or not. At that time, approximately 6.5 million of shares had been tendered.[50]

iii. White knight

1. Implemented strategy

Eventually, on 20 October 1997, ITT found a white knight in Starwood Lodging Trust. The Phoenix-based hotel owner and operator indeed announced that day that it would offer $82 per share or $9.8 billion for the total equity, which represented $13.3 billion for the company with the assumption of debt. Starwood's offer was structured in the following way: they offered $15 directly in cash to shareholders and $67 as a swap between ITT's and Starwood's stock.[51]

ITT's shares were at that time trading above the $70 offered by Hilton, which made the offer launched by Starwood Lodging Trust even more attractive for shareholders.[52] In addition to this, the binding agreement between ITT and Starwood also included a $195 million break-up fee, should the two parties decide to stop negotiations.[53]

2. Hilton's reaction

Knowing that a shareholder vote was taking place on 12 November 1997, Hilton reacted to the announcement of Starwood's offer by saying that it would not raise its offer. However, on 3 November 1997, Hilton increased its offer from $70 per share to $80 per share. Although this offer fell short of Starwood's bid offering $82 per share, Hilton's offer was structured in a way that returned more cash to shareholders.

Indeed, under its revised bid, Hilton offered $80 in cash up to a 55% stake in ITT, and then offered to exchange against each remaining ITT share two Hilton shares plus a new preferred stock worth $5 or more and guaranteeing that ITT's shareholders indeed get $80 whatever Hilton's share price fluctuations. This offer was perceived by many analysts as more attractive than Starwood's offer, even considering the fact that the price was lower.[54]

c. Limits and achievements of this strategy based on financial defences

After Hilton announced the upward revision of its offer, Starwood hinted that it might also revise its offer in order to offer more cash to shareholders. As a consequence of this battle, ITT ended up considering Hilton's offer as adequate and started an "auction" between Starwood and Hilton as ITT was in talks with both potential acquirers.

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[50] *Hilton extends ITT offer*, CNN Money, 30/09/1997
[51] *Hilton boosts ITT bid,* CNN Money, 03/11/1997
[52] *Hilton won't raise its offer*, CNN Money, 21/10/1997
[53] *ITT in auction mode*, CNN Money, 04/11/1997
[54] *Hilton boosts ITT bid*, CNN Money, 03/11/1997

Eventually, on 12 November 1997, ITT's shareholders re-elected ITT's slate of director at a 72% majority, thus endorsing the merger with Starwood Lodging Trust and fending off Hilton's hostile offer after a takeover battle that lasted almost a year long.[55] This outcome represents both a defeat and a victory for ITT. Indeed, ITT did not manage to remain independent, but in the same time, its defence strategy brought about a significant increase in the premium offered to its shareholders.

i. Limits: ITT lost its independence

The outcome of this takeover battle is disappointing for ITT's managers as they did not manage to preserve the independence of their company. Indeed, ITT Corporation was eventually merged with Starwood Lodging Trust and managers lost their positions.

The comprehensive three-way break-up plan could have been enough in itself to fend off Hilton's offer, as its extensive range of defences played the role of a serious deterrent for Hilton. However, the questioned legality of such a plan and the management entrenchment issues it raised limited the power of such financial defences.

In this context, the only option that was left for ITT's management was to find a more suitable acquirer that would better fit the corporate culture of the company. This white knight helped ITT fend off Hilton's takeover bid, but the inherent consequence of this defence strategy is that ITT lost its independence in the battle.

ii. Achievements: Better terms offered to ITT's shareholders

But the outcome of this battle can also be considered a victory for incumbent ITT shareholders. Indeed, after a year of takeover battle, they saw the value of their investment rise to $82 per share. From the initial $55 offer, this final offer represented a 49% improvement of the bid. We can also argue that the stock part of the offer on Starwood's side is a great opportunity for ITT's incumbent shareholders to benefit from the upside potential resulting from the synergies generated within the larger hotel and gaming entity.

As a consequence, we can argue that the financial defences were efficient in their ability to defend the shareholders' rights. Indeed, the financial defences implemented by ITT allowed shareholders to obtain a better value for their initial investment by forcing the hostile raider to match and sometimes surpass the value of the financial defence plan developed by the target's management.

[55] Kenneth N. Gilpin, *Shareholders of ITT reject hostile takeover by Hilton*, The New York Times, 13/11/1997

B. LVMH-Hermes: The efficiency of legal mechanisms in preventing takeovers

a. Contextual elements

i. Presentation of Hermès International and LVMH

1. Hermès International

Created in 1837 by the famous harness-maker Thierry Hermès, Hermès progressively turned into a wider group specialised in luxury products. Hermès International is famous today for its high quality products such as leather goods, ready-to-wear and accessories, silk and textiles, perfumes, watches and tableware, among other products. In 2013, Hermès generated 36% of its revenues in Europe, 17% in America and 45% in Asia-Pacific. The key figures summarising the activities of Hermès are summed up in the following table:

(€m unless otherwise stated)	2013	2012	2011	2010	2009
Revenue	3,755	3,484	2,841	2,401	1,914
Operating income	1,218	1,119	885	668	463
Net income to owners of the parent	790	740	594	422	289
Operating cash flow	1,016	885	723	572	401
Investments	232	370	214	154	207
Shareholders' equity	2,826	2,344	2,313	2,150	1,790
Net cash position	1,022	686	1,038	829	508
Economic value added	679	629	464	333	192
Return on capital employed	41%	46%	42%	32%	21%
Number of employees	11,037	10,118	9,081	8,366	8,057

Source: Hermès International Annual Report 2013, French version, p20

2. LVMH - Moët Hennessy Louis Vuitton

LVMH is a luxury conglomerate whose activities include wines and spirits, fashion and leather goods, perfumes and cosmetics, watches and jewellery, selective retailing and other products. In 2013, LVMH generated 30% of its revenues in Europe, 23% in the US and 37% in Asia. LVMH's key figures are summed up in the following table:

(€m unless otherwise stated)	2013	2012	2011	2010	2009
Revenue	29,149	28,103	23,659	20,320	17,053
Operating income	5,894	5,789	5,154	4,169	3,161
Net income to owners of the parent	3,433	3,424	3,064	3,032	1,755
Operating cash flow	4,621	4,176	3,907	4,049	2,934
Investments	1,663	1,702	1,730	976	729
Shareholders' equity	26,695	24,424	22,371	17,198	13,796
Net financial debt	5,388	4,261	4,660	2,678	2,994
Number of employees	114,635	106,348	97,559	83,542	77,302

Source: LVMH Annual Reports 2013 and 2011

ii. Legal structure of Hermès and preventative antitakeover measures

1. A legal form designed to prevent takeovers

As a "*société en commandite par actions*" (partnership limited by shares), Hermès International has three major stakeholders with different roles.

First, the "commanditaires", meaning "shareholders" or "limited partners", contribute capital and are liable only up to their initial contribution. They have the following roles:

- They appoint the Supervisory Board, whose members must be limited partners
- They appoint the Statutory Auditors
- They approve the accounts approved by the executive management
- They decide on the distribution of dividends and appropriation of earnings[56]

Second, the "commandités", meaning "active partners", are liable for all the company's debts for an indefinite period of time, jointly and severally. They have the following roles:

- They appoint and revoke the executive management on the recommendation of the Supervisory Board
- They determine strategic options, operating and investment budget for the group and propose an appropriation of share premiums, reserves and retained earnings
- They give recommendations to the executive management
- They give their authorisation for loans, sureties, endorsements, guarantees, pledges of collateral and encumbrances on the firm's property, acquisitions or creations of any company when they exceed 10% of the group's net worth[57]

Emile Hermès SARL is the only active partner of Hermès International. In order to protect the interests of the Hermès family, the company Emile Hermès SARL must respect the following rules mentioned in the annual reports of Hermès International:

"*In order to maintain its status of active partner, and failing which it will automatically lose such status ipso jure, Emile Hermès SARL must maintain in its Articles of Association clauses in their original wording or in any new wording as may be approved by the Supervisory Board of Hermès International by a three-quarter majority of the votes of members present or represented, stipulating the following:*

- *The legal form of Emile Hermès SARL is that of a "société à responsabilité limitée à capital variable" (limited company with variable capital)*
- *The exclusive purpose of Emile Hermès SARL is to serve as active partner and if applicable as executive chairman of Hermès International; potentially to own an equity interest in Hermès International; and to carry out all transactions in view of pursuing and accomplishing these activities and to ascertain that any liquid assets it may hold are appropriately managed*

[56] Hermès International Annual Report 2010, p8-11

[57] Ibid

- *Only the following may be partners in the company: descendants of Mr Emile-Maurice Hermès and his wife, born Julie Hollande; and their spouses, but only as beneficial owners of the shares*
- *Each partner of Emile Hermès SARL must have deposited, or arrange to have deposited, shares in the present company in the corporate accounts of Emile Hermès SARL in order to be a partner of this company."*[58]

Third, the "gérance", meaning the "executive management", is chosen for an indefinite period of time by the active partner from among the active partners or from outside the company. The executive management runs the company on a daily basis and is appointed by the annual general meeting of shareholders on the recommendation of Emile Hermès SARL and after consultation of the supervisory board. [59]

Two important rules must be kept in mind. First, the same person can be both a limited partner and an active partner. Second, if a limited partner is also an active partner, this person will not be allowed to vote on the appointment of supervisory board members during the annual general meeting of shareholders. This ensures a perfect dissociation between the owners and the managers of Hermès International.

In addition to this, the supervisory board decides on the appropriation of Hermès International's net income to be submitted to the general meeting of shareholders and approves any new wording of the clauses of Emile Hermès SARL's Articles of Association. There also exist a "joint council" between the executive management of the firm and the supervisory board. However, this council has no decision-making powers. Its only role is to foster a better collaboration between the different parties involved.[60]

This limited partnership by shares structure is a powerful defensive tool that completely dissociates the management of the firm from its shareholders. This structure is even reinforced by the fact that Hermès International can be converted into a limited liability company (SARL) or into a corporation (SA) only with the consent of Emile Hermès SARL, the active partner of Hermès International. In addition to this, decisions taken by the general meeting of shareholders are valid only if they have been approved by Emile Hermès SARL before the end of the said meeting, which grants all the executive decision-making power to the executive management of the firm, which is locked into the family's hands.[61]

2. *Other preventative measures*

In addition to this legal structure, Hermès International implemented other defensive measures in order to stabilise the shareholding structure and to prevent creeping takeover attempts. These measures are described in the annual reports in the following words:

[58] Ibid
[59] Ibid
[60] Ibid
[61] Ibid

"Hermès International's Articles of Association also contain stipulations that are liable to produce en impact on the outcome of a public offering, namely:

- *Voting rights are exercised by the legal owners at all general meetings, except for decisions regarding the appropriation of net income, in which case the beneficial owner shall exercise the voting rights;*
- *Double voting rights are allocated to each share registered on the books in the name of the same shareholder for a period of four consecutive years;*
- *Any shareholder who comes to hold 0.5% of the shares and/or voting rights, or any multiple of that fraction, must disclose this fact.*

Lastly, the Executive management has a grant of authority to carry out capital increases."[62]

In addition to these defensive measures disclosed in the annual reports, Bertrand Puech, chairman of Emile Hermès SARL, stated in an interview given to "*Le Figaro*" that the family shareholders of Hermès International were linked by a series of shareholder agreements aiming at preventing family members from selling their shares to third party investors.[63] However, at that time, the family shareholding was not concentrated in a single holding company, but rather in several holding companies or via direct personal ownership stakes weighing differently in the family shareholding structure.

b. *Chronology of the takeover attempt*

i. *How LVMH managed to accumulate Hermès shares*

1. *Accumulation of stock just below the disclosure threshold*

According to "*Le Monde*", LVMH started accumulating shares of Hermès International in 2001 and 2002. LVMH bought shares through its subsidiaries Hannibal and Altaïr, located respectively in Luxembourg and in Delaware, which are both well-known for their attractive fiscal environment. The shares acquired by Altaïr were then mostly transferred to other subsidiaries of LVMH located in Panama: Ashburry Finances, Bratton Direction and Ivelford Business. In total, LVMH accumulated a 4.9% ownership in Hermès at that time.[64]

In addition to the fact that LVMH stopped accumulating shares just below the first legal threshold of 5% requiring a formal disclosure, LVMH also decided not to disclose its ownership to Hermès, whose corporate charter requires that any shareholder who comes to hold 0.5% of the shares and/or voting rights, or any multiple of that fraction, disclose this fact.[65] In addition to this, an investigation conducted by the French regulator concluded that LVMH failed to mention the mere existence of these shares in its consolidated accounts, which circumvents the international accounting rules.

This accumulation of shares has to be compared with the 3.5% stake that LVMH owned in the Italian luxury group Tod's at that time. This ownership in Tod's was fully disclosed in the

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[62] Hermès International Annual Report 2010, p71
[63] Bertrand Puech, interview with Le Figaro, 02/11/2010
[64] Nicole Vulser, *Le plan très secret de LVMH pour entrer chez Hermès*, Le Monde, 18/05/2013
[65] Hermès International Annual Report 2010, p71

consolidated accounts of LVMH whereas LVMH kept silent about its stake in Hermès. These facts induced observers to conclude that this acquisition of a 4.9% ownership in Hermès was initially thought of as a way of preparing a later increase in share ownership.[66]

In any case, in its 2009 annual report, Hermès does not mention LVMH as a shareholder and even ignores the fact that LVMH started accumulating shares below the legal threshold of 5% of share capital and/or voting rights. Here is the ownership of share capital and voting rights as of 31 December 2009 as presented in the annual report of Hermès:

	Share Capital		Voting Rights			
			Appropriation of net income		Other	
	Number	%	Number	%	Number	%
SAS SDH	9,548,996	9.05%	19,073,836	11.37%	19,073,836	11.37%
SAS POLLUX & CONSORTS	6,602,525	6.25%	12,164,450	7.25%	12,164,450	7.25%
SC FLECHES	5,869,213	5.56%	11,394,195	6.79%	11,394,195	6.79%
SC FALAISES	5,567,610	5.27%	11,135,220	6.64%	11,135,220	6.64%
SC AXAM	5,559,480	5.27%	11,118,960	6.63%	11,118,960	6.63%
SA JAKYVAL	5,344,332	5.06%	5,344,332	3.19%	5,344,332	3.19%
Jean-Louis DUMAS	5,137,342	4.87%	10,274,684	6.13%	-	-
Total of shareholders owning more than 5% of share capital or voting rights	**43,629,498**	**41.33%**	**80,505,677**	**48.00%**	**70,230,993**	**41.87%**
Own shares	422,000	0.40%	-	-	-	-
Other shareholders	61,517,914	58.27%	87,215,945	52.00%	97,490,629	58.13%
Total	**105,569,412**	**100.00%**	**167,721,622**	**100.00%**	**167,721,622**	**100.00%**

Source: Hermès International Annual Report 2009 p.78

2. Acquisition of shares through derivative products

On 21 October 2010, LVMH suddenly announced that it owned 14.22% of the share capital of Hermès and 8.95% of the voting rights, thus moving above the 5% and 10% thresholds of share capital and above the 5% threshold of voting rights. Three days later, on 24 October 2010, LVMH announced that it owned 17.07% of the share capital of Hermès and 10.74% of the voting rights, thus surpassing the 15% threshold of share capital and the 10% threshold of voting rights.[67] This came as a total surprise for Hermès that was aware neither of LVMH's intentions nor of its earlier acquisition of a 4.9% stake in the company.

In order to cross all these thresholds at the same time, LVMH used financial derivative products called "equity-linked swaps". LVMH subscribed to these products with three French banks: Natixis, Société Générale and Crédit Agricole. These products basically consist in giving the buyer an economic exposure to the performance of a stock against the payment of interests on a pre-specified schedule.

In order to hedge themselves against the volatility of the underlying asset, the banks physically buy the stock which is the underlying asset of the equity-linked swaps. In the

[66] Nicole Vulser, *Le plan très secret de LVMH pour entrer chez Hermès*, Le Monde, 18/05/2013
[67] Hermès International Annual Report 2010, p74-76

particular case of LVMH, Nexgen, which is a subsidiary of Natixis, bought 4.7% of the share capital of Hermès for its "Harry 1" and "Harry 2" products, whereas Société Générale bought 4.5% of the share capital and Crédit Agricole bought 3% of the share capital for its "Gold 1" and "Gold 2" products. This three-bank structure enables the banks not to disclose their ownership in Hermès, thus keeping the existence of equity swaps on the capital of Hermès completely confidential.[68]

Initially, these contracts were cash-settled equity swaps, meaning that at maturity, these contracts should have been settled by the payment of the gain or loss on the underlying asset. However, in June 2010, LVMH required that its equity swaps be settled by the physical delivery of the underlying Hermès shares acquired by the banks for hedging purposes. This amendment was approved by LVMH's board of directors on 21 October 2010 and as a consequence, the contracts were unwound with two banks on that day, allowing LVMH to raise its stake in Hermès from 4.9% to 14.2%. The third bank agreed to unwind its swap three days later, allowing LVMH to get an additional 3% ownership in Hermès.[69]

From a legal standpoint, LVMH was able to keep these equity swap contracts confidential because the French law did not require holders of cash-settled equity swap contracts to disclose their potential ownership in the underlying company. As a consequence, as of 24 October 2010, LVMH holds 17.07% of Hermès through its subsidiaries as follows:

	Share Capital		Voting Rights	
	Number	%	Number	%
Sofidiv SAS	12,801,246	12.13%	12,801,246	7.63%
Hannibal SA	730,000	0.69%	730,000	0.44%
Altaïr Holding LLC	908,400	0.86%	908,400	0.54%
Ivelford Business SA	2,200,000	2.08%	2,200,000	1.31%
Bratton Services Inc.	837,600	0.79%	837,600	0.50%
Ashburry Finance Inc.	540,000	0.51%	540,000	0.32%
Total LVMH	**18,017,246**	**17.07%**	**18,017,246**	**10.74%**

Source: Hermès International Annual Report 2010 p.75

3. *Further acquisition of shares on the market*

Following this increase in ownership, LVMH filed the following declaration of intent: "*Statement of objectives of LVMH Moët Hennessy Louis Vuitton for the next six months. LVMH Moët Hennessy Louis Vuitton declares that:*

- *It is not acting in concert with a third party;*
- *It does not intend to seek representation on the Supervisory Board of Hermès International, in its own name or by the appointment of a representative;*
- *It plans to pursue, where appropriate, its acquisitions of Hermès International shares according to market conditions;*

[68] Nicole Vulser, *Le plan très secret de LVMH pour entrer chez Hermès*, Le Monde, 18/05/2013
[69] Rodd Levy, Hubert Segain, Adam Charles and Paul Delpech, *Hot Couture – Things heat up in the French fashion industry over equity swaps, Herbert Smith Freehills*, 05/08/2013

- *It has not entered into any temporary agreement of sale targeting the shares and voting rights of the issuer;*
- *It financed the purchase of the Hermès International shares from its group's own funds;*
- *It does not plan to take control of Hermès International or to file a public takeover bid, and, consequently, it is not considering any of the transactions cited in Article 233-17 I 6° of the AMF General Regulation*

LVMH's investment in Hermès International is strategic and for the long run. LVMH supports the strategic vision, the development and positioning of Hermès International."[70]

In accordance with this statement, LVMH continued to buy Hermès shares on the market, thus raising its share ownership from 17.07% on 24 October 2010 to 20.21% on 31 December 2010. As of 31 December 2013, LVMH owned 23.14% of Hermès share capital, which results in the following capital structure:

	Share Capital		Voting Rights			
			Appropriation of net income		Other	
	Number	%	Number	%	Number	%
H51 SAS	53,108,799	50.31%	85,143,884	58.19%	85,143,884	58.19%
H2 SAS (ex THEODULE)	6,876,102	6.51%	8,046,102	5.50%	8,046,102	5.50%
Other family members	6,473,055	6.13%	7,814,689	5.34%	11,894,689	8.13%
Total Hermès family	**66,457,956**	**62.95%**	**101,004,675**	**69.03%**	**105,084,675**	**71.82%**
LVMH	24,430,343	23.14%	24,430,343	16.70%	24,430,343	16.70%
Free float	7,157,189	6.78%	14,798,132	10.11%	10,718,132	7.33%
M. Nicolas PUECH	6,082,615	5.76%	6,082,615	4.16%	6,082,615	4.16%
Own shares	1,441,309	1.37%	-	-	-	-
Total	**105,569,412**	**100.00%**	**146,315,765**	**100.00%**	**146,315,765**	**100.00%**

Source: Hermès International Annual Report 2013 p.106

ii. A growing need for additional protections

1. Hostile reaction of the Hermès family

When Bernard Arnault, Chairman and CEO of LVMH since 1989, announced to the Hermès family that it had acquired a 17.07% stake in the company, he insisted that this was a friendly move. He claimed that he would not launch a takeover bid on Hermès, that he would not ask for a seat at the board of directors and that he fully supported the management of Hermès and its vision.

However, LVMH's move was directly perceived by the Hermès family as a hostile move. In an interview released on 2 November 2010 in the French newspaper "*Le Figaro*", Patrick Thomas and Bertrand Puech, respectively executive manager and chairman of Emile Hermès SARL, reacted to LVMH's move on behalf of the Hermès family. They stated:

Patrick Thomas: "*The fact that a shareholder holds 17% of our capital will not change the culture and the know-how of our company. Hermès needs absolutely no help, no support and*

[70] Hermès International Annual Report 2010, p74-76

no tutor, contrary to what M. Arnault believes. By the way, if you have a look at our performances since our IPO in 1993, the annual growth rate of LVMH's net income was 7.6%, ours was 14.7%. On the market, LVMH's stock was multiplied by 6, Hermès stock by 35. If someone needs help, it would rather be the other way round. Hermès is doing great, better than LVMH, and Hermès capital is locked up."[71]

Bertrand Puech: "*I believe that M. Arnault launched a financial battle that is missing its target. He is a great finance expert but he has not always been successful. We want to be very courteous. Our family states it clearly and unanimously: "If you want to be friendly, M. Arnault, withdraw from our capital."*[72]

This theory of a hostile move aiming at taking control of Hermès in due time is confirmed by a report conducted by the French regulator, AMF. According to this report, the fact that LVMH kept its 4.9% stake secret, the fact that LVMH used equity swaps and the fact that LVMH worked with Rothschild and Lazard on projects analysing the different ways LVMH could take control of Hermès make sense together only if LVMH is actually planning to increase its stake in Hermès on the long run, and potentially to take control of Hermès.[73]

2. *Potential family dissension?*

In addition to the assumed hostility of the Hermès family towards LVMH's move, other factors play in favour of the implementation of further antitakeover protection tools.

First, some observers point at a potential family dissent.[74] The three branches of the Hermès family, the Dumas, the Guerrands and the Puechs, are said to be not as united as they pretend to be. Only about ten family members are actually working for Hermès, whereas some other members have been ousted from the firm's management. It is also said that some family members find the tax burden related to their Hermès shares too heavy, and might be willing to sell their shares to invest in other activities. For example, Patrick Guerrand-Hermès might be willing to invest more in the Chantilly Polo-Club and Renaud Mommeja might need more funds to develop its vineyard "Château Fourcas-Hosten".

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[71] Originally in French: « *Le fait qu'un actionnaire ait 17% de notre capital ne modifiera pas la culture et la façon de travailler de cette maison. Hermès n'a absolument pas besoin d'aide, de soutien ou de tuteur, contrairement à ce que pense M. Arnault. D'ailleurs, si vous regardez les performances depuis notre entrée en Bourse en 1993, la croissance annuelle du bénéfice net de LVMH a été de 7,6%, celle d'Hermès de 14,7%. En Bourse, l'action LVMH a été multipliée par 6, celle d'Hermès par 35. Si quelqu'un a besoin d'aide, ce serait plutôt dans l'autre sens. Hermès va très bien, mieux que LVMH, et Hermès est verrouillée*. » Patrick Thomas, interview with Le Figaro, 02/11/2010

[72] Originally in French: « *Je pense que M. Arnault a lancé une bataille financière qui passe à côté de nous. C'est un grand financier mais il n'a pas connu que des succès. Nous voulons être très courtois. La famille le dit clairement et à l'unanimité : « Si vous voulez être amical, Monsieur Arnault, il faut vous retirer ». »* Bertrand Puech, interview with Le Figaro, 02/11/2010

[73] Nicole Vulser, *Le plan très secret de LVMH pour entrer chez Hermès*, Le Monde, 18/05/2013

[74] Sophie Lécluse, *Pourquoi Bernard Arnault tient tant à Hermès*, La Tribune, 02/02/2011

In addition to these potential threats, a report released in 2013 by the French regulator AMF claimed that a member of the Hermès family itself, M. Nicolas Puech-Hermès, contributed to allow LVMH to use equity swaps. Indeed, this report states that M. Puech-Hermès sold 8.8 millions of shares to the banks that were mandated by LVMH to set up equity swap contracts. These shares represented about 68% of the shares acquired by the banks for hedging purposes, according to the AMF report. These shares are said to have transited from M. Puech-Hermès' accounts in the Geneva-based portfolio manager Semper Gestion to an ad-hoc vehicle called Dilico whose legal representative, Alexandre Montavon, works for LVMH and is also an administrator at Semper Gestion. They apparently used futures contracts allowing them to keep the identity of the seller confidential.[75]

As a consequence of these additional threats, Hermès decided to implement more efficient protection devices in order to lock up its share capital. These mechanisms are further described in the following section.

c. Reactive antitakeover measures implemented by Hermès

i. An efficient use of legal defences

1. Creation of the H51 holding vehicle

The Hermès family took a major decision in 2010 when it decided to regroup the Hermès shares held by family members into a single holding company called "H51".

This variable capital simplified joint stock company resulted from the share contribution of some family members along with the merger with former holding vehicles of family members: SAS SDH, SAS POLLUX & CONSORTS, SAS FLECHES, SAS FALAISES and SC AXAM. The contribution of shares to H51 resulted in a concentration of 50.15% of the share capital of Hermès into a single holding company.[76]

In addition to this structure, the Hermès family holds 5.01% of the capital via H2 SAS, formerly known as SAS THEODULE, and 7.66% directly or via former structures such as SA JAKYVAL. As a consequence, the Hermès family held 62.82% of the share capital as of 31 December 2011, among which 50.15% directly through a single holding company.[77]

It also has to be noted that M. Nicolas Puech-Hermès holds 5.76% of the share capital but is not listed as a family member in the annual reports, following his refusal to contribute his shares to a holding company.[78]

The contribution of Hermès International shares to the family holding vehicle H51 and to other vehicles such as H2 SAS resulted in the following structure of share capital and voting rights in December 2011:

[75] Nicole Vulser, *Nicolas Puech-Hermès, le meilleur allié de Bernard Arnault*, Le Monde, 18/05/2013
[76] Hermès International Annual Report 2011, p81-83
[77] Ibid
[78] Ibid

	Share Capital		Voting Rights			
			Appropriation of net income		Other	
	Number	%	Number	%	Number	%
H51 SAS	52,943,797	50.15%	81,424,658	56.68%	81,424,658	56.68%
H2 SAS (ex THEODULE)	5,289,090	5.01%	6,459,090	4.50%	6,459,090	4.50%
Other family members	8,090,707	7.66%	10,422,503	7.26%	14,502,505	10.10%
Total Hermès family	**66,323,594**	**62.82%**	**98,306,251**	**68.43%**	**102,386,253**	**71.27%**
LVMH	23,518,942	22.28%	23,518,942	16.37%	23,518,942	16.37%
Free float	8,122,721	7.69%	15,749,088	10.96%	11,669,086	8.12%
M. Nicolas PUECH	6,082,615	5.76%	6,082,615	4.23%	6,082,615	4.23%
Own shares	1,521,540	1.44%	-	-	-	-
Total	**105,569,412**	**100.00%**	**143,656,896**	**100.00%**	**143,656,896**	**100.00%**

Source: Hermès International Annual Report 2011 p.88

The main advantage of this shareholding structure is that it enables the implementation of priority acquisition rights between family members. According to the 2011 annual report of Hermès, this right *"has been granted by 102 natural person and 33 legal persons (all members, held by members or having a parent who is a member of the Hermès family group) in favour of H51"*.[79]

This right will remain effective at least until 31 December 2040 and allows H51 to have *"a priority acquisition right relative to Hermès International shares (i) for which the number for each signatory is shown in the agreement (i.e. a total representing approximately 12.3% of the capital of Hermès International or (ii) that would be held by these signatories in the future (notably as part of the variability of the H51 capital)."*[80]

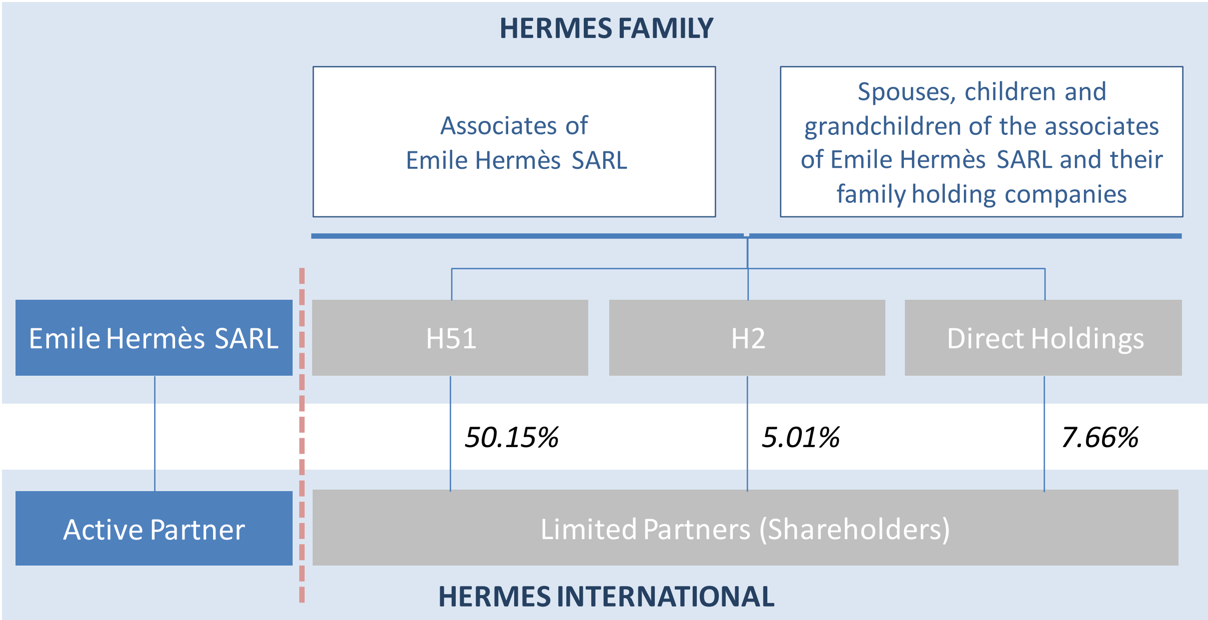
H51 can exercise this right at a price equal to the volume weighted average price calculated on the five days prior to notification, except if the shares are not liquid enough or if the seller has already sold more than 0.05% of Hermès capital within the last 12 months, in which case the price will be determined by an independent expert based on a multi-criteria valuation methodology.[81]

H51 has the possibility to use one third of the dividends paid by Hermès International in order to acquire new shares of Hermès International. As a consequence, the Hermès family managed to lock up 50.15% of the share capital of Hermès International in a single holding company and has the possibility to acquire the remaining 12.67% held by other family members but also to acquire shares directly on the market in order to consolidate its majority shareholding.

This structure is a guarantee for the Hermès family. Indeed, the Hermès family will keep a majority shareholding in Hermès International even if some members of the family decide to sell their shares, as they will not be able to sell them to LVMH or to a third party that might sell the shares to LVMH later.

[79] Hermès International Annual Report 2011, p82-83
[80] Ibid
[81] Ibid

As a consequence of the creation of this holding structure, the Hermès family has simplified the structure of the group, thus reinforcing the power of the family over the firm. Here is a simplified chart representing the organisational structure of Hermès International:[82]



The implementation of this new holding structure was made possible because the French regulator, AMF, exempted H51 from launching a takeover bid on the remaining capital of Hermès International after H51 moved above the 30% threshold of shares and voting rights of Hermès International. In its D&I 211C0024 decision of 6 January 2011, the AMF indeed exempted H51 to file a proposed public offer to buy out the shares of Hermès International because this surpassing of the shares and voting rights thresholds resulted from the willingness of the Hermès family to gather its majority stake in Hermès in a single entity, which does not change the intentions of the family regarding the strategy of Hermès. This decision has been subject to two appeals filed by minority shareholders, but both have been rejected by the Paris Court of Appeal.[83]

2. *Litigation around the use of equity-linked swap*

The second tool Hermès used in order to defend itself against a takeover is litigation. By suing LVMH, Hermès indeed hopes LVMH will withdraw from its capital, either willingly or following a decision of the court regarding the use of equity swaps.

First, in 2011, Hermès filed a case at the Nanterre Commercial Court and at the Versailles Court of Appeal in order to obtain the contracts of LVMH's equity swaps in order to cancel them for fraud. They failed to obtain these documents.[84]

[82] Hermès International Annual Report 2013, French version, p107
[83] Ibid, p86
[84] *Hermès: LVMH s'explique devant l'AMF*, Le Figaro, 31/05/2013

Then, on 10 July 2012, Hermès sued LVMH at the Paris Court of First Instance for reasons including "insider trading, collusion and manipulating stock prices". Hermès also filed a case at the Paris Commercial Court on 18 June 2013 and asked the Commercial Court to wait the decision of the Court of First Instance before investigating. This early demand allows Hermès to make sure it will be able to sue LVMH at the Paris Commercial Court in case the Paris Court of First Instance refuses to cancel the equity swaps concluded in 2008 or does not respond before the end of the limitation period. The objective of Hermès is to obtain the cancelation of the equity swap contracts, which would force LVMH to sell the shares it acquired through these derivative products back in the market. [85]

In addition to these legal proceedings, the French market watchdog AMF investigated for two years on the way LVMH obtained its stake in Hermès. A report dated from 2 October 2012 stated that there had been neither insider trading nor manipulation of stock prices. However, on 1 July 2013, the AMF decided to impose an €8 million fine on LVMH, noting that *"circumvention of the rules intended to ensure transparency, which is so vital to orderly markets, must be punished to the same extent as the disruption it causes"*.

Indeed, the AMF concluded that "*the search for financial profit alone was not enough to explain the unusual way in which these swaps had been arranged. This applied equally to: the swaps' unusual amounts; the fact that they were divided among several banks to sidestep disclosure reporting rules; the fact that they had been entered into by foreign subsidiaries of LVMH that were not listed as consolidated companies until the 2010 annual report; the fact that LVMH had informed the banks about the blocks of shares enabling them to cover the swaps; the size of the guarantees that LVMH had given to the banks: the measures taken in LVMH's consolidated financial statements to conceal the fact that the swaps were concentrated on a single stock."*[86] This failure to disclose its intentions to the market along with the fact that the existence of equity swaps should have been disclosed in June 2010 when LVMH reached an agreement with two banks on the physical delivery of Hermès shares instead of October 2010 explain why the AMF decided to fine LVMH.

Of course, this €8 million fine represents very little money for LVMH. However, one should not forget the reputational risk this series of legal proceedings represent for an international luxury group like LVMH. First, LVMH decided to fight back by suing Hermès and some of its representatives for blackmail and false allegations.[87] LVMH also pretended that it did not plan to acquire shares in Hermès and that it ended up with Hermès shares after it had to unwind the equity swaps by the physical delivery of shares in order not to weigh too much on Hermès stock prices. However, on 3 September 2013, LVMH decided to terminate the AMF proceedings to reflect its "*commitment to ensuring the soundest possible management of its investment in Hermès*", despite the fact that LVMH considers it would be "*entirely*

[85] Hermès International Annual Report 2013, French version, p104-105
[86] *AMF Enforcement Commitee Sanctions LVMH*, www.amf-france.org, 01/07/2013
[87] *LVMH porte plainte contre Hermès*, Le Figaro, 04/09/2012

justified in appealing the disciplinary commission's administrative decision".[88] This decision reflects the willingness of LVMH to limit the reputational damage caused by such legal proceedings, which can be analysed as a victory on the Hermès side, even before any decision from the Court regarding the potential cancelation of equity swaps.

3. Communication around cultural mismatch

In addition to the implementation of these legal and statutory defence tools, Hermès also insisted on the cultural mismatch that would arise between Hermès and a larger luxury conglomerate like LVMH. After the revelation of LVMH's acquisition of a large block of shares, some members of the Hermès family engaged a communication battle aiming at convincing both the market and the potential stakeholders that Hermès could not remain such a successful brand name if it were to be integrated in a conglomerate like LVMH.

In an interview given to the French newspaper "*Le Figaro*", Patrick Thomas and Bertrand Puech, respectively executive manager and chairman of Emile Hermès SARL, explained their views on the differences between the corporate cultures of Hermès and LVMH:

Patrick Thomas: "*Hermès is not a company, it is not only a brand name, it is a cultural seedbed in which the flowers of creativity grow every season. It is a formidable heritage, an artisanal culture, a tradition of respect for the people and the products, a very complex alchemy. This culture is incompatible with that of a conglomerate. This is not a financial battle, this is a cultural battle.*"[89]

Bertrand Puech: "*We have an artisanal culture. Our goal is not make the best products in the world. Hermès in not about luxury, it is about quality.*"[90]

ii. Potential limits of this defence strategy

The Hermès family has implemented two major defence tools in order to avoid third party investors to take control of the company:

- Shareholder agreements between the members of the Hermès family and at H51 level are a guarantee that the Hermès family will keep a majority ownership of the company even if some family members are willing to exit

[88] *Hermès : LVMH brings an end to AMF proceedings*, LVMH Press Release, 03/09/2013

[89] Originally in French: « *Hermès, ce n'est pas une société, ce n'est pas qu'une signature, c'est un terreau culturel dans lequel poussent chaque saison les fleurs de la créativité. C'est un héritage formidable, une culture artisanale, une tradition de respect des hommes et des matières, une chimie très complexe. Cette culture est difficilement compatible avec celle d'un grand groupe. Ce n'est pas un combat financier, c'est un combat de cultures. Evidemment on pourrait doubler les bénéfices d'Hermès en cinq ans, mais Hermès en mourrait à petit feu.* » Patrick Thomas, interview with Le Figaro, 2/11/2010

[90] Originally in French: « *Nous sommes des artisans, notre but est de faire des produits les meilleurs du monde. Nous ne sommes pas dans le luxe, nous sommes dans la qualité.* » Bertrand Puech, interview with Le Figaro, 2/11/2010

- The legal form of Hermès as a limited partnership by shares is a guarantee that the Hermès family will be able to keep the executive control of the firm even if it were to lose the majority of shares and/or voting rights

However, there exists some legal ways to bypass these protective measures that could enable LVMH to take control of Hermès in some particular circumstances. These legal pitfalls relates both to shareholder agreements and to limited partnerships by shares.

1. No forced execution of shareholder agreement

As seen previously, a shareholder agreement is a contract between shareholders stating that if a shareholder wants to exit its investment, he or she has to offer to sell his or her shares to other signatories of the agreement at a pre-specified price, that is fixed or whose drivers have been agreed upon. This kind of agreements aims at maintaining the shares within the family or the block of shareholders acting in concert.

However, the French law related to contracts stipulates that "*Any obligation to do or not to do resolves itself into damages, in case of non-performance on the part of the debtor*"[91], meaning that if a signatory of a contract does not respect what he committed to, the court can award damages to parties affected by the non-execution of the contract. However, the court cannot force the signatory to physically execute the contract.

This law seriously limits the efficiency of such shareholder agreements and their ability to effectively prevent signatories from selling their shares to third party investors that might be willing to take control of the firm or to sell their shares later to unfriendly bidders. Indeed, according to this law, if a signatory of the shareholder agreement does not respect the contract and actually sells its shares to a third party investors, the only thing the court can do is to award damages to the other signatories of the shareholder agreement. The court will not be able to cancel the transfer of shares, which results in the inability of signatories to maintain a stable ownership if a shareholder is willing to sell its shares to someone offering a better price than the price specified in the shareholder agreement.

As a consequence of this, if a family dissent were to arise between members of the Hermès family, even the signatories of the shareholder agreement that binds the family members together could potentially sell their shares to LVMH if they believe the premium offered for the shares is sufficient to cover potential damages awarded to other signatories of the shareholder agreement. This might not be sufficient for LVMH to acquire a majority ownership in Hermès, but coupled with acquisitions of Hermès shares on the market, this technique could allow LVMH to raise its stake significantly in the firm's capital.

However, it has to be noted that recently some French courts have actually given their authorisation to force the execution of the shareholder agreement in some particular

[91] Originally in French: « *Toute obligation de faire ou de ne pas faire se résout en dommages et intérêts en cas d'inexécution de la part du débiteur*. », Art. 1142, Code Civil, www.legifrance.gouv.fr

circumstances. For example, in 2002 the Paris Court of Appeal recognised that a forced execution of the shareholder agreement was not forbidden when the forced execution was materially possible. This decision was also confirmed in 2010 by the Versailles Court of Appeal, even if it got rejected later by the Court of Cassation.[92] This recent evolution of the French jurisprudence plays in favour of the Hermès family in case a family member decides to breach the agreement to sell only to other family members.

2. *Possibility to bypass the "commandite" structure*

As explained previously, the legal structure of Hermès International as a "*société en commandite par actions*" (partnership limited by shares) is supposed to allow the Hermès family to keep the executive control of the firm even if it were to lose its majority ownership in the listed shares. However, bypassing this structure is possible in the long run, even if it often requires a lot of time. In practice, investors interested in long term partnerships such as LVMH can thus obtain the replacement of the executive management of the firm.

Indeed, if a conflict arises between the limited partners (the shareholders) and the active partner, both parties are prevented from acting without the consent of the other party. As a consequence, if a corporate raider takes control of the supervisory board, it still will not be able to take the executive control of the firm that remains in the hands of the active partner. Reciprocally, the active partner will not be able to make the supervisory board approve the accounts. As a consequence, it will be impossible for the active partner to distribute dividends or to receive compensations without the consent of the supervisory board. This situation often ends up in the firm being totally blocked by the conflict between the two parties, which results in an obligation for both parties to negotiate.[93]

This situation of complete paralysis can also result in the appointment of a provisory judiciary administrator that will take the role of the executive management. In this case, the limited partners (the shareholders) still do not control the company from an executive point of view, but at least they managed to replace the incumbent management, which gives them room for negotiation. Alternatively, this situation can also lead to the liquidation of the firm if a court concludes that the firm no longer has an actual "*affectio societatis*".[94]

It could thus be LVMH's strategy to continue to acquire new Hermès shares on the market or by other mechanisms in order to take control of the supervisory board and block the daily management of the firm by not approving the accounts. If correctly implemented, this strategy could force the Hermès family to negotiate with LVMH and could eventually result in the replacement of Emile Hermès SARL as the sole active partner of Hermès International.

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[92] Sarah Assetou Garcia, *Les pactes d'actionnaires à l'épreuve de la pratique*, www.village-justice.com

[93] Patrice Charlier and Jean-Baptiste Cartier, *Les particularités de la société en commandite par actions au regard des conflits d'agence*, published in « Fiscalité, Droit et Sciences de Gestion, 4e colloque international, Marrakech, Maroc, 2012 »

[94] Ibid

C. Arcelor-Mittal: The role of communication and political hostility

a. Contextual elements

i. Presentation of Arcelor and Mittal Steel

1. Arcelor

Arcelor was created in 2002 as a result of the combination of three European steelmakers, namely the Spanish company Aceralia, the Luxembourg company Arbed and the French company Usinor. In 2006, Arcelor was a global steel leader operating in six main business segments: Flat Carbon Steel Europe; Flat Carbon Steel Americas; Asia, Africa and CIS; Long Carbon Steel; Stainless Steel; and Steel Solutions and Services. In 2006, Arcelor was the second largest player in terms of shipments, but the first global player in terms of revenues.

In 2006, Arcelor employed 104,000 persons in the world and was operating in more than 60 countries. Arcelor produced 53.5 million tonnes of crude steel that year. Arcelor's key financial metrics are summarised in the following table:

(€m unless otherwise stated)	2006	2005
Revenue	40,611	32,611
Operating income	4,454	4,417
Net income to owners of the parent	3,007	3,873
Operating cash flow	4,280	4,464
Investments	2,298	2,070
Shareholders' equity	22,086	17,430
Net debt position	4,710	1,257
Number of employees	103,935	103,935

Source: Arcelor Annual Report 2006, p.56-59

2. Mittal Steel

Mittal Steel is an India-based steelmaker that was developed on a global scale by the famous businessman Lakshmi Mittal across the years. After a series of acquisitions, for example the acquisition of the French company Unimétal in 1999, LNM Holdings, the private steel business owned by Lakshmi Mittal, participated to a three-way merger with the listed company Ispat, in which Lakshmi Mittal held a 77% stake, and with the American steel company International Steel Group, and thus became Mittal Steel in 2004.[95]

Following this three-way merger, the newly formed Mittal Steel became the world leader in the steel business in 2004. In 2006, the Mittal Steel group was controlled at 88% by the Mittal family, originally from India but naturalised British, and was also listed in the Netherlands and in the United States of America. The key financial metrics of the Mittal Steel group are summarised in the following table:

[95] Edward Simpkins, *Arcelor adds steel to its defence*, The Telegraph, 19/02/2006

($m unless otherwise stated)	2005	2004
Revenue	28,132	22,197
Operating income	4,746	6,146
Net income to owners of the parent	3,365	4,701
Operating cash flow	3,974	4,611
Investments	1,181	898
Shareholders' equity	10,150	5,846
Net debt position	6,159	(654)
Number of employees	224,286	164,393

Source: Mittal Steel SEC filing 2005

ii. Arcelor's vulnerability to takeovers

1. Market undervaluation

One of the most important factors that made Arcelor vulnerable to potential takeover attempts is its poor performance on the market. According to Marc Roche in "*The Bank: How Goldman Sachs rules the world*", the shares of Arcelor were undervalued by the market before the bid was launched and had been undervalued at least since November 2005 because of negative speculation on Arcelor shares.[96] This is shown in the following table:

	Average closing price	Highest closing price	Lowest closing price
September 2005	18.54	19.46	17.79
October 2005	19.12	19.93	18.25
November 2005	20.25	20.64	19.76
December 2005	20.94	21.27	20.55
January 2006	22.61	29.75	20.86
February 2006	30.12	31.31	29.23
March 2006	31.89	33.05	31.09
April 2006	33.24	34.11	32.50
May 2006	33.91	35.76	32.00
June 2006	34.66	37.80	32.10
July 2006	38.89	43.00	35.29
August 2006	40.83	42.00	40.50
September 2006	40.62	40.99	40.45
October 2006	41.60	43.55	40.60
November 2006	42.97	43.76	42.56
December 2006	43.29	43.77	43.01

Source: Arcelor Annual Report 2006, p.20

[96] Marc Roche, *La Banque : Comment Goldman Sachs dirige le monde*

As explained in the introduction of this paper, a poor market performance is one of the most important factors that make a target desirable for a potential bidder. As a consequence, Arcelor was vulnerable in 2005-2006 because of its low market valuation.

2. Mild operational efficiency

In addition to this poor market performance, based on the figures given in the annual report published by Arcelor in 2006, Arcelor has a ROE of 13.6% (return on equity calculated as the net income group share divided by the shareholder's equity). This ROE is based on a ROCE of 10.9% (return on capital employed calculated as the net operating profit after tax divided by the sum of shareholder's equity and net financial position).[97]

(€m unless otherwise stated)	2006	2005
Net income to owners of the parent	3,007	3,873
Shareholders' equity	22,086	17,430
ROE	13.6%	22.2%
Operating income	4,454	4,417
Operating income after tax	2,920	2,896
Capital employed	26,796	18,687
ROCE	10.9%	15.5%

Source: Arcelor Annual Report 2006, p.56-59

This poor operational performance is also a factor that makes Arcelor attractive in the eyes of potential raiders. Indeed, the low operational efficiency of Arcelor gives potential buyers headroom to increase the value of their investment by enhancing the operational performance of the target.

3. Dispersed shareholding

A third important factor making Arcelor vulnerable is the fact that its shareholder base is completely dispersed, as shown in the following table:

	Shareholding Structure		
	Number of securities	% of capital	% of voting rights
Free float	539,933,861	84.39%	87.09%
Treasury stock	19,771,296	3.09%	-
Luxembourg state	35,967,997	5.62%	5.80%
J.M.A.C B.V. (Aristrain)	22,730,890	3.55%	3.67%
Wallonia region	15,351,973	2.40%	2.48%
Employees	6,018,310	0.94%	1.00%
Total	**639,774,327**	**100.00%**	**100.00%**

Source: Arcelor Annual Report 2006 p.20

[97] Arcelor Annual Report 2006, p56-59

Since EDF sold its stake in Arcelor in 2004, Arcelor's major shareholder is the Luxembourg state, but it only holds 5.62% of Arcelor's share capital. This dispersion of shareholding is a major threat for Arcelor as there is no reference shareholder willing to defend the company should a takeover be launched on the company's share capital.

iii. Description of Mittal's initial bid

On 27 January 2006, Mittal Steel announced its intention to launch a takeover bid on Arcelor for a total consideration of €18.6 billion. The offer is structured in the following way: 4 Mittal Steel shares and €32.25 for 5 Arcelor shares. Taking into account the €29.20 value of Mittal Steel shares as of 31 January 2006, this mixed offer represents a value of €29.81 for each Arcelor share and a 34.2% premium compared to the pre-rumour share price of Arcelor.[98]

According to Lakshmi Mittal, the merger of Arcelor with Mittal Steel would create a global leader able to produce almost 115 million tonnes of steel a year. The Indian leader also insisted on the geographical complementarities between the two groups and on the tremendous level of synergies such a merger would generate from the first year onwards. Mittal Steel also promised to sell the Canadian subsidiary Dofasco to ThyssenKrupp for €68 per share should the merger between Arcelor and Mittal become effective.[99]

b. The defence strategy implemented by Arcelor

i. Political reactions

1. In Luxembourg

Shortly after Mittal Steel submitted its tender offer to the Luxembourg authority, the Luxembourg state announced the early adoption of the European directive related to takeover. Indeed, until then, the Luxembourg state did not have any regulation directive regarding takeovers. Potential targets were thus allowed to use any possible antitakeover device in order to protect themselves. This European directive has two major articles: the Article 9 regarding the obligation of the board of directors to call for a vote during the general meeting of shareholders before implementing any defence mechanism; and the Article 11 that neutralises the shareholder agreements and double voting rights when takeover offers are launched.

However, the adoption of this European directive by Luxembourg was done in a way that gave a clear advantage to Arcelor:

- The Luxembourg national transposition of the law states that companies that are incorporated in Luxembourg have the right to choose whether they want to follow the restrictions brought to their ability to implement defence mechanisms (transposition of articles 9 and 11) or not;

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[98] Jean-Christophe Labastugue, *OPA sur Arcelor : faut-il déjà céder ses titres ou patienter ?*, Le Revenu Hebdo Bourse, 03/02/2006

[99] Ibid

- This new law allows buyers to squeeze-out minority shareholders, which was not possible in Luxembourg before the transposition of the European directive. This could have been good news for Mittal Steel. However, contrary to what the European directive recommends, the Luxembourg state decided to set the squeeze-out threshold at 95% instead of the recommended 90%. As the Luxembourg state owns 5.6% of Arcelor's capital, this decision goes against Mittal Steel's interests. Indeed, to be able to merge the two companies, Mittal Steel needs to be able to obtain 100% of the share capital of Arcelor.[100]

The early transposition of this directive was in line with the willingness of the Luxembourg Prime Minister Jean-Claude Juncker to help Arcelor resist this hostile takeover attempt. However, in March 2007, the Luxembourg senate voted against all the measures taken in order to fend off Mittal Steel's offer. They rejected the retroactivity of this directive and stated that this new takeover regulation could not be applied to ongoing offers.

2. *In France*

In France as well, where Arcelor employs 30,000 persons and generates a large part of its turnover, this hostile takeover bid faced hostile reactions for the political class. Although the French state renounced to apply its own takeover law, judging that the Luxembourg law would be more efficient to help Arcelor, the French political class played a role in this takeover battle by communicating a lot against Mittal Steel's offer.

In an interview given to the financial newspaper "*Les Echos*", the French Minister of Economy Thierry Breton stated that "*In a modern economy, a company willing to build an exciting project that creates value for its future shareholders, its employees and its clients cannot in any case behave this way with global companies. On the contrary to that, the rule in today's business world is to make sure beforehand that there does exist a common industrial project and compatible corporate cultures and governance rules. Wise businessmen learned from the failures of a large majority of hostile mergers that were trendy in the eighties.*"[101] In the same interview, Thierry Breton also stated that Mittal Steel's offer was problematic not only because of communication issues, but also because it did not respect the "*business world grammar*", suggesting that launching a takeover offer without trying to evaluate the relevance of a merger between the two entities was inappropriate and unworthy of modern business behaviours.

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[100] Myriam Chauvot and Caroline Lechantre, *OPA : le Luxembourg dévoile un projet de loi favorable à Arcelor*, Les Echos, 08/02/2006

[101] Originally in French: « *Dans l'économie modern, une entreprise qui veut bâtir un projet, motivant, créateur de valeur pour ses futurs actionnaires, ses salariés et ses clients ne peut en aucun cas procéder de la sorte avec des groupes de taille mondiale. Tout au contraire, la règle dans le monde des affaires d'aujourd'hui, c'est de s'assurer au préalable qu'il y a bien un projet industriel commun, des cultures d'entreprise que l'on peut marier et des règles de gouvernance compatibles. Les chefs d'entreprise avisés ont tiré les leçons de l'échec de la majorité écrasante des fusions hostiles qui étaient à la mode dans les années 80.* » Thierry Breton, interview with Les Echos, 30/01/2006

Following Thierry Breton's interview, the French Prime Minister Dominique de Villepin also reacted to Mittal Steel's offer on the French television channel "France 2" on 31 January 2006. He stated that Mittal's offer was very hostile in its form and was also lacking "industrial logic". As a consequence, he called on his European counterparts to foster "economic patriotism" and to organise a relevant reaction to this kind of hostile takeover attempts on European flagship companies. On 1 February 2006, Jean-Claude Juncker visited both French Prime Minister Dominique de Villepin and French President Jacques Chirac in order to discuss strategies to defend the European flagship steelmaker Arcelor.

ii. Communication battle

The quality of communication in a large company is extremely important, all the more so when the shareholding structure is dispersed as it is the case for Arcelor. Indeed, the outcome of Mittal Steel's takeover attempt does not depend so much on economic or regulatory issues, as the US and European authorities have accepted this transaction and the European directive making hostile takeovers more difficult will be implemented too late in France and Luxembourg. As a consequence, the only thing that matters in this takeover battle is to convince the free float to tender or not to tender their shares. To achieve this, the offered premium is important, but communication is even more important in order to convince shareholders about the relevance or irrelevance of the consolidation project. This is the reason why Arcelor and Mittal Steel will insist so much on communication during the offer period, using all the networks and communication tools available to them.

1. Attack the industrial logic

This communication battle started right after the phone call given to Guy Dollé by Lakshmi Mittal in order to inform Arcelor about the upcoming takeover bid on its share capital. In a press conference that followed the public announcement that Mittal Steel was launching a takeover on Arcelor, the Chairman and CEO of Arcelor, Guy Dollé, fiercely attacked the industrial project led by Lakshmi Mittal.

Guy Dollé argued that Arcelor was a truly multicultural company whereas 88% of Mittal Steel's capital was held by the Mittal family. Then, he stated that Mittal's economic model was flailing because Mittal Steel resulted from a series of mediocre acquisitions in low cost emerging countries whereas Arcelor was born after the merger of three European champion steelmakers. Arcelor's Chairman and CEO went even further when he stated that Mittal Steel produced "cologne" while Arcelor produced "perfume", pointing at the fact that Arcelor produced high quality steel whereas Mittal Steel was specialising in low quality products.[102]

In addition to this, Guy Dollé attacked Mittal Steel on the grounds of a cultural mismatch between the two companies. According to him, Mittal Steel and Arcelor are worlds apart in terms of governance, strategy and market performance. He said that he considered this

[102] *Mittal Steel défend son OPA, Arcelor réaffirme son refus*, Le Monde, 30/01/2006

hostile offer as opaque and value destructive and that this takeover attempt was a threat for Arcelor's employees.[103] This set of arguments were largely communicated to Arcelor's employees and stakeholders in general by Arcelor's trade unions, that decided to fight against Mittal Steel's offer out of fear that Mittal Steel would shut down some factories and lay off their employees. This contributed to instigate a climate of deep distrust and suspicion in the countries in which Arcelor had operational activities.

2. *Project Tiger*

Arcelor's executives decided to go further in the communication battle when they prepared a briefing aimed at shareholders. This briefing, called "Project Tiger" and in which the Mittals are referred to as "the Moon family", intends to convince incumbent shareholders of Arcelor that Mittal Steel has weak corporate governance standards and does not respect its commitments to shareholders.[104]

In this briefing, Arcelor claims that the original prospectus for Ispat International mentioned that the controlling shareholder, i.e. LNM Holdings that is fully controlled by the Mittal family, promised that it did not plan to "*participate in any significant future acquisitions of steel and steel-related companies, except through Ispat International*". The "Project Tiger" briefing claims that this promise was breached as LNM Holdings acquired many steel companies independently from Ispat International. This briefing also cites more than six acquisitions carried out by LNM Holdings up to 2004 whereas only two acquisitions were carried out by Ispat International in the same time period.[105]

The second claim made by Arcelor points out that Ispat International stated it had no intention to buy Ispat Karmet or Ispat Indo but actually bought at least one of these two subsidiaries of LNM Holdings in 2004 as part of the group consolidation. "Project Tiger" also claims that Ispat International's promise to pay dividends was often disregarded as Ispat International paid dividends only three times in 17 years whereas it had positive results in all but one year. For comparison, LNM Holdings shareholder, i.e. the Mittal family, received €2,386 million dividends as part of the acquisition of Ispat International.[106] These claims were also aiming at instigating a climate of distrust towards Mittal Steel, thus inducing Arcelor's shareholders not to tender their shares to the takeover offer launched by Mittal.

iii. *Financial defences*

Arcelor also started searching for financial reactive defence measures to fend off Mittal's hostile takeover bid. Three main solutions have been contemplated: finding a white knight, using a dividend recapitalisation and restructuring the corporate assets. Communication to shareholders around these measures was also a key component of this defence strategy.

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[103] *Mittal Steel défend son OPA, Arcelor réaffirme son refus*, Le Monde, 30/01/2006
[104] Edward Simpkins, *Arcelor adds steel to its defence*, The Telegraph, 19/02/2006
[105] Ibid
[106] Ibid

1. White knights: Nippon Steel and Severstal

In February 2006, rumour had it that Nippon Steel might serve as a “white knight” and propose a better offer to Arcelor’s shareholders. Indeed, on 2 February 2006, Akio Mimura, the president of Nippon Steel, came to Paris to meet Guy Dollé, the chairman and CEO of Arcelor. Officially, the goal of this official visit was to discuss the five-year partnership that existed between the two companies. However, many observers concluded that the real reason for this meeting was that Arcelor was looking for other companies willing to partner with Arcelor. Nevertheless, a few days later, Akio Mimura publicly stated that Nippon Steel would not act as a “white knight”. The market considered this declaration as a confirmation that Arcelor was actually looking for a “white knight” to fend off Mittal’s offer.[107]

A few months later, in 26 May 2006, Arcelor indeed announced that it found a white knight in the Russian steelmaker Severstal. The merger between Arcelor and Severstal would create the new global leader in the steel business with operations in Europe, Russia and Brazil. However, on 31 May 2006, Mittal managed to force Arcelor to organise a shareholder vote regarding the alliance with Severstal. Indeed, Mittal used the network of its investment bank Goldman Sachs to convince 30% of Arcelor’s shareholders to request such a vote. These shareholders are mostly hedge funds that are close to Goldman Sachs, for example Atticus Partners, Fidelity, Merril Lynch, Deka, Centaurus, Heyman Investment Associates etc.[108] As a consequence of this new obligation to organise a vote, a communication battle started, in which Arcelor tried to convince its shareholders that an alliance with Severstal would make more industrial sense and would create more value for them than a merger with Mittal. Some of the posters used by Arcelor are shown in the next two pages.

Despite all Arcelor’s efforts to convince the remaining 70% of shareholders to vote in favour of Severstal, some additional shareholders declared on 8 June 2006 that they would vote against an alliance with Severstal. The situation worsened on 14 June 2006 when Romain Zaleski, a French-Polish businessman owning about 5% of Arcelor’s capital declared that he would oppose a merger with Severstal and the share buyback programme that is necessary to conduct this transaction. This opposition arose after negotiations with Alexei Mordachov, head of Severstal, failed to satisfy the expectations of Romain Zaleski.

Following this massive opposition of shareholders, Severstal agreed to revise its offer on 21 June 2006. It agreed to decrease its stake in the merged entity from the initially contemplated 38% to a lower 25% and also stated that in case of a merger with Arcelor, it would not demand any seat at the board.[109] These improvements aimed at convincing shareholders to eventually vote in favour of Severstal against Mittal.

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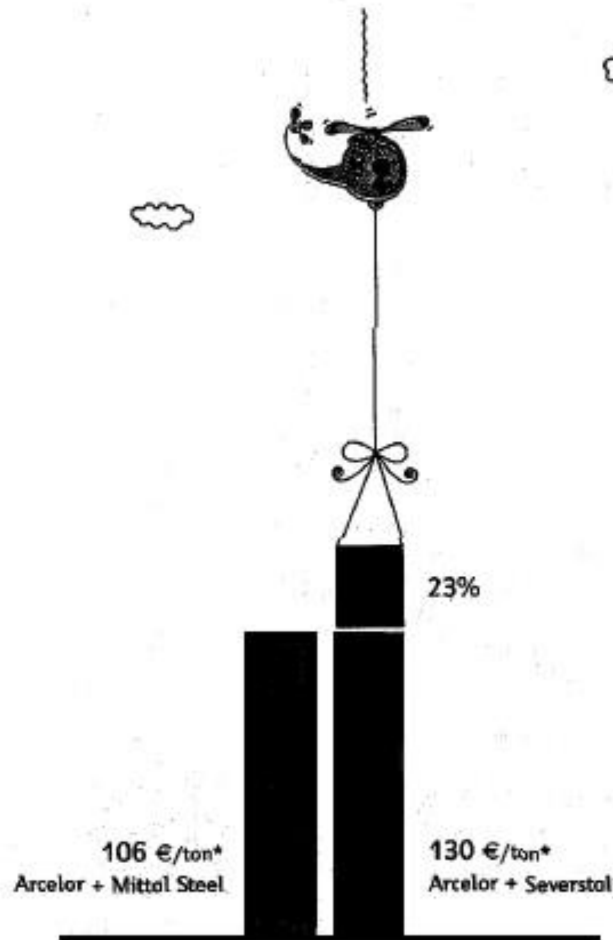
[107] Mariko Sanchanta, *Nippon will not aid Arcelor*, The Financial Times, 07/02/2006

[108] Virginie Allaire, Laurence Balmayer, Hervé Basset, François Desfournaux, Silvio Lo Niglio and José Nangis, *OPA de Mittal sur Arcelor : La sidérurgie européenne dans le chaudron de la globalisation financière,* La Lettre Sentinel, 39, July-August 2006

[109] Ibid

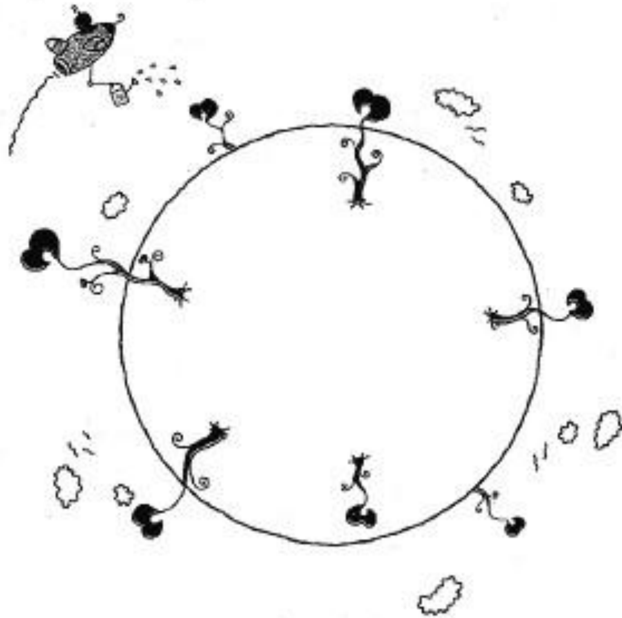
Do you prefer tons that are worth more or those that are worth less?



Take the profitability of Mittal Steel's proposal, increase it by 23%, and you have the value of Arcelor-Severstal.

It's your choice.

Is it better to be everywhere at once
or in the places that really count?



It's your choice.

Among all the factors that go into creating a truly competitive steel company, there is one that's crucial – plant location. Proximity to raw materials, ports, customers and the most lucrative markets in the world is what counts. With this criteria in mind, compare the Arcelor-Severstal merger to Mittal Steel's proposition.
Is it better to be the leader of the world's most lucrative markets – North America, Western Europe, Latin America and,as of today, Russia – or to hoist a flag in countries with an uncertain economic outlook.

2. Dividend recapitalisation

In addition to these negotiations in order to make shareholders accept the alliance with Severstal, Arcelor also announced to its shareholders on 4 April 2006 that it would increase its dividend from the originally proposed €1.20 per share to €1.85 per share. In a press release, Arcelor explained that this dividend increase reflected the confidence Arcelor had in its future performances and in its ability to meet the objectives of its "value creation plan". Arcelor also stated that this value of €1.85 corresponds to a target 30% payout ratio, which is in line with the announced improvement of Arcelor's dividend distribution policy.

In the same press release dated from 4 April 2006, Arcelor announced that it was willing to distribute €5 billion to its shareholders in addition to the €1.85 dividend per share. This extraordinary distribution could take the form of a share buyback, of an extraordinary dividend or of a self-tender offer, that would take place between the 28 April 2006 and the end of the twelfth month following the rejection of Mittal's offer. [110]

The main objectives of these measures were to make Arcelor less attractive for Mittal by deteriorating its net financial situation and, reciprocally, to make Mittal's offer less attractive for Arcelor's shareholders thanks to the distribution of an extraordinary dividend in case Mittal's offer was rejected.

3. Asset restructuring

On the same date, Arcelor also announced that it had placed its recently acquired subsidiary Dofasco in a Dutch foundation. According to Arcelor's press release, the shares of Dofasco held by Arcelor were transferred to a foundation called "Strategic Steel Stichting" (3S). This structure allowed Arcelor to keep the exclusive executive control of Dofasco, including economic and strategic decisions. However, following this share transfer, the members of the foundation's board obtained the power to control independently any decision related to the disposal of Dofasco out of the Arcelor group, in order to preserve the integrity of the Arcelor group. This foundation structure was supposed to stay in place for at least 5 years, except if the board members of the foundation itself decided to dissolve this structure.[111]

This defence mechanism was set up in order to prevent Mittal Steel from financing the acquisition of Arcelor by selling Dofasco to ThyssenKrupp as was planned in the initial offer made by Mittal Steel. By making the disposal of Dofasco impossible or highly complicated, Arcelor seriously hindered Mittal's ability to finance its merger with Arcelor and also deteriorated seriously the financial stability of the group should the merger be accepted by Arcelor's shareholders. In its press release, Arcelor also insisted a lot on the fact that selling such a strategic asset as Dofasco would make no sense from an industrial point of view and would destroy value for the firm and for shareholders.

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[110] Arcelor Press Release, *Le conseil d'administration d'Arcelor prend des mesures visant à défendre l'intérêt de ses actionnaires,* 04/04/2006

[111] Ibid

c. *Limits and achievements of this communication-centred defence strategy*

Eventually, following this communication battle, Mittal decided to revise its offer. Mittal Steel decided to offer 13 Mittal shares plus €150.6 cash for 12 Arcelor shares, which values Arcelor shares at €40.4 at the closing price of 23 June. The conditions remained similar, namely a minimum acceptance threshold of 50% and no material change in Arcelor or Mittal Steel substance during the offer. This new offer represented an ownership of 50.5% for Arcelor investors and of 49.5% for Mittal Steel investors. On 26 June 2006, Mittal had accumulated 92% of Arcelor shares, thus making the merger possible.

This outcome represents both a defeat and a victory for Arcelor. Indeed, Arcelor did not manage to fend off Mittal's hostile takeover, but in the same time, its defence strategy brought about a significant increase in the premium offered to shareholders and a significant improvement of the terms offered to Arcelor's other stakeholders. Let us analyse in this section the major limits and achievements of a communication-centred strategy like the one that was implemented around Arcelor.

i. *Limits: Mittal managed to get its bid accepted*

The first limitation of a communication-centred defence strategy is that it can be used by both parties as well. Indeed, in the case of Arcelor, Mittal Steel did not hesitate to meet political leaders and use large scale communication plans in order to cancel the effects of Arcelor's communication strategy towards political leaders and public opinion.

1. *Political alliances*

Lakshmi Mittal visited European political leaders from the 30 January 2006 onwards. He met the French Minister of Economy Thierry Breton, the Luxembourg Prime Minister Jean-Claude Juncker, but also the European Commissioners Neely Kroes, responsible for competition, and Gunter Verheugen, responsible for economy. These visits aimed at convincing political leaders that Arcelor should support Mittal's offer. For example, Lakshmi Mittal offered Jean-Claude Juncker to keep the headquarters of the merged entity in Luxembourg, which was also the condition for the merger of Arbed with Aceralia and Usinor to be accepted.

On 9 May 2006, Lakshmi Mittal also announced its intention to nominate François Pinault at the board of the merged entity. This businessman, head of the French luxury group PPR, had a lot of connections with French economic and political leaders. As a consequence, his participation in the takeover project would reassure political leaders about the industrial relevance of the takeover. In addition to this, Mittal's connections with Goldman Sachs and the communication specialist Anne Méaux, former counselor of right-wing political leaders, allowed Mittal Steel to benefit from political alliances with hedge funds, activist shareholders and a certain political class in France.[112]

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[112] Ibid

Some observers also noted that family relationships between the Zaoui brothers might also have interfered in favour of Mittal Steel. Indeed, Yoël Zaoui, managing director at Goldman Sachs, is the brother of Michael Zaoui, managing director at Morgan Stanley, which advised the board of Arcelor to organise a formal vote around the possible merger with Severstal, which resulted in a failure of this "white knight" strategy.[113]

2. *Communication around industrial logic*

The effect of these "political" relationships was further completed by a large scale communication plan implemented by Anne Méaux, a communication magnate, via her company Image 7. In order to convince Arcelor's shareholders of the relevance of Mittal's offer, she used all the possible way of communicating, among which press conferences, press releases, conference calls, interviews, visits of Mittal's factories in Chicago and in France, ads in the financial press and partnerships with communication agencies.[114]

Anne Méaux centred Mittal's communication strategy on two axes:

- Trade unions: Image 7 organised meetings between Lakshmi Mittal and Arcelor's trade unions in order to convince them of the industrial relevance of the takeover project and in order to show Mittal's commitment to employees;
- Shareholders and public opinion in general: Anne Méaux focused her communication plan around the notion of "self-made man" in order to amplify Lakshmi Mittal's credibility in the European business spheres and to make people forget the image that the gutter press forged him based on his taste for extravagant parties.[115]

Mittal also riposted to Arcelor's communication plan around the alliance with Severstal by creating the same kind of posters as Arcelor. Two of these posters are shown in the following pages. They insist on the fact that Arcelor's shareholders have the right to refuse the merger with Severstal and should thus vote no at the general meeting of shareholders. This communication strategy proved to be successful as most shareholders rejected the alliance with Severstal and eventually tendered their shares to Mittal's offer.

ii. Achievements: Better terms offered to Arcelor's stakeholders

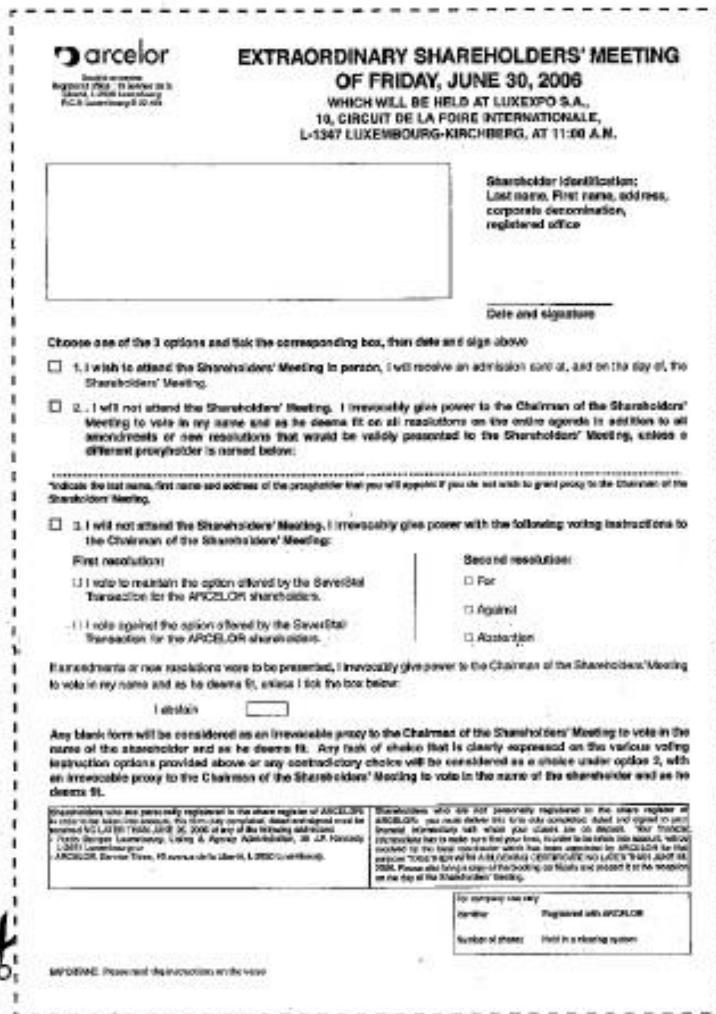
However, thanks to its communication battle, Arcelor achieved to improve the terms and conditions of the takeover offer launched by Mittal on its share capital, thus defending the interests of Arcelor's stakeholders:

- The premium offered to shareholders was significantly increased and allowed shareholders to get a good value for their investment
- The conditions offered to managers, employees and political leaders were enhanced as well in the final offer.

[113] Ibid
[114] Ibid
[115] Ibid

Arcelor shareholders,
vote NO to the forced Severstal merger.

Here's how:



arcelor

[illegible]

EXTRAORDINARY SHAREHOLDERS' MEETING
OF FRIDAY, JUNE 30, 2006
WHICH WILL BE HELD AT LUXEXPO S.A.,
10, CIRCUIT DE LA FOIRE INTERNATIONALE,
L-1347 LUXEMBOURG-KIRCHBERG, AT 11:00 A.M.

Shareholder identification:
Last name, First name, address,
corporate denomination,
registered office

Date and signature

Choose one of the 3 options and tick the corresponding box, then date and sign above

☐ 1. I wish to attend the Shareholders' Meeting in person, I will receive an admission card at, and on the day of, the Shareholders' Meeting.

☐ 2. I will not attend the Shareholders' Meeting. I irrevocably give power to the Chairman of the Shareholders' Meeting to vote in my name and as he deems fit on all resolutions on the entire agenda in addition to all amendments or new resolutions that would be validly presented to the Shareholders' Meeting, unless a different proxyholder is named below:

....

*Indicate the last name, first name and address of the proxyholder that you will appoint if you do not wish to grant proxy to the Chairman of the Shareholders' Meeting.

☐ 3. I will not attend the Shareholders' Meeting. I irrevocably give power with the following voting instructions to the Chairman of the Shareholders' Meeting:

First resolution:

☐ I vote to maintain the option offered by the SeverStal Transaction for the ARCELOR shareholders.

☐ I vote against the option offered by the SeverStal Transaction for the ARCELOR shareholders.

Second resolution:

☐ For

☐ Against

☐ Abstention

If amendments or new resolutions were to be presented, I irrevocably give power to the Chairman of the Shareholders' Meeting to vote in my name and as he deems fit, unless I tick the box below:

I abstain ☐

Any blank form will be considered as an irrevocable proxy to the Chairman of the Shareholders' Meeting to vote in the name of the shareholder and as he deems fit. Any lack of choice that is clearly expressed on the various voting instruction options provided above or any contradictory choice will be considered as a choice under option 2, with an irrevocable proxy to the Chairman of the Shareholders' Meeting to vote in the name of the shareholder and as he deems fit.

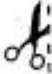
[illegible]

For company use only

[illegible] Registered with ARCELOR

Number of shares Held in a clearing system

[illegible]



You now have up to close of business Tuesday June 27* to

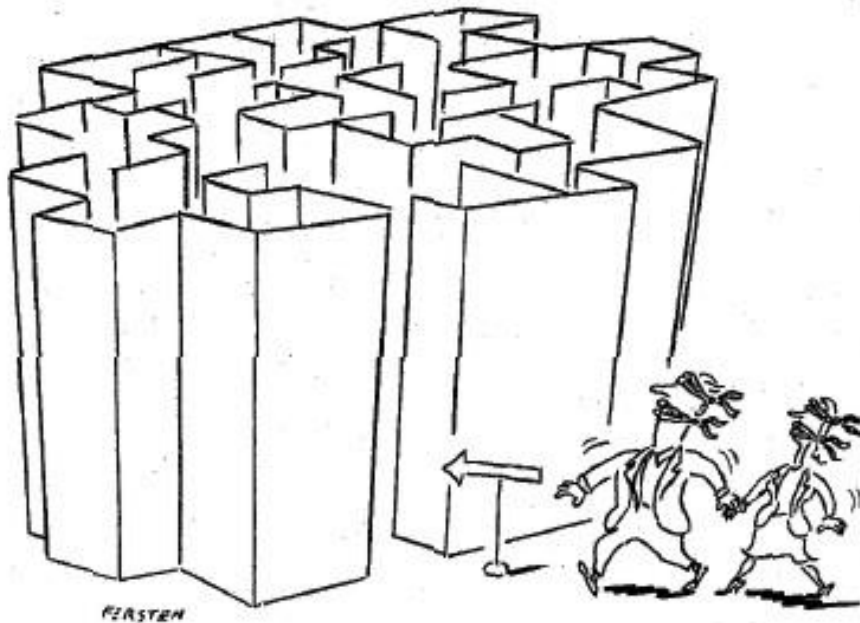
1/ cut out this form or obtain a copy from your financial intermediary or at www.arcelor.fr/index.php?lang=en&page=236

2/ complete, date and sign it

3/ address it by mail

- if you are a registered shareholder, to Arcelor - Services titres 19 avenue de la Liberté L-2930 Luxembourg
- if you are NOT a registered shareholder, to your financial intermediary together with your blocking certificate

A real choice for Arcelor shareholders **MITTAL**



— *"To vote 'NO'? It's very simple, right this way..."*

Arcelor shareholders, you don't have to accept being forced to say "yes".

Call us at 0 800 051 7207 or +44 20 7920 9700.

A real choice for Arcelor shareholders **MITTAL**

1. *Benefits for Arcelor’s initial shareholders*

First of all, Arcelor managed to obtain a substantially higher premium for its shareholders. Indeed, the final price of €40.4 represents a 35.5% increase compared to the initial €29.81 offered price, which is a clear victory for incumbent shareholders. For that matter, we can consider that Arcelor’s defence strategy has been successful in defending the best interests of its owners.[116]

Second, the final financial structure proposed by Mittal grants a majority ownership in the new entity to former Arcelor’s shareholders. Indeed, after the merger, Arcelor’s shareholders represent 50.5% of ArcelorMittal’s share ownership.[117] This improvement of the financial terms of the offer was allowed because of Arcelor’s battle against the initial bid offer presented by Mittal.

2. *Benefits in terms of corporate governance*

According to the analyst presentation released on 26 June 2006 by Mittal, the new entity will be characterised by high standards of corporate governance:

- All shares have identical voting rights and economic rights regardless of how long they have been held by the same person;
- The board of directors will be composed 18 non-executive members, among which 6 members from Arcelor, 6 members from Mittal Steel, 3 current representatives of existing Arcelor major shareholders and 3 employee representatives;
- Initially, Mr Mittal will be President and Mr Kinsch will be Chairman and after the retirement of Mr Kinsch, Mr Mittal will become Chairman;
- After a three year period, shareholders will have the right to elect the board of directors;
- An “Audit Committee” composed of independent directors and an “Appointments and Remuneration Committee” composed of the Chairman, the President and two independent directors will be created;
- The Management will be comprised of 4 current Arcelor executives and of 3 Mittal Steel executives, the CEO will be proposed by the Chairman.[118]

In addition to these internal corporate governance measures, the commitments of Mittal Steel regarding the preservation of employment and the incorporation of the merged entity in Luxembourg is a victory for political leaders and for the trade unions that fought alongside Arcelor’s management to soften the terms and conditions of Mittal Steel’s initial hostile offer.

[116] Mittal Analyst Presentation, 26/06/2006, p8
[117] Ibid, p5
[118] Ibid, p9

IV. Recommendations

As developed in the introduction of this paper, hostile takeovers are unsolicited tender offers that three players might be willing to fend off: the managers of the firm, its shareholders and political leaders from its country of incorporation. In the light of the literature review and case studies conducted in this paper, let us conclude on which defence strategies are the most efficient to protect the best interests of each of these three players.

Managers have a fiduciary duty towards shareholders. Their role is thus to protect the best interests of the shareholders by setting up a level of protection high enough to fend off inadequate offers but also allowing adequate offers to go through. To achieve this goal, preventative financial and legal defences are efficient in deterring opportunist raiders from launching a hostile takeover but they are often not sufficient to fend off hostile raiders interested in long term synergies. Reactive financial and legal measures such as asset and capital restructuring or litigation are often considered as value destructive for shareholders. However, a reasonable level of reactive measures can serve the best interests of shareholders by helping them to get a higher premium for their shares.

However, some managers tend to be willing to entrench themselves instead of serving the best interests of their shareholders. It appears that the current legal framework makes it really difficult for managers to completely entrench themselves if they face the opposition of shareholders. Indeed, in many cases, antitakeover defences implemented by managers have been ruled out by courts because they were not in line with their fiduciary duty. As a consequence of this, the best defence for managers not willing to see their company absorbed by a hostile raider is to find a white knight considered friendlier by managers. However, this defence strategy is difficult to implement in practice and still suppose losing independence. This is the reason why managers willing to retain their positions should always keep in mind that the best defence strategy is to avoid being the target of a hostile raid, by keeping excellent track record and operational performance on the long run.

As for shareholders, we believe that legal defences such as shareholder agreements, holding companies and legal forms of incorporation are the most efficient tools in order to lock up the firm's capital. However, these legal defences can always be bypassed one way or another, so we believe they should be completed by other defence measures in order to make sure potential dissension among the shareholder block will not ruin this defence strategy based on legal and statutory measures.

As for political leaders, the analysis of past real life case studies showed that reactive measures and communication battles have proved to be inefficient and did not allow national champions to remain independent. However, setting up in advance a legal framework aiming at protecting national flagships in some strategic sectors is a winning strategy, even if it raises some issues related to protectionism.

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