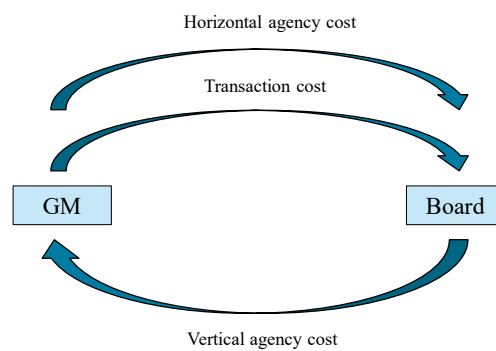


2.3. Board independence

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Introduction



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Board independence

- Boards may curb the horizontal agency cost by acting in the corporate interest (>< interest of the controlling shareholder)
- Directors may receive pressure from (controlling or activist) shareholders.
- Board dependence thus results in/maintains horizontal agency cost.
- Increasing board *independence* may reduce horizontal agency cost.
 - What are the disadvantages?
 - If ownership is high, can you expect more or less board independence?
- How can Boards be (made) independent from (controlling or activist) shareholders?

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Board independence

- How can Boards be (made) independent from (controlling or activist) shareholders?
 1. Procedural: liability rules
 - ✓ business judgment rule: courts do not review business decisions, unless in certain circumstances (*e.g.*, fraud);
 - ✓ “judicial deference”: if decisions are reviewed, only gross/manifest violations/deviations are sanctioned:
 - ✓ lack of authority of courts to review business decisions;
 - ✓ incapability of courts to review business decisions;
 2. Structural independence:
 - Staggered boards >< at will revocability
 - Independent directors
 - Two-tier boards
 - Board committees

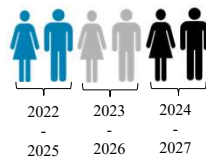
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Staggered boards: US

□ Meaning:

- directors' mandates have a fixed duration; *and*
- no termination for convenience prior to the term ($><$ at will revocability); *and*
- each class serving different length across staggered terms



- ### □ Goal: insulate Board from pressure from (controlling or activist) shareholders.

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Staggered boards

Country

Can Board be staggered?



§ 141(k) DGCL:

"Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors, except as follows: (1) Unless the certificate of incorporation otherwise provides, in the case of a corporation whose board is classified as provided in subsection (d) of this section, stockholders may effect such removal only for cause



L.225-18 C.Com.: *"Directors are eligible for re-election, unless otherwise stipulated in the articles of association. They can be revoked at any time by the ordinary general meeting."*



Art. 7:85 BCCA: *"The general meeting may terminate the mandate of any director at any time and without stating reasons with immediate effect."*

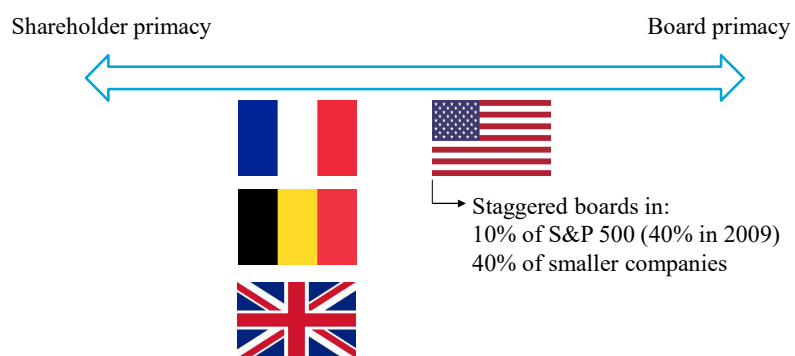


S. 168 CA 2006: *"A company may by ordinary resolution at a meeting remove a director before the expiration of his period of office, notwithstanding anything in any agreement between it and him."*

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Staggered boards



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Staggered boards

□ Open questions:

- Are staggered boards good or bad?
- Should at will revocability be mandatory?
- Do staggered board encourage or discourage hostile takeovers?
- How can we explain the difference between USA and Europe?
- How can we explain the decline of staggered boards in USA?

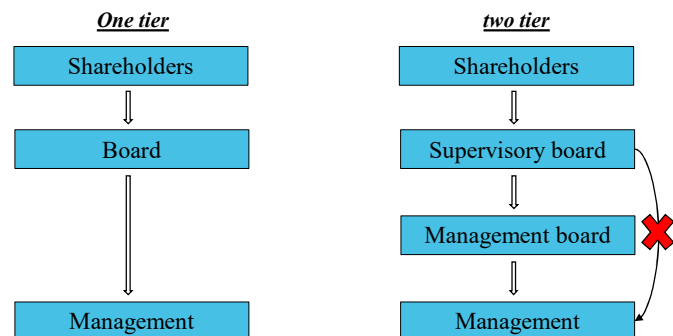
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Two-tier boards

□ Meaning:

- board responsibilities are divided among two separate bodies: management board and supervisory board;
- supervisory board appoints and supervises management board, but cannot interfere in management of the company.



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Two-tier boards

□ Meaning:

- board responsibilities are divided among two separate bodies: management board and supervisory board;
- supervisory board appoints and supervises management board, but cannot interfere in management of the company.

- Goal: insulate Board from pressure from (controlling or activist) shareholders.

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Two-tier boards

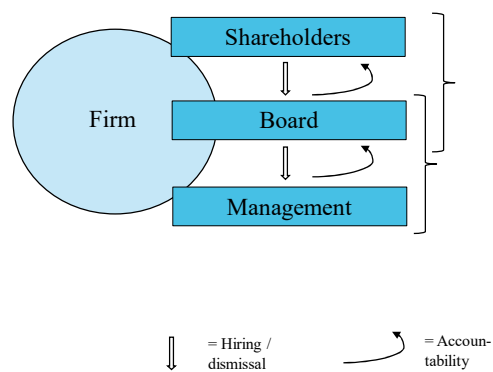
Country	Two-tier board?
	Article 7:104 BCCA: Optional (“ <i>Conseil de direction</i> ” and “ <i>Conseil de surveillance</i> ”)
	L.225-57 et seq. C.Com.: Optional (“ <i>Directoire</i> ” and “ <i>Conseil de surveillance</i> ”)
	S. 95 et seq. AktG: Mandatory in AG (“ <i>Vorstand</i> ” and “ <i>Aufsichtsrat</i> ”)
	Article 152 et seq. NBW: Mandatory in larger NV (“ <i>Raad van commissarissen</i> ”)
	N/A
	N/A

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Independent directors

□ Recap

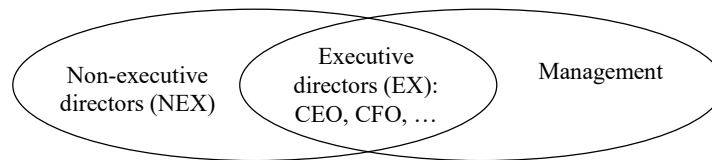


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Independent directors

- Board composition:



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Independent directors

- Origins:
 - USA / Widely held firms:
 - failure of the “shareholder franchise” resulting from, among other things, collective action problem (*supra*)
 - problem of “auto-control” by management;
 - market reaction: appointment of independent directors as “bonding mechanism” (*i.e.*, committing to good governance);
- Purpose: foster active and independent monitoring of management
- Criteria for independence: next slides

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Independent directors

□ §303A.01 NYSE Listed Company Manual

(ii) In addition, in affirmatively determining the independence of any director who will serve on the compensation committee of the listed company's board of directors, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:

(A) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listed company to such director; and

(B) whether such director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company.

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Independent directors

□ §303A.01 NYSE Listed Company Manual

(b) In addition, a director is not independent if:

(i) The director is, or has been within the last three years, an employee of the listed company, or an immediate family member is, or has been within the last three years, an executive officer, ¹ of the listed company.

(ii) The director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$120,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service).

(iii) (A) The director is a current partner or employee of a firm that is the listed company's internal or external auditor; (B) the director has an immediate family member who is a current partner of such a firm; (C) the director has an immediate family member who is a current employee of such a firm and personally works on the listed company's audit; or (D) the director or an immediate family member was within the last three years a partner or employee of such a firm and personally worked on the listed company's audit within that time.

(iv) The director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee.

(v) The director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million, or 2% of such other company's consolidated gross revenues.

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Independent directors

□ Critics:

- do independent directors result in a less involved board?
- do independent directors have sufficient incentives to monitor the board?
- do independent directors prevent innovation?
- other concerns?

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Independent directors

□ Financial crisis 2008: “transplantation” in other legal systems:



E.g.: Principe 3.4 of the 2020 Corporate Governance Code

3.4 The board of directors should comprise a majority of non-executive directors. The board should include an appropriate number of independent directors. At least three directors should qualify as independent according to the criteria described in the Code.

The supervisory board should include an appropriate number of independent members. At least three members should qualify as independent according to the criteria described in the Code.

□ Critics:

- independent directors protect shareholders against management; in controlled companies, the dominant agency problem is horizontal, not vertical (“*Different disease, same treatment*”)

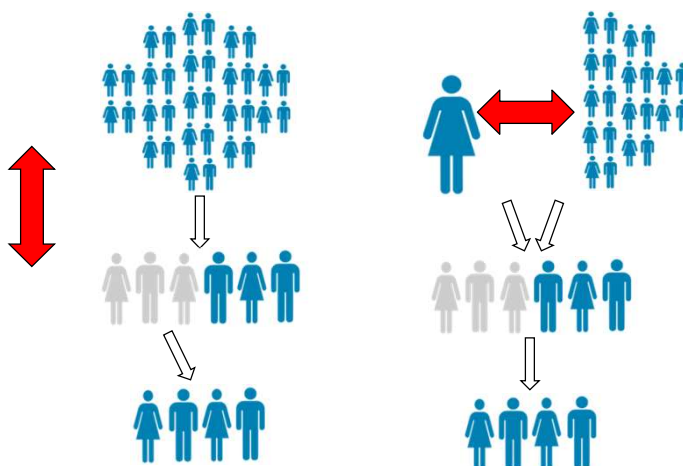
- E.g.: Urtagia & Saez, Deconstructing Independent Directors (2012):

“European jurisdictions have failed to make this distinction. In fact, both in the codes of best practices and in other regulations, such as listing requirements, independent directors are seen as a protection for shareholders specifically against managers, not against other shareholders. We believe that in Europe, independent directors are being used for the wrong purposes. This may be another example of lobbying by the interest groups: notions of good corporate governance can be manipulated to turn out rules against their own purposes”

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Independent directors

□ Critics:



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Independent directors

□ Critics:

- independent directors protect shareholders against management; in controlled companies, the dominant agency problem is horizontal, not vertical (“*Different disease, same treatment*”);
- if independent directors have any role in controlled firms, they must be independent from controlling shareholders; however, independent directors are not independent from controlling shareholders:
 - E.g., Bebchuk & Hamdani: “Independent directors and controlling shareholders” (2017):
“Directors at firms with controlling shareholders—including independent directors—cannot be elected or reelected following their initial term—unless the controlling shareholder supports their candidacies. Nor will they stay in office once the controlling shareholder decides to end their service on the board.”
 - E.g., Kastiel, “Executive compensation in controlled companies” (2015)
“A rational, value-maximizing controller will pay extra compensation to a professional manager if the additional private benefits such a controller derives from overpaying the manager outweigh the prorated costs such a controller incurs due to the payment of extra compensation and the decrease in firm value as a result of the enhanced transfer of private benefits (in case such decrease actually occurs).”

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Independent directors

- Alternative for independent directors in controlled firms: “minority directors”



LR 9.2.2 FCA Handbook (Listing Rules):

9.2.2E

R

Where ■ LR 9.2.2ADR applies, the election or re-election of any *independent director* by shareholders must be approved by:

- (1) the shareholders of the *listed company*; and
- (2) the *independent shareholders* of the *listed company*.

- Open questions:

- why do minority investors not exist in other jurisdiction where controlled firms are dominant?
- could there be a connection between approach to independent directors and ownership concentration?

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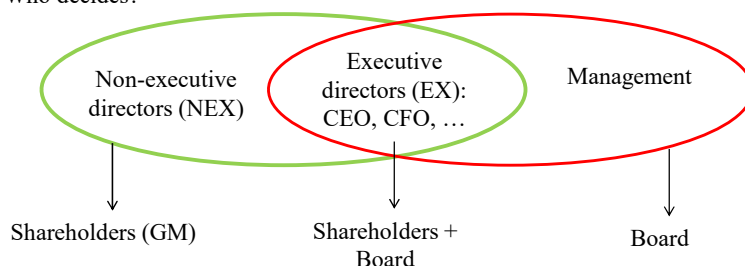
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2.4. Executive compensation

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Executive compensation

- Two types of executive compensation:
 - fixed remuneration;
 - variable remuneration (stock option, shares, bonus, etc.)
 - Ratio?
 - Shortcomings?
- Who decides?



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Executive compensation

- Who decides?
 - Traditionally:
 - Board mandates: usually GM
 - Executive mandates: usually Board
 - Recent response:



Article 9a SRD II: “1. Member States shall ensure that companies establish a remuneration policy as regards directors and that shareholders have the right to vote on the remuneration policy at the general meeting.
2. Member States shall ensure that the vote by the shareholders at the general meeting on the remuneration policy is binding. Companies shall pay remuneration to their directors only in accordance with a remuneration policy that has been approved by the general meeting.”

- Open questions:
 - which problem does Article 9a SRD II aim to address?
 - is this problem the same in controlled firms as in widely held firms?
 - why are conflict of interest rules not sufficient?

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2.5. *Conflicts of interest and RPT*

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Conflicts of interest

- General definition:
 - person owes duty of loyalty (or similar duty) to another person or legal entity;
 - *e.g.*: directors, trustees, advisors, lawyers
 - personal interest conflicts with that person's interest.
- Company law:
 - directors are generally considered to be under a duty of loyalty *vis-à-vis* their company;
 - legal consequences depend on jurisdiction:
 - obligation to disclose (transparency);
 - obligation to abstain from deliberations;
 - obligation to abstain from voting;
 - obligation to escalate decision to another corporate body (*e.g.*, GM).

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Conflicts of interest

Country

Conflict of interest procedure



Art. 2:129 NBW:

"A director shall not participate in the deliberations and decision-making if he has a direct or indirect personal interest that conflicts with the interest referred to in paragraph 5."



L.225-38 C.Com.: *"The person directly or indirectly interested in the agreement is required to inform the Board as soon as he becomes aware of an agreement to which Article L. 225-38 is applicable. It may not take part in the deliberations or in the vote on the requested authorization."*



Art. 7:96 BCCA: *"The director with a conflict of interest as referred to in the first paragraph may not participate in the deliberations of the board of directors on these transactions or decisions, nor in the voting in that regard."*



S. 175 CA 2006: *"A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company... Authorisation may be given by the directors... The authorisation is effective only if (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director; and (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted."*

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Conflicts of interest

Country

Conflict of interest procedure



§144 DGCL

"No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if:

(1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the stockholders."

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Conflicts of interest

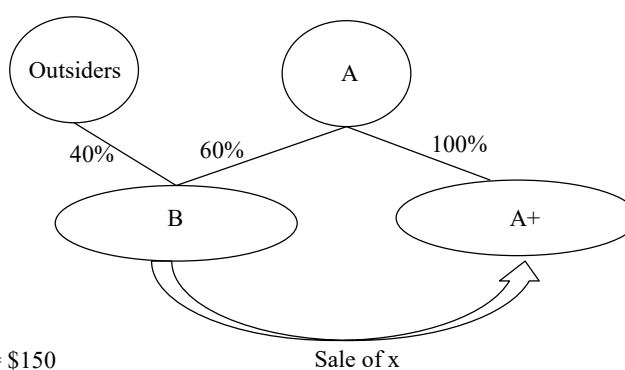
- Shortcomings of conflict of interest procedures:
 - loyalty among Board members and “tit for tat”;
 - abstention from voting does not prevent conflicted directors from influencing decision;
 - limitations on scope of application and “regulatory arbitrage”;
 - other shortcomings?
- Do conflict of interest procedures apply to (controlling) shareholders?
 - in most jurisdictions, scope is limited to the Board;
 - however, in listed companies, related-party transaction procedure applies (*infra*).

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Related-party transactions (RPT)

- “Tunnelling”: value diversion by controlling shareholders



Market value $x = \$150$
 Price paid for $x = \$100$

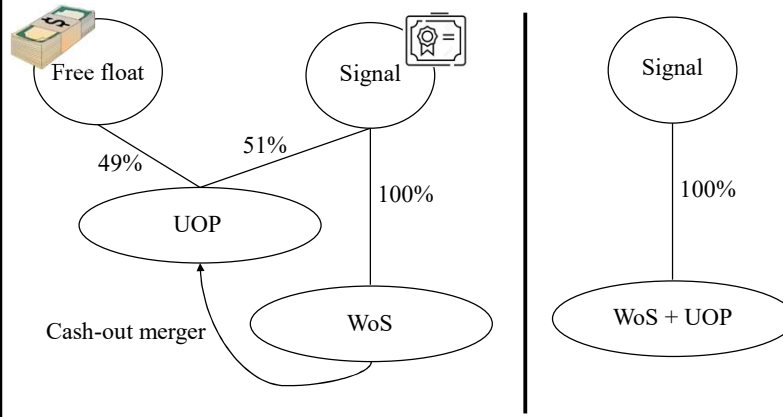
Transfer from outsiders to A of \$20 (*i.e.*, $\$50 \times 0.4$)

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Related-party transactions (RPT)

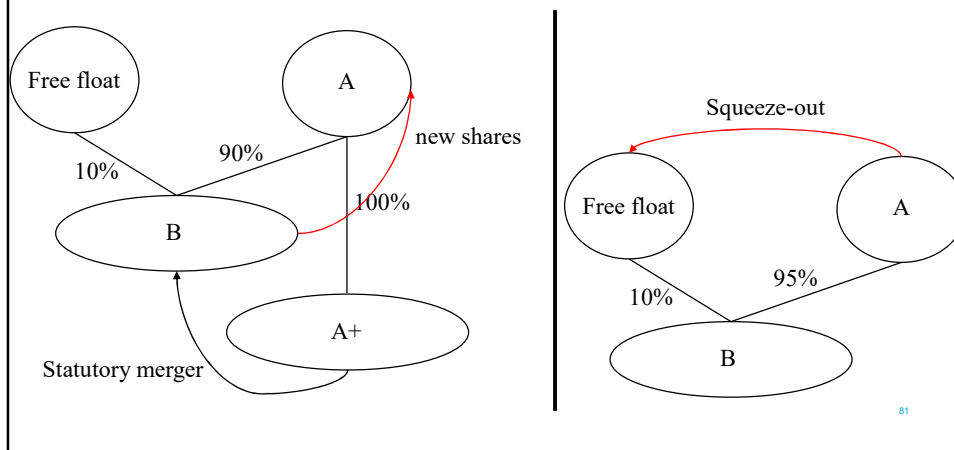
- “Freeze-outs”: forcing minority shareholders out of a company
 - US – triangular cash-out mergers:
 - E.g., *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983)



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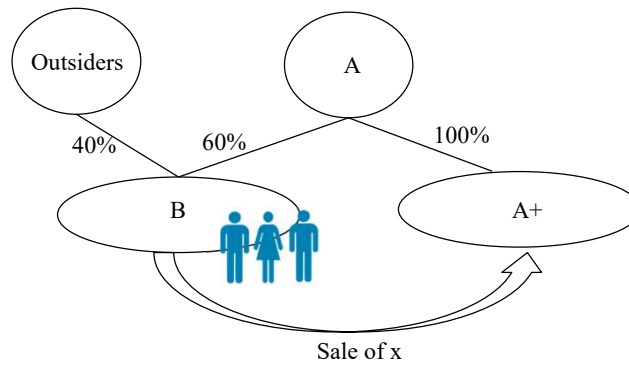
Related-party transactions (RPT)

- “Freeze-outs”: forcing minority shareholders out of a company
 - Combination of statutory merger and “squeeze-out”



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Related-party transactions (RPT)

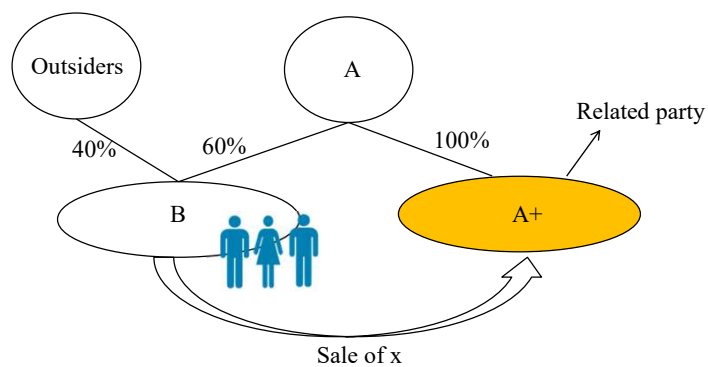


- Two questions:
- ✓ Who, in fact, appoints directors?
 - ✓ Do conflict of interest rules apply?
 - ✓ If they apply, are they sufficient?

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Related-party transactions (RPT)



- Two questions:
- ✓ Who, in fact, appoints directors?
 - ✓ Do conflict of interest rules apply?
 - ✓ If they apply, are they sufficient?

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Related-party transactions (RPT)

- Reasons for additional regulation:
 - horizontal agency problem:
 - controlling shareholders controls the Board and dominates GM;
 - Board: conflict of interest rules do not per se apply to RPT (unless director is (financially interested in) the related party);
 - GM: usually no conflict of interest rules.
 - insufficiency of other control mechanisms:
 - shareholder approval;
 - board autonomy;
 - requirement of shareholder equality;
 - transparency;

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Related-party transactions (RPT)

- Reasons for additional regulation:
 - insufficiency of other control mechanisms:
 - judicial review:
 - ✓ business judgment rule: courts do not review business decisions, unless in certain circumstances (*e.g.*, fraud);
 - ✓ “judicial deference”: if decisions are reviewed, only gross/manifest violations/deviations are sanctioned:
 - ✓ lack of authority of courts to review business decisions;
 - ✓ incapability of courts to review business decisions;
 - other mechanisms?
 - why not prohibit all RPT ?

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Related-party transactions (RPT)



Article 9c, para. 4 SRD II: “Member States shall ensure that material transactions with related parties are approved by the general meeting or by the administrative or supervisory body of the company according to procedures which prevent the related party from taking advantage of its position and provide adequate protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders.

Member States may provide for shareholders in the general meeting to have the right to vote on material transactions with related parties which have been approved by the administrative or supervisory body of the company.

Where the related party transaction involves a director or a shareholder, the director or shareholder shall not take part in the approval or the vote.

Member States may allow the shareholder who is a related party to take part in the vote provided that national law ensures appropriate safeguards which apply before or during the voting process to protect the interests of the company and of the shareholders who are not a related party, including minority shareholders, by preventing the related party from approving the transaction despite the opposing opinion of the majority of the shareholders who are not a related party or despite the opposing opinion of the majority of the independent directors.

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Related-party transactions (RPT)

- What is “adequate protection” (cfr. Article 9c, para. 4 SRD II) ?
 - procedural fairness (options 1 and 2) *versus* substantive fairness (option 3) or combination of both (option 4)
 - Option 1: decision remains with the Board
 - additional safeguard: independent directors must approve/advice + disclosure
 - example: Article 7:97 BCCA 
 - critics:
 - ✓ if advice is not binding, controlling shareholders may overstep advice;
 - ✓ are independent directors (sufficiently) independent from controlling shareholders?

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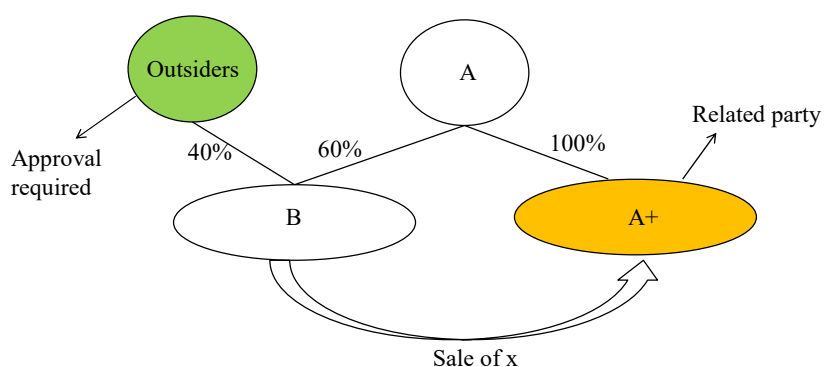
Related-party transactions (RPT)

- What is “adequate protection”(cfr. Article 9c, para. 4 SRD II) ?
 - Option 2: decision must be approved by the general meeting of shareholders
 - additional safeguard: controlling shareholder (related party) may not vote: “*majority of minority vote*” (MoM)
 - examples:
 - ✓ L.225-40 
 - ✓ Listing rule 11.1 
 - disadvantages:
 - ✓ transaction cost;
 - ✓ risk of expropriation by minority (reverse horizontal agency problem);
 - ✓ risk that value-increasing decisions may be blocked by shareholders.

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Related-party transactions (RPT)



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Related-party transactions (RPT)

□ What is “adequate protection” (*cfr.* Article 9c, para. 4 SRD II) ?

– **Option 3**: decision may be reviewed by the courts

• additional safeguard: increased judicial scrutiny

• example: *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983): 

“When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. ...The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts”

→ “entire fairness review” instead of “business judgment rule”

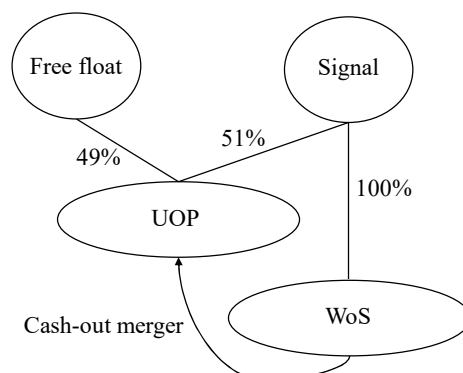
→ entire fairness entails “fair dealing” and “fair price”

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Related-party transactions (RPT)

□ *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983)



“Arledge and Chitrea concluded that it would be a good investment for Signal to acquire the remaining 49.5% of UOP shares at any price up to \$24 each. [...] It was ultimately agreed that a meeting of Signal’s executive committee would be called to propose that Signal acquire the remaining outstanding stock of UOP through a cash-out merger in the range of \$20 to \$21 per share.”

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Related-party transactions (RPT)

- What is “adequate protection” (*cfr.* Article 9c, para. 4 SRD II) ?
 - Option 3: decision may be reviewed by the courts
 - additional safeguard: increased judicial scrutiny
 - disadvantages:
 - ✓ risk and cost of litigation;
 - ✓ collective action problem of minority shareholders;
 - ✓ risk of judicial error: adequacy of this strategy depends on quality of the courts (speed, expertise, familiarity with commercial matters, etc.)
 - open questions:
 - can this strategy be adopted in other jurisdictions (other than Delaware) ?
 - do the disadvantages of judicial review outweigh disadvantages of procedural fairness (MoM) ? Which factors should be taken into account ?

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Related-party transactions (RPT)

- What is “adequate protection” (*cfr.* Article 9c, para. 4 SRD II) ?
 - Option 4: combination of procedural fairness and substantive fairness

- example: *Kahn v. M&F Worldwide Corp.*, 88 A.3D 635: 

“To summarize our holding, in controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.”

→ either company applies procedural fairness (special committee + MoM) or courts apply entire fairness

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Example

Tesla asks shareholders to back \$56bn pay for Elon Musk rejected by judge

Delaware court in nullified compensation deal based on carmaker's market value in January, calling it 'unfathomable sum'



Elon Musk's record-breaking \$56bn pay was set in 2018 but rejected by a Delaware judge in January. Photograph: Tingshu Wang/Reuters

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Exam – sample questions

- It has been reported that European jurisdictions typically grant stronger rights to shareholders than U.S. jurisdiction to control the board and to influence the corporate decision-making process. How could this difference be explained?
- Amoras is a small country which recently became independent. In order to cut all ties with its former oppressor, it wishes to re-write most of its laws. You are hired as an expert to advise a committee on the preparation of a new companies' code in a certain country. One topic to be discussed is the requirement of appointing independent directors. You are asked to advise the committee on what rules could be implemented and what are the advantages and disadvantages of each approach.
- You are working as in-house legal advisor to a listed company based in Belgium. The company recently had to deal with a few scandals within the board. As a result of those scandals, the price of the company's shares on the exchange has crashed. The company therefore wishes to launch a media campaign to polish its reputation. One of the proposals is to enact a rule that a board decision relating to major acquisitions or sales of substantial assets by the company shall be submitted to the general meeting of shareholders for deliberation and a vote. You are asked to advise the board on (i) the advantages and disadvantages of this proposal, and (ii) if the proposal would be accepted, whether it would need to be included in the articles of association (bylaws) or in the company's corporate governance charter.

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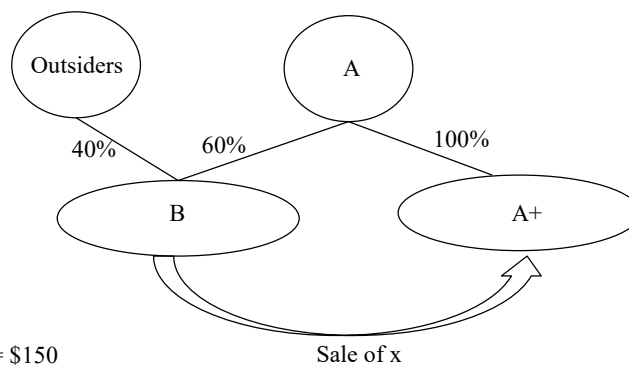
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2.6. Control-enhancing mechanisms (CEM)

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Control-enhancing mechanisms (CEM)

- “Tunnelling”: value diversion by controlling shareholders



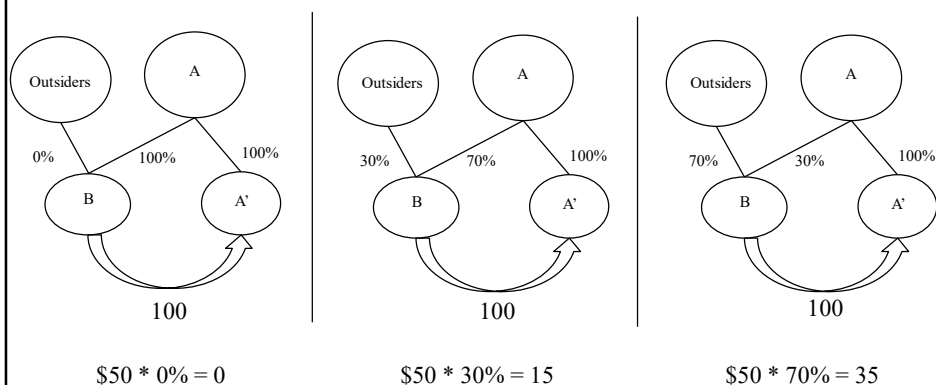
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Control-enhancing mechanisms (CEM)

Market value $x = \$150$

Price paid for $x = \$100$



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Control-enhancing mechanisms (CEM)

□ Mechanisms:

- Corporate pyramids
- Cross-ownership
- Dual class shares

□ Problem: intensification of horizontal agency problem:

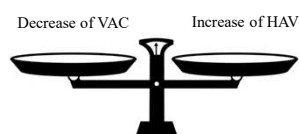
- HAC/PBC exist where cash-flow rights (ownership) are disproportionate to control rights;
- if controlling shareholders decrease cash-flow rights but maintain control, HAC/PBC increase;
- Bebchuk, Kraakman & Triantis, "Stock Pyramids, Cross-Ownership and Dual Class Equity" (2000): "We demonstrate that the agency cost imposed by controlling shareholders who have a small minority of the cash-flow rights in their companies can be an order of magnitude larger than those imposed by controlling shareholders who hold a majority of the cash-flow rights. This is because, as the size of cash-flow rights held decreases, the size of agency costs increases, not linearly, but rather at a sharply increasing rate."

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Control-enhancing mechanisms (CEM)

- CEM may increase horizontal agency cost (disadvantage)
- However, CEM may have advantages:
 - maintaining/obtaining control becomes “cheaper”; vertical agency cost may decrease;
 - firms may more easily become public and/or “widely held”.
- CEM may thus be beneficial if:
 - vertical agency cost is high; and/or
 - horizontal agency cost is low.
- Who decides?
 - legislative approach: legislator decides through mandatory rule (“one share, one vote”):
 - reasons?
 - market approach: no mandatory rule; firms decide under “control” of the market;
 - however: no “midstream” changes.



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Dual class shares

Country	One share, one vote (1S1V)
	Art. 2:118 NBW: “If the share capital is divided into shares of the same amount, each shareholder casts as many votes as he has shares. If the share capital is divided into shares of different amounts, the number of votes of each shareholder is equal to the number of times that the amount of the smaller share is included in the aggregate amount of his shares; parts of votes are neglected.”
	L.225-122 C.Com.: “the voting rights attached to capital or dividend shares are proportional to the share of capital they represent and each share gives the right to at least one vote. Any clause to the contrary is deemed unwritten.” (exception: loyalty shares – <i>infra</i>)
	Art. 7:51 BCCA: “If the shares have the same [par value], they each give the right to one vote. If not all shares have the [par value], their holder is entitled to a number of votes equal to the number of times the share representing the lowest amount is included in the total capital representative value of his shares, ignoring parts of the votes, except in the cases specified in Article 7:155.” (exception: loyalty shares – <i>infra</i>)
	§12 AktG: “(1) Each share of stock shall confer the right to vote. According to the regulations of the present Act, preferential stock may be issued as shares of stock without a voting right. (2) Multiple voting rights are impermissible.”

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Dual class shares



United States:

- **§151 DGCL:** “Every corporation may issue 1 or more classes of stock or 1 or more series of stock within any class thereof, any or all of which classes may be of stock with par value or stock without par value and which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation”
- a few limitations in listing rules (NYSE, Nasdaq, ...), but primarily targeting new issuances – not upon IPO, e.g.:



- **Nasdaq IM-5640:** “The restriction against the issuance of super voting stock is primarily intended to apply to the issuance of a new class of stock, and Companies with existing dual class capital structures would generally be permitted to issue additional shares of the existing super voting stock without conflict with this policy.”

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Dual class shares

United States:



examples:

- Section 3.2 articles of incorporation: “Except as otherwise expressly provided herein or required by applicable law, each holder of Class A Common Stock shall have the right to one (1) vote per share of Class A Common Stock held of record by such holder and each holder of Class B Common Stock shall have the right to ten (10) votes per share of Class B Common Stock held of record by such holder.”
- allocation (2022):

	Shares	%	Voting rights	%
A shares	2,293,518,778	85%	2,293,518,778	35%
B shares	412,804,609	15%	4,128,046,090	65%
Total	2,706,323,387	100%	6,421,564,868	100%



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Dual class shares

□ United States:



– examples:

- Section 3.2 articles of incorporation: “except as required by law, the Class A Common Stock will have no voting rights and no holder thereof shall be entitled to vote on any matter. [...] Each holder of shares of Class B Common Stock will be entitled to one vote for each share [...] Each holder of shares of Class C Common Stock will be entitled to ten votes for each share thereof held at the record date for the determination of the stockholders entitled to vote on such matters or, if no such record date is established, the date such vote is taken or any written consent of stockholders is solicited.”

• allocation (2022):

	Shares	%	Voting rights	%
A shares	1,636,324,304	87%	0	0%
B shares	22,646,636	1%	22,646,636	1%
C shares	231,626,943	12%	2,316,269,430	99%
Total	1,890,597,883	100%	2,338,916,066	100%



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Dual class shares

□ Recent tendency: “loyalty shares”:

– reasoning:

- advantages of double voting rights:
 - ✓ decreasing the cost of control;
 - ✓ firms can more easily go public and/or become “widely held”;
- however,
 - controlling shareholders may misuse voting rights (horizontal agency cost)
 - controlling shareholders may pursue short-term profit rather than long-term value creation;
- compromise: permitting double voting rights, subject to the beneficiaries having a longer investment horizon.

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Dual class shares

- Recent tendency: “loyalty shares”:

- examples:

Country

Loyalty shares



Art. 2:118 NBW:

“A double voting right double [...] may be allocated, by the articles of association, to all the fully paid-up shares for which it will be justified to be registered, from at least two years, in the name of the same shareholder.”



Art. 7:53 BCCA: *“In listed companies, the articles of association may grant to fully paid-up shares that have been registered continuously for at least two years in the name of the same shareholder in the register of registered shares, a double voting right in comparison with the other shares that have an equal share in the capital. represent.”*

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Dual class shares

- Recent tendency: “loyalty shares”:

- Open questions:

- Is the danger of short-termism real ?
- Do shareholders who own shares for two years necessarily remain shareholder in the long term and/or do they necessarily pursue long term value creation ?
- Do loyalty shares curb short-termism (if any) ?

- E.g., Roe & Venezze, “Will Loyalty Shares Do Much for Corporate Short-Termism?” (2021):

“Because the high-voting shares become low-voting shares upon those shares’ sale, the controller cannot readily monetize the value of loyalty-share voting power. This locks the controller into the firm and means that the controller cannot readily sell the firm to an outsider who has a long-term vision for that firm.”

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2.7. Public takeovers

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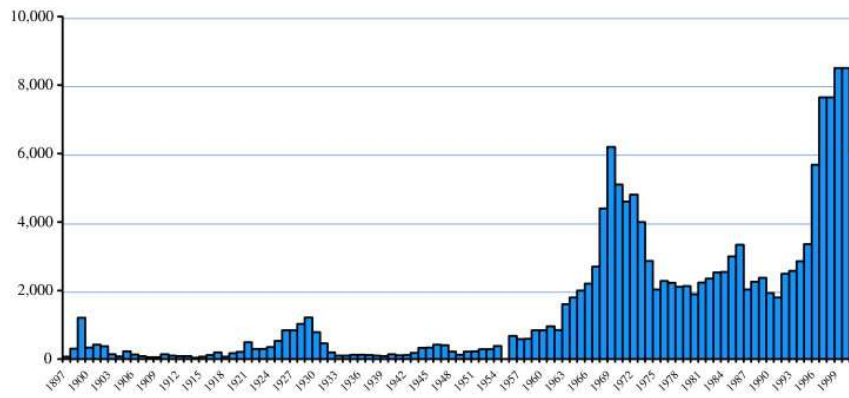
Public takeovers

- Multiple corporate governance aspects:
 - reduction of agency cost: if firm is underperforming, public takeover becomes cheaper and less likely → incentive for board/management to perform well:
 - takeover wave in '70s – '90s and the corporate raiders
 - only in widely held firms; in controlled firms, control is not contestable.

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Public takeovers



Source: Martynova & Renneboog, A century of corporate takeovers: What have we learned and where do we stand? (2008)

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Public takeovers



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Public takeovers

- Multiple corporate governance aspects:
 - reduction of agency cost: if firm is underperforming, public takeover becomes cheaper and less likely → incentive for board/management to perform well:
 - takeover wave in '70s – '90s and the corporate raiders
 - only in widely held firms; in controlled firms, control is not contestable.
 - cause of agency cost:
 - during takeover, boards may block efficient takeovers or authorize inefficient takeovers;
 - following takeover, horizontal agency cost may exist.
- Two questions:
 - Who benefits from takeovers?
 - Who decides on takeovers?

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Public takeovers

- First question: who benefits from takeovers?
 - Option 1: market rule: partial bid permitted
 - Option 2: equal treatment rule: full bid required

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Public takeovers

□ First question: who benefits from takeovers?

– Option 1: market rule:



- partial bid permitted (e.g., 50%) → “First come, first served”
- Advantage: control becomes cheaper, which is good if VAC is high;
- Disadvantage: control becomes cheaper, which is bad if HAC is high.
- Example:
 - 100 shares
 - firm value: 1000 (10 per share)
 - bid on 50% of shares at 600 (12 per share) → “control premium” of 20
 - firm value post-takeover: 800
 - public: 400 (8 per share)
 - bidder: 400 + 200 PBC

→ “prisoners’ dilemma”

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Public takeovers

□ First question: who benefits from takeovers?

– Option 2: equal treatment rule:



Directive 2004/25/EC of the European Parliament and of the Council (“Takeover Directive”):

Article 3

General principles

1. For the purpose of implementing this Directive, Member States shall ensure that the following principles are complied with:
 - (a) all holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected;
 - (b) the holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company’s places of business;
 - (c) the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid;
 - (d) false markets must not be created in the securities of the offeree company, of the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted;
 - (e) an offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration;
 - (f) an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.
2. With a view to ensuring compliance with the principles laid down in paragraph 1, Member States:
 - (a) shall ensure that the minimum requirements set out in this Directive are observed;
 - (b) may lay down additional conditions and provisions more stringent than those of this Directive for the regulation of bids.

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Public takeovers

□ First question: who benefits from takeovers?

– Option 2: equal treatment rule:



Problem: “stakebuilding”:

✓ need for transparency:

Directive 2004/109/EC: “The home Member State shall ensure that, where a shareholder acquires or disposes of shares of an issuer whose shares are admitted to trading on a regulated market and to which voting rights are attached, such shareholder notifies the issuer of the proportion of voting rights of the issuer held by the shareholder as a result of the acquisition or disposal where that proportion reaches, exceeds or falls below the thresholds of 5 %, 10 %, 15 %, 20 %, 25 %, 30 %, 50 % and 75 %.”

✓ need for “mandatory takeover” rules:

Directive 2004/25/EC / Takeover Directive:

Article 5

Protection of minority shareholders, the mandatory bid and the equitable price

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

however: many companies are “grandfathered”

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Public takeovers

□ Second question: who decides on takeovers?

- principle: sufficient shareholders should decide to tender their shares;
- however: board has, in theory, power to discourage or block takeovers: “takeover defences”, depending on applicable law:
 - discouragement (*ex ante*):
 - “poison pills” (*e.g.*, change of control provisions)
 - staggered boards;
 - stand-still agreements;
 - ...
 - block (*ex post*):
 - stock repurchase and capital increase;
 - sale of assets (“*sale of crown jewels*”);
 - counter-offer by “*wite knight*”;

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Public takeovers

- Second question: who decides on takeovers?
 - board has power to discourage or block takeovers: “takeover defences”;
 - difference between “hostile takeovers” and “friendly takeovers”
 - should board be authorized to use takeover defences?
 - advantages:
 - ✓ protection of shareholders, especially if market rule is applied;
 - disadvantages:
 - ✓ “conflict of interest” (however, COI/RPT rules typically do not apply)
 - role of other stakeholders:
 - can/should board protect other shareholders?
 - could/would such result in protectionism or inefficiencies?

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Public takeovers

- Second question: who decides on takeovers?
 - board has power to discourage or block takeovers: “takeover defences”;
 - should board be authorized to use takeover defences?
 - approach 1: boards may use takeover defences, subject to judicial review
 - E.g., United States: **Unocal Corp. v. Mesa Petroleum Co. (Del. 1985)**: 
 - “The business judgment rule, including the standards by which director conduct is judged, is applicable in the context of a takeover. The business judgment rule is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. A court will not substitute its judgment for that of the board if the latter's decision can be attributed to any rational business purpose.”
 - note: standard of review was increased in later case law (e.g., Revlon): “range of reasonableness”

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Public takeovers

- Second question: who decides on takeovers?
 - board has power to discourage or block takeovers: “takeover defences”;
 - should board be authorized to use takeover defences?
 - approach 2: “Board neutrality rule”



Directive 2004/25/EC / Takeover Directive :

- “During the period referred to in the second subparagraph, the board of the offeree company shall obtain the prior authorisation of the general meeting of shareholders given for this purpose before taking any action, other than seeking alternative bids, which may result in the frustration of the bid and in particular before issuing any shares which may result in a lasting impediment to the offeror’s acquiring control of the offeree company”
- however: “Member States may reserve the right not to require companies as referred to in Article 1(1) which have their registered offices within their territories to apply Article 9(2)”
 - Possibility for Member States to “opt-out” (with possibility for companies to “opt-in”).

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Public takeovers

- Second question: who decides on takeovers?
 - board has power to discourage or block takeovers: “takeover defences”;
 - should board be authorized to use takeover defences?
 - approach 2: “Board neutrality rule”

Opt-out countries



Directive 2004/25/EC / Takeover Directive :

Member States which have opted out. Seven out of 22 Member States have opted out from the board neutrality rule (Belgium, Denmark, Germany, Hungary, Luxembourg, the Netherlands and Poland). However, Germany²⁸⁹ provides for a modified passivity rule that existed before the transposition of the Directive. None of the aforementioned Member States had a strict board neutrality obligation before the transposition of the Directive.

Company opt-in. The Member States which have opted out have introduced the opt-in procedure, which allows companies to choose to apply the neutrality rule. According to the information available, companies do not seem to apply the board neutrality rule on a voluntary basis and are not likely to do so.

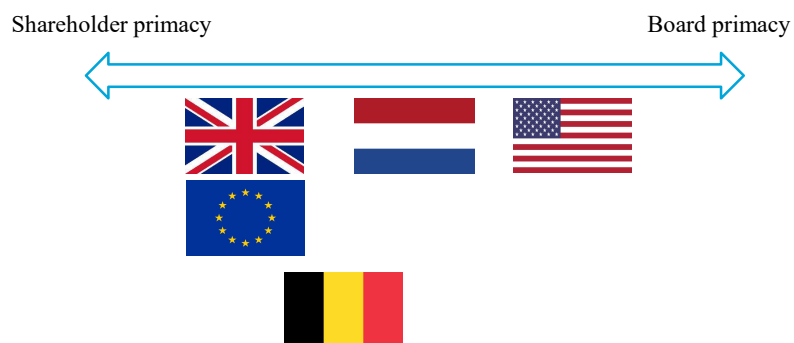
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- Second question: who decides on takeovers?
 - board has power to discourage or block takeovers: “takeover defences”;
 - should board be authorized to use takeover defences?
 - approach 2: “*Board neutrality rule*”
 - Why would countries “opt-out” ?
 - ✓ Protectionism [REDACTED]
 - ✓ Stakeholderism, e.g., Dutch model: [REDACTED]
 - Dutch Supreme Court 13 July 2007 (*ABN-AMRO*): directors should take into account “*the interests of all stakeholders, including shareholders*”;
 - Enterprise Court Amsterdam 29 May 2017 (*AkzoNobel*): “*When assessing proposals from a potential bidder, the management board of a target company must, under the supervision of the supervisory board, focus on – in the terms of the Corporate Governance Code – the long-term value creation of the company and the affiliated company and to that end weigh the relevant interests of the stakeholders*. Logically, that guideline implies that it is conceivable that the target company decides not to support a proposal from a potential bidder, even if a majority of the shareholders of the target company would accept a corresponding offer.”

Public takeovers



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