Financial Tunnelling and the Revenge of the Insider System

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March 2005

Abstract

In this paper, we document how European companies can use financial tunnelling to the disadvantage of minority shareholders, despite improved legislation directed at eliminating such activities. In four case studies, two German and two Italian, we document how newly established corporate governance standards were successfully circumvented by dominant shareholders, major financial institutions, politicians, and in the worst case the regulator. These cases demonstrate that for effective Corporate Governance to work, one not only has to change the law, but even more importantly, one has to ensure the widespread acceptance of new rules. The litmus test of corporate governance reforms in any country is whether the rules are applied objectively in situations where powerful elites perceive they are disadvantaged under the new regulations.

JEL Classifications: G34, G32
Keywords: Financial tunnelling, minority shareholders, mandatory bid threshold, corporate governance, Europe

We would like to thank Sir Geoffrey Owen, Peter Abell, David deMeza, Steve Thompson, Miguel Segoviano at the IMF, Gabriele Muthreich of Deminor and Guido Ferrarini of Telecom Italia as well as Irma Clots-Figueras and Rafael Gomez for helpful comments on this and earlier drafts. All remaining errors are ours. The views expressed are purely those of the authors.
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If we want things to stay as they are, things will have to change …

What will happen next? Oh, well. Just negotiations punctuated by a little harmless shooting, then all will be the same though all will be changed.

Giuseppe Tomasi di Lampedusa, Il Gattopardo

Minority shareholders just have to get used to the fact that it isn't Christmas every day.

Hartmut Schauerte, German Christian Democrat (Rega, 2003)

Financial Tunnelling and the Revenge of the Insider System

In this paper we document how European companies use financial tunnelling to the disadvantage of minority shareholders, despite new legislation that should eliminate such activities. When companies tunnel assets, they transfer them out of the company to the benefit of those individuals that control it and at the expense of minority shareholders (Johnson *et al.*, 2000). They can do so through self-dealing by the controlling shareholder/corporate insiders[1], or alternatively through indirect actions like "dilutive share issues, minority freeze-outs, insider trading, creeping acquisitions, or other financial transactions that discriminate against minorities" (ditto, p. 24). We term the latter financial tunnelling, as it does not entail directly transferring assets out of the firm. Rather it allows the controlling shareholder to increase his share of the firm, and the private benefits of control, while expropriating minority investors. It often entails the circumvention of the mandatory bid rule (MBR) in Europe, which requires shareholders taking control of a firm to bid for all outstanding shares.[2]

Controlling shareholders come both at a benefit and a cost to the firm. On the one hand they can provide for better control of management, as size of ownership stake and the incentive to monitor are positively correlated. In turn, this should improve firm performance and equally benefit minority shareholders. On the other hand, it often comes with costs for minority shareholders as the controlling owners might expropriate from them via a number of methods including tunnelling. This is one of a number of private control benefits enjoyed by large block holders at the expense of firm value. Surveys have attempted to measure these at the country level. For example, Nenova (2000) documents differing levels of private control benefits across a large cross-section of countries reflected in premiums paid for voting shares.[3] Dyck and Zingales (2004) document similar control premium paid in European block trades.

La Porta *et al*. (1998) argue that civil law countries in general are less protective of minority shareholders and so more prone to expropriation than shareholders in common-law countries. This statement is rooted in the idea that principles on the

protection of minority shareholders, as formulated in common-law countries, are both harder to circumvent and easier to enforce compared to pre-defined statutes on which the civil-law is based (La Porta *et al.,* 1996, 97, 99, 00). From the European perspective, Enriques (2004, p. 74) is critical of the power of a legal code to enforce corporate governance rules in general and the Mandatory Bid Threshold in particular, as "for every takeover, legions of high-priced lawyers and investment bankers will be available to acquirers (and sellers) willing to avoid its [the mandatory bid rule] application by using loopholes and devising transaction forms as similar as possible to those eligible for exemptions and discounts".

To illustrate their earlier points, Johnson *et al.* (2000, p.22) have documented cases in France, Italy, and Belgium in which majority shareholders were able to tunnel assets out of the company through related party transactions and transfer pricing. In one case, a German company exploited its minority shareholders through a two-tier offer.[4] These examples pre-date the current corporate governance rules, and with the exception of the latter case would not necessarily have been affected by them. Indeed, the courts at the time found that the tunnelling activity was well within the letter of the law and so "allowed substantial expropriation of minority shareholders".

In contrast to Johnson *et al.* (ditto), we describe four cases from civil law countries (Germany and Italy) in which such expropriations have occurred after legislation was passed that aimed to prevent just this. All the case are linked by the fact that minority shareholders were disadvantaged by transactions undertaken by controlling shareholders, which transferred value from minorities to those with control. Two of the cases in this paper can be considered illegal, while the two others violated the spirit rather than the letter of the law.

As a consequence, we show that for effective Corporate Governance to work, one not only has to change the law, but even more importantly ensure the widespread acceptance of new rules. The litmus test of corporate governance reforms for any country is whether the rules are applied objectively in cases where powerful elites perceive that they are disadvantaged under the new regulations. In addition, we show that the introduction of mandatory bid rules in the European Union, and with it the elimination of differences between civil and common law systems in relation to this

issue, did not equally eliminate the exploitation of minorities, although it is based on principles of equality of all shareholders.

The cases are as follows:

1) **Tchibo's Acquisition of Beiersdorf:** In which the acquirer Tchibo, acting in concert with other shareholders, was able to purchase a control stake in the target without having to bid for the outstanding shares of minority investors. This was in violation of the German Takeover Code.
2) **The Acquisition of Control of Telecom Italia by Pirelli:** The acquirer, Pirelli, purchased a control stake in the target below the mandatory bid threshold, using a private holding company.
3) **Merger of SAI and Fondaria:** Parties acting in concert, were able to compel a merger between these two Italian insurers on unfavourable terms to Fondaria. The actions of the parties concerned where in clear breach of the Italian Takeover Code.
4) **The Buyout of T-Online by Deutsche Telecom:** The controlling shareholder attempted to compel minority shareholders to tender into an under-priced two-tier offer.

Mandatory Bid Rules

Mandatory Bid Rules (MBR) were recently introduced by most national legislatures in Europe to ensure the equality of all shareholders. As stated above, they require block owners (typically above 30% ownership) to widen their offer to all shareholders should they wish to extend their degree of control, thereby protecting minority shareholders from financial tunnelling. For example, in Italy, the Draghi Decree of 1998 set up the MBR, which is enforced by Consob, the Italian stock market regulator. In Germany, a revised Takeover Code was passed by the Bundestag in 2002, and is enforced by BaFin, the German financial markets regulator.

The effectiveness of the MBR in protecting minority shareholders is undisputed, at least ex-post.[6] The European Commission, which drafted the pan-European Takeover code, modelled it on the UK City Takeover Code.[7] The principle at the heart of the UK code is the equal treatment of all shareholders. This is a "fundamental principle in

almost all Western European countries" (Goergen *et al.*, 2005, p. 10). Mandatory bid thresholds have been enshrined in European law via the European Takeover Directive (2004). Article 3 of the Explanatory Memorandum to the Directive states as a fundamental principle, "if a person acquires control of a company, the other holders of securities must be protected".

Because it took 14 years for a final version to receive the backing of all member states, many European countries had already instituted into their national legislation Takeover Codes with bid thresholds and empowered stock market regulators to enforce these. However, in light of the Takeover Directive and, unlike classic tunnelling, financial tunnelling that violates mandatory bid rules should not be treated any differently under a civil law system than a common law one, as the same principle is applied regardless of the legal system.

Cases and Data

This clinical study, comprised of a series of detailed case studies, offers a unique insight into how firms circumvent existing legislation designed to protect market participants. To the best of our knowledge we are the first to document these recent cases of financial tunnelling, which occurred in highly developed market economies and despite new European takeover regulation. We compiled the cases by extracting the relevant information – in a forensic manner – from publicly available sources like financial statements and regulatory filings, annual and quarterly reports, press releases and investment banking reports on these companies, as well as legal discussions and opinions. In relation to the Beiersdorf case, we additionally interviewed the regulator, BaFin, the lawyer representing minority shareholders and conducted a short interview with Dieter Ammer, the Chairman of the acquiring firm, Tchibo. As financial tunnelling is a highly complex phenomena, and different in each example, case studies are the only way to document and study it. Of the four cases documented in this paper, the first three, Beiersdorf/Tchibo, Telecom Italia and SAI Fondaria demonstrate how firms managed to engage in financial tunnelling to effectively circumvent the respective Mandatory Bid Thresholds, and the failure of the regulator to prevent these manoeuvres. The acquirers were able to gain control of the targets (and the attached benefits), without having to make a full bid for the minorities, in

clear violation of the principle of equality of treatment of shareholders. In the fourth case we examine a minority freeze-out.

Case I: The Acquisition of Control of Beiersdorf by Tchibo

In 2003, Beiersdorf, a Hamburg based skin care and adhesives manufacturer, was taken over by Tchibo, a Hamburg based coffee retailer, in a convoluted scheme. It was publicly stated by parties involved that one of the aims was to keep assets under local ownership. This was despite strong interest from better-placed firms in the same sector including the US consumer giant Proctor and Gamble. In this case study, we show how all the players worked closely together, management, workers council, local and national politicians and major financial institutions, to achieve this goal. However, the actors openly exploited minority shareholders. The financial markets regulator sanctioned this exploitation and the violation of the newly installed takeover code, while the city of Hamburg granted, what could be considered, illegal state aid, and company's surplus cash was used to facilitate this takeover instead of being paid out to its shareholders, the bearers of residual risk.

Therefore, the Beiersdorf/Tchibo transaction presents an excellent case of how vested interests are able to exert corporate control via financial tunnelling in Europe, despite substantial reform of European corporate governance over the last decade to protect the interests of minority shareholders. This deal also highlights in detail the workings of German corporations and their governance institutions, and is particularly informative because it happened after Germany had introduced a series of major legislative reforms to modernize its domestic financial architecture – KonTrag[8] (1998), Takeover Code (2002), and the Cromme Corporate Governance Code (2002). It illustrates the deficiencies of the German takeover code as currently interpreted by the regulator BaFin.

History of Beiersdorf

In the early 20th Century, Oscar Troplowitz, a Jewish entrepreneur built Beiersdorf into a modern pharmaceutical and cosmetics group. He launched Nivea, the world's

first stable oil in water moisturizing cream in 1911, deploying cinema advertising for the first time in Germany. After his death in 1918, Beiersdorf was transformed into an AG, and long term shareholder Allianz, the German insurer, acquired a stake in the company in 1937.[9] Until the turn of the century, the Claussen family, Troplowitz's descendants, played a major role in the firm. For example, Georg W. Claussen was CEO of Beiersdorf from 1954 until 1979. He then moved into the Chairmanship position, and ended his career as Honorary Chairman in 2003. In 1974, the Herz family acquired a 25% stake in the firm, with Günter Herz joining the Supervisory board.[10] Beiersdorf mirrored the traditional German corporate structure dominated by family members and insulated from shareholder pressure[11]. The controlling families of Claussen and Herz have dominated the Supervisory board.

Ownership structures of German public companies have traditionally revolved around families as dominant shareholders and a complex network of cross shareholdings known as "Deutschland AG" (see Appendix 1). These "have bound together German industry and finance since the Second World War" (Major, 2003). Harris (2000) estimated that 31% of the market capitalization of German equity markets was represented by strategic and industrial shareholdings and cross-shareholdings. These were held in place, despite the fact that capital was not being invested to its highest value added usage, by capital gains tax penalties any selling shareholder faced on disposal.

However, the capital gains tax reforms introduced in 2002 allowed all corporations for the first time to sell shares in subsidiaries held for at least one year without facing a 38.5% tax bill now, or 58% before 2000 (Major, 2003). The aim of the reform was to stimulate the restructuring of German industry, and to allow a more efficient allocation of capital tied up in diverse industrial stakes enabling German firms to compete more effectively on a global scale.

As one of the founder members of Deutschland AG, Allianz, Beiersdorf's major shareholder, wanted to release value from its US$ 50bn portfolio of industrial holdings[12]. In the interests of maximizing returns to Allianz's shareholders, it approached Proctor & Gamble about acquiring the 43.6% stake in 2002.

P&G CEO, A.G. Lafley viewed the acquisition of the Nivea brand as an attractive opportunity.[13] Encouraged by Allianz, he approached Beiersdorf CEO Rolf Kunisch. When news leaked, Jürgen Krause, deputy chairman, employee representative on the Supervisory Board and head of Beirsdorf's Works Council, expressed his opposition. In fact, he began to hold meetings with employees to work on defence strategies, including reaching an agreement of worker representatives on the supervisory board to block the appointment of any new management.[14] Krause feared that a takeover by P&G would lead to job losses and the shifting of Beiersdorf's production facilities to lower cost locations. Ironically, he told the press, "If you want to succeed in a takeover in Germany, you have to play by the local rules and regulations" (Taylor and Ellison, 2004).

Family Feud

However, P&G was not the only potential buyer. Tchibo, a coffee retailer privately held by the Herz family, had increased its stake in Beiersdorf to just above 30% in 2002, and made it clear that they would also be interested in taking control of the company. The strategic rational for Tchibo to increase its stake to 30.3% was to take advantage of a grandfathering provision in the 2002 German Takeover Code. On one interpretation this exempts existing shareholders from making a mandatory bid to buyout all minorities when increasing their stake. However, as we shall see, such a provision is legally highly ambiguous. On the other hand, if P&G had acquired Allianz's 43.6% stake, it would have been required under German law to extend this offer to all Beiersdorf shareholders.

At the same time, the Herz family was beset by a "Dallas style" family feud. Günter Herz, had been embroiled in a conflict with his siblings over the future of the family fortune, since the death of Max Herz, the family patriarch.[15] However, his three brothers ejected Günter and his sister Daniela out of Tchibo in 2003. Tchibo was forced to buy out their 40% combined stakes for approximately €4bn.[16] Having undertaken this transaction, Tchibo made it clear that it would not put up all the money needed to buy out Allianz at the price demanded, let alone make a bid for the outstanding minorities.

Yet, Tchibo, wanted control of Beiersdorf without having to pay the full cost, and decided that it could get what it wanted by siding with Beiersdorf's employees and Germany's politicians. Like Krause, the head of Beiersdorf's Works Council, Hamburg's Christian Democrat (CDU) mayor, Ole von Beust feared the loss of employment as well as tax revenue to the City. Facing an election, he was highly motivated to defend local employment. Von Beust contacted the office of the German chancellor Gerhard Schröder in Berlin and other national politicians to successfully enlist their support (Taylor and Ellison, 2004).

Subsequently, the CEO of Tchibo, Ammer, sent a letter to Achleitner, the CFO of Allianz, telling him that a consortium, including Tchibo, was prepared to purchase most of Allianz's stake. At the time, Achleitner was continuing negotiations with P&G. Despite the letter, P&G's board gave Lafley permission to keep pursuing a deal, although he had made it clear that he was unwilling to go hostile telling the German press, "What we buy must really be for sale. With Beiersdorf, I'm not sure at the moment" (Graham, 2003, p. 24).[17]

In late October, Ammer telephoned Achleitner telling him 'it's now or never' (Taylor and Ellison, 2004). There then occurred an extraordinarily complex and opaque series of transactions to minimize the costs to Tchibo, while delivering them control over Beiersdorf and rewarding Allianz with a significant premium to the current share price (itself reflecting a prospective takeover premium) that was not extended to minority shareholders.[18]

Mechanics of the Deal

Under the deal, Allianz sold a majority of its 43.6% stake to a consortium consisting of Tchibo, a holding company for the assets of the City of Hamburg[19] and Beiersdorf's own pension fund (TROMA). Tchibo took a 19.6% stake, Hamburg a 10% stake and the pension fund 4%. The consortium paid an average price of €133.69 per share, a 33.5% premium to the closing price on 31 October 2003. Additionally, in December, Beiersdorf's own cash (and debt capacity) was deployed in a share buyback offer to support the Tchibo deal.[20] The offer itself was effectively 80% reserved for Allianz's shares, thus leaving minority shareholders out in the cold.[21] Subsequently, in a side deal, Allianz purchased 4% of the Claussen family's 10%

stake at an average price of €135 per share (a 40% premium).[22] This also indicates that the Claussen's were party to agreements between the consortium and Allianz. Diagram 1 below depicts the ownership structure before and after the deal.

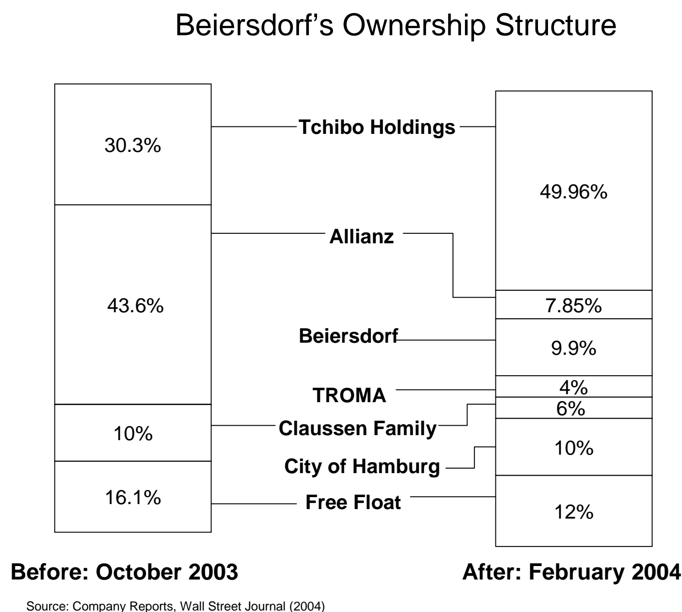

Figure 1: Beiersdorf Ownership Structure

The nature of the deal highlights a number of issues in relation to Corporate Governance in Germany.

Minority Shareholder Protection

The Tchibo/Beiersdorf deal provides an example of minority shareholder exploitation through circumvention of the German Takeover Code of 2002, particularly its provisions requiring an acquirer to make a mandatory bid for all outstanding minorities. As stated, Tchibo increased its stake in Beiersdorf to just above the mandatory bid threshold of 30% before the takeover code came into force. It argued that it was exempt from the mandatory bid provisions that would require P&G, as well as any other investor, to extend its offer to all shareholders at the same price. However, the Takeover Code itself does not mention this grandfathering provision. Rather, there is a reference to grandfathering in the explanatory notes to the code, which were not ratified by the Bundestag. This means that the concept of grandfathering, which is one of Tchibo's main arguments in the case, is legally ambiguous.

Moreover, the first principle of the German Takeover Code states: “holders of securities of the target company of the same class must be treated equally” (Freshfields, 2003). Since Beiersdorf only has one class of shares, the Tchibo offer clearly discriminates against minorities. The acquiring consortium argued that there was no change in control as Tchibo was increasing an existing stake from 30% to approximately 50%. However, this ignores the fact that Allianz was previously the largest shareholder with 43.5% of the shares. At best, Tchibo was a blocking minority shareholder. The new shareholder structure leaves Tchibo as the largest shareholder in a consortium with at least 63% of the stock. This is more than enough to trigger a mandatory bid for the minorities. Finally, the consortium contained two new parties which acted in concert with Tchibo, namely TROMA and the City of Hamburg, and together the consortium acquired a stake of 33.6%, well over the mandatory bid threshold.

In their defence, the consortium has claimed that it did not act in concert. Tchibo’s Chairman Dieter Ammer says that Hamburg made an independent investment decision and no undertakings of any nature were made to them by Tchibo, and certainly none guaranteeing their future tax revenues.[23] Therefore, it seems remarkable that Hamburg would spend hundreds of millions of dollars of its taxpayers money with no promises in return. However, even if Hamburg was unable to elicit any promises from Tchibo, it is evident that the parties to the consortium acted in concert. There actions were governed by a series of formal agreements, which were detailed in Beiersdorf’s Buyback Prospectus.[24] These included a contractual agreement to transfer all their rights in the share buyback to Allianz. Moreover, the prospectus also details their current and continuing joint interests in blocking a takeover bid from P&G, and the continuing strategic interests in retaining production in Hamburg. Subsequently, Hamburg has communicated that it will not require a representative on the Supervisory Board as “it feels well represented by the Tchibo representatives”.[25] The German takeover code clearly requires parties that act in concert and are above the 30% threshold to make a mandatory bid to minorities.

Overall, the arguments for extending the consortium’s offer to Allianz to all shareholders are strongly reinforced when you examine the European Directive upon

which the Takeover Code is based. This in turn was modeled on the UK's City Takeover Code, under which the consortium would clearly be found to be acting in concert. It would then be required to pay an equitable price to minority shareholders.[26]

Following complaints from Beiersdorf's minority shareholders, BaFin, Germany's Federal financial regulator examined the deal, and subsequently cleared it. In a brief statement (in German) released on its website on 23 January 2004[27], the regulator stated that although there had been a joint acquisition, there was no evidence that the parties had acted in concert. It went on to argue that the parties had no continued common strategic interests or voting interests, despite the fact that these had been extensively detailed by the parties in the buyback prospectus issued by Beiersdorf.

A further issue relates to support for the bid from Beiersdorf's own cash pile via its share buyback offer in December 2003. Here the consortium was able to use changes in Germany's financial regulations to its advantage. Share buybacks have only been legal in Germany since the 'Kontrag' laws of 1998, as a way of returning cash to minority shareholders. However, shareholders funds were deployed to support a transaction that is against their interests. Free cash-flow should be returned to shareholders or otherwise be deployed in developing marketing and distribution channels. Therefore, the buyback is a further exploitation of minority shareholders. At its June 2004 Annual General Meeting, Beiersdorf gained support for another buyback program, which could be deployed in the future to buy out the remaining stake of Allianz or buy back Hamburg's shares. Again, this would increase the ownership percentages and hence cash flow rights of the remaining shareholders with Tchibo as the prime beneficiary. However, such a buyback would have to be conducted at a large premium to prevent Hamburg from making a loss on its dealings with the firm.

In conclusion, Tchibo was able to seize control of Beiersdorf via a series of transactions which allowed it to circumvent the mandatory bid rule. In this case it is clear that these manoeuvres violated both the spirit and the letter of the law. (See Appendix 2 for further documentation). The next case documents a similar situation, Pirelli's acquisition of control of Telecom Italia. However, it highlights loopholes in

the MBR which allowed the acquirer to gain control legally while disadvantaging minority shareholders.

Case II: The Battle for Telecom Italia

Telecom Italia illustrates how the correct implementation of new regulatory reforms in Italy, such as mandatory bid rules under the Draghi Decree of 1998, can work to protect minority shareholders. It is also a case study on how these rules can be circumvented. The initial leveraged buyout by Olivetti saw equal treatment of all shareholders. However, subsequent transactions delivered control to Pirelli, via the exploitation of an extended pyramidal corporate structure, allowing it to control a much larger corporate entity with a direct economic stake of less than 10%. This demonstrates the ease with which financial tunnelling can be deployed via exploitation of a loophole, in violation of the spirit of the law.

History of Telecom Italia

Telecom Italia (TI) was a former state monopoly telecommunications services provider. The company was privatized in two stages in 1997, driven by EU regulations pertaining to the deregulation of the European telecoms market, privatization of former state monopolies and Italy's need to reduce its large fiscal deficits to conform with the Maastricht convergence criteria for entrance into the Euro.

To these ends an initial tranche of shares were sold in a private placement to a group of core shareholders (nucleo stabile) in the summer of 1997.[30] The core shareholders were lead by Ifil (an investment vehicle of the Agnelli family) and also included Assicurazioni Generali, Banca Commerciale Italiana and Unicredito. The private placement was later followed by a secondary offering of 55% of the government's holding in the markets. The shares were sold to both institutional and retail investors, raising over $12bn, and were priced at Euro 5.63 for retail investors and Euro 5.78 for institutions. The government retained special powers over the company via a 'Golden Share'[31], and also imposed a 3% voting rights ceiling on individual shareholders under the privatization laws.

Telecom Italia was a highly bureaucratic and inefficient organization, well positioned to realize significant shareholder value through major restructuring, since it was already generating annual cash flows of over €8bn. However, rather than a steep increase in the share price, a phenomena that has followed the privatization of many other poorly managed state bureaucracies (Megginson and Netter, 2001), the following year witnessed management chaos within the firm due to conflict between senior management and core shareholders. This resulted in the share price falling below the offer price in October 1998. Eventually, the government and core shareholders appointed a new CEO, Franco Bernabe, who had previously turned around the Italian state energy company ENI.

TI Deal 1: Olivetti's Big Play

While TI was in crisis, Olivetti, an alternative telecoms services provider lead by CEO Roberto Colaninno, put together a strategy for a hostile takeover of the troubled incumbent. This would take the form of a highly leveraged offer: part cash, part stock and part bond.

The corporate structure of Olivetti was complex. The company was ultimately controlled by a Luxembourg based holding company, Bell SA. Bell was owned by syndicate of investors including Colaninno, who held a small percentage of the equity. Others were families from the Brescia region.[32] In turn, Bell held 13.8% of Olivetti, which in turn owned a controlling stake in Infostrada, an alternative fixed line carrier, and a smaller stake in Omnitel, Italy's second wireless network operator.[33] (see Figure 2 and 3 below for Olivetti's Corporate Structure before and after the TI deal).

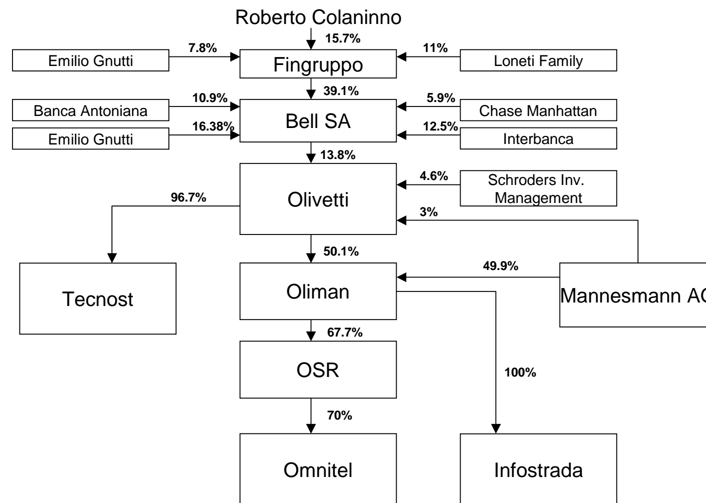

Figure 2: Olivetti's Corporate Structure I

Compared to most Italian companies, Olivetti was widely held. Thus it decided to use a wholly owned subsidiary, Technost Mael S.p.A., as an acquisition vehicle. Technost was leveraged up to the tune of €14.9bn for the hostile offer.[34] Ultimately, in 1999, Olivetti, through Tecnost, offered TI shareholders €11.50 a share, an approximately 100% premium to the floatation price valuing TI at €60bn. This hostile and highly leveraged offer was a success with a 52.2% acceptance rate.[35]

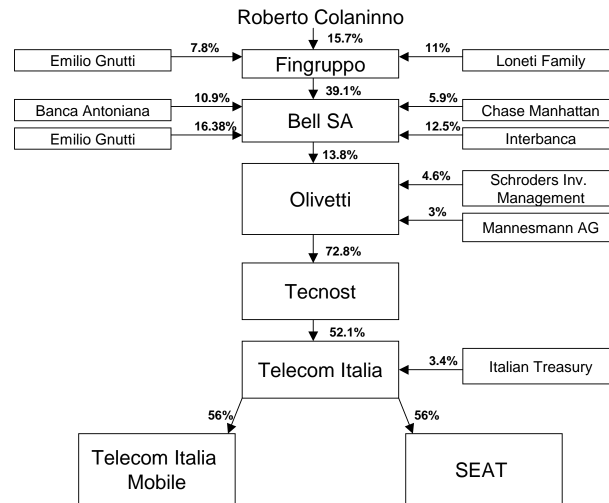

Figure 3: Olivetti's Corporate Structure II

Discussion of the Olivetti Takeover

The first takeover of Telecom Italia by Olivetti can be heralded as a case of successful protection of minorities. In Italy, historically, dominant shareholders could sell their controlling stake in a firm without the acquirer having to bid for all the outstanding shares held by minorities. Even when an acquirer buys all outstanding shares, it will often pay a premium for the control stake only (Zingales 1994, Dyck and Zingales, 2004). In 1998, Italy modernized its financial regulation under the stewardship of then Director General of the Treasury and Privatisation Commissioner, Mario Draghi. The Draghi Decree instituted tight regulation of the takeover process including the adoption of a mandatory bid rule, requiring an acquirer with over 30% of the equity of a firm to make a bid for all outstanding shares.[36] Draghi, hoping to encourage more hostile takeovers in Italy, cleverly inserted a breakthrough clause into Article 212 of the legislation, stating that upon the launch of a tender offer for 100% of the outstanding shares of a firm, the 3% voting ceiling created under the privatization laws would be void. Moreover, the incumbent management were prevented from creating post bid defences (such as special dividends and poison pills) without the support of at least 30% of the common stock in a shareholders meeting.

Therefore, the Olivetti acquisition of Telecom Italia stands as a prime example of a deal that was equitable and beneficial to minority shareholders, with those who tendered receiving the same consideration as core shareholders such as the Agnelli family, a considerable premium to the floatation price. However, all of this would subsequently change.

TI Deal 2: Pirelli Arrives

Within two years, control of Telecom Italia would change for the second time. The tire and cable manufacturer Pirelli, run by CEO Marco Tronchetti Provera, announced that it had wrested control of Olivetti from Bell, supported by the Benetton family in July 2001. They used a takeover vehicle, Olimpia, 60% owned by Pirelli and 20% by Edizione Holdings[37], tendering over €7bn for Bell's 27.7% stake in Olivetti at an average price of €3.91 (see Appendix 2 for further mechanics of the deal). This was an 80% premium to the current market price, indicating that substantial private control benefits were being transferred.[38] Within the new chain, Tronchetti and Pirelli had effective control over Olivetti, Telecom Italia, along with Telecom Italia Mobile (TIM) and the separately listed Yellow Pages business SEAT Pagine, despite owning less than 10% of TI's ordinary share capital. Therefore, Pirelli, which itself was controlled through a pyramid structure by Marco Tronchetti Provera, had effective control over two of Europe's largest telecom services providers, with a market capitalization well over 20 times that of Pirellis' (Woods, 2002). (See Diagrams 4 and 5 below for Telecom Italia/Pirelli ownership structure).

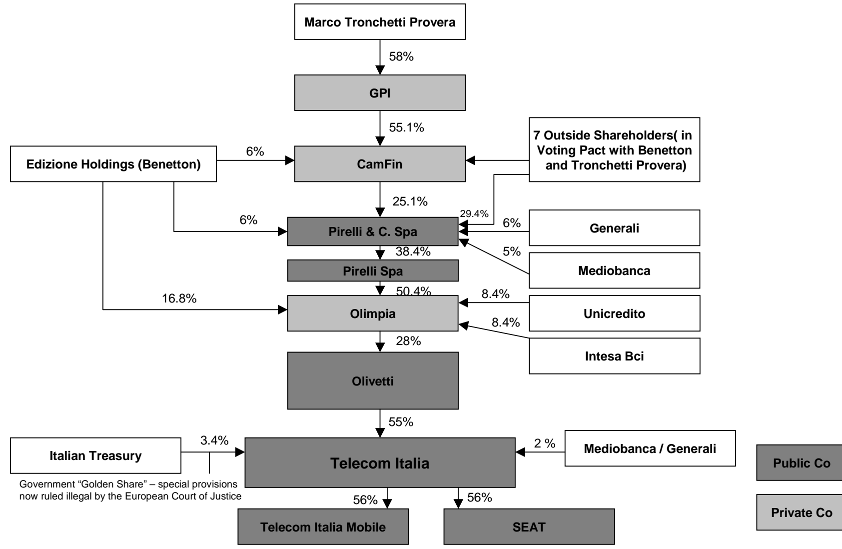

Figure 4: Telecom Italia Ownership Structure (Post Pirelli Acquisition in 2001)

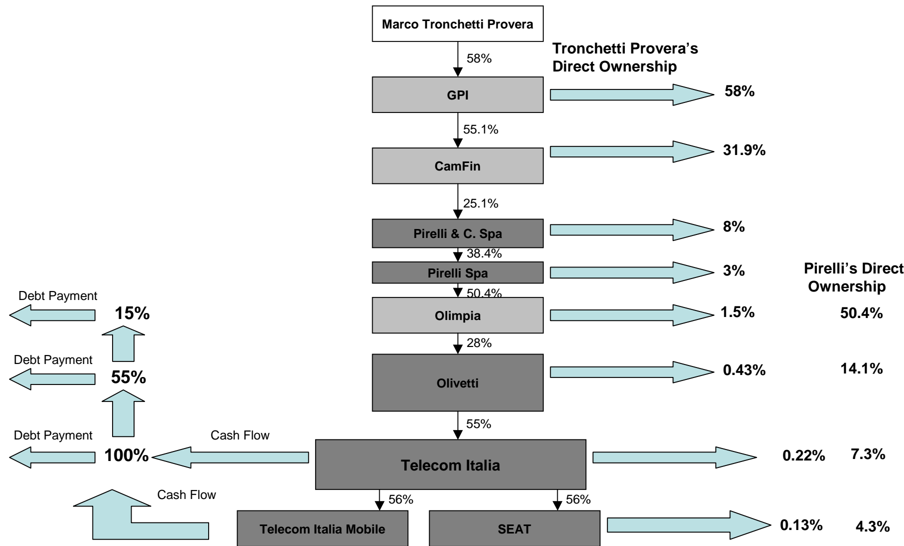

Figure 5: Marco Tronchetti Provera's Ownership Structure of Telecom Italia (Post Pirelli Acquisition 2001)

Moreover, because only 28% of Olivetti was needed to control TI, Pirelli did not cross the mandatory bid threshold, and therefore was not required to extend its very

generous offer to minority shareholders who held the other 70% plus of Olivetti's equity and 45% of Telecom Italia. Clearly, Pirelli benefited from the fact that aside from the Bell stake, Olivetti was widely held.[39] Therefore, the deal cut out minority shareholders, whilst destroying significant value both in TI and Pirelli by handing control of a Telecoms group to a firm that manufactured tires (with the support of a clothing retailer) and defying industrial logic. Moreover, Telecom Italia was controlled through a leveraged vehicle, Olimpia, half way up a control chain. Meanwhile, the cash flows to pay off the debt were at the bottom, being generated by the real assets of Telecom Italia and Telecom Italia Mobile. The deal signifies how one can control large operations with only a minority stake, while violating the spirit but remaining within the letter of the law.[40]

Minority Shareholders Protection

Pirelli was able to circumvent the law by acquiring control further up the control chain from a privately held company. Because of this and the fact that the stake acquired (28%) was just below the MBT, Pirelli did not violate the law as the threshold was not crossed.[41] However, it did violate the principle of equal treatment of all shareholders. In contrast with the Italian civil law system, an acquirer of a control stake below the MBT in a common law system, would be subject to strict regulatory requirements and fiduciary duties to minority shareholders. Therefore, while the acquisition of a 28% stake without making a full bid is clearly legal in both Italy and, for example, the UK, other corporate governance mechanisms would compensate to protect minorities in the latter including institutional pressure.

Pirelli suffered little in the way of external pressure from institutional investors. Italy has the second largest mutual fund market in Continental Europe with holdings of approximately 35% of Italian market capitalization. However, about 90% of asset managers are affiliated with banking or insurance groups (Bianchi and Enriques, 2001). These have a conflict of interest since they also do substantial business with the firms they are charged with monitoring. The banks hold both equity and debt of these companies, as well as being holders of third parties stock in their asset management divisions.

Moreover, voting under the Italian system in shareholder meetings is difficult and costly. For example, at the height of Olivetti's raid on TI in 1999, only 22.4% of the shareholders turned up at a TI meeting to exercise their votes on post-bid defenses. In 2003, after a deal to merge TI and Olivetti was announced, many foreign asset managers found that their back offices had "lent" out shares to M&A arbitrageurs, and thus they could not be voted (Kapner, 2003). Fidelity and Morgan Stanley, which lead opposition to the deal and together held 10% of TI's stock, were only able to vote 1% of its stock.

Legal recourse for minority shareholders has traditionally been very weak in Italy. Minority investors cannot sue directors unless they own 5% plus of the company, while Magistrates are not always well prepared to handle corporate legal cases (see Enriques, 2002).

In conclusion, Telecom Italia changed ownership and control two times between 1997 and 2001. The fact that minority shareholders lost out from the second control change illustrates the fact that there are still significant hurdles to implementing the MBR to prevent financial tunnelling in Italy, despite the rule being deployed successfully at the time of the Olivetti takeover. Our next case illustrates this further.

Case III: SAI/Fondiaria – Hidden Control

If Telecom Italia exploited a loophole, then the acquisition of SAI by Fondaria demonstrates the ease with which financial tunnelling can be deployed in violation of the letter of the law. It also illustrates the difficulties that regulators can face in applying newly created corporate governance standards and laws. Enriques (2004, p. 795) argues, "supervisory agency officials will not be on an equal footing in terms of skills and incentives with lawyers and investment bankers when they have to evaluate these complex deal structures." Even when corporate governance standards and laws are eventually applied, minority shareholders are often still disadvantaged compared to controlling shareholders.

History of SAI/Fondiaria

In July 2001, two publicly listed Italian insurance firms, SAI and Fondiaria, announced a merger. SAI was controlled by a Sicilian property developer Salavatore Ligresti through Premafin, a leveraged financial holding company. One of Fondiaria's largest shareholders, both directly and indirectly, was Mediobanca, Italy's premiere merchant bank. Since SAI did not have enough cash to make a full offer for Fondiaria, it acquired a 29% stake from Montedison, a holding company controlled by Mediobanca, at a 56% premium. The size of the premium indicated that substantial private control benefits were being conferred. This stake was 1% below the mandatory bid threshold of the Draghi Decree.

Since Mediobanca also owned directly 14% of Fondiaria, Consob, Italy's stock market regulator decreed that Mediobanca and SAI were acting in concert, requiring a full tender offer for all minority shareholders. This would have cost SAI €1.7bn, an amount that it could not afford. Therefore, in a clever move, SAI parked 22% of its stake with a consortium of five banks. These included JP Morgan and Commerzbank, and they paid the same price for the stake as SAI had in the original transaction with Montedison (i.e. each paid a control premium despite the fact that individually none would have control). However, the separate agreements with the banks each contained a call option for SAI to repurchase the stake if a merger between SAI and Fondiaria

was agreed. Despite each agreement containing the same terms, the banks claimed that they were acting independently, because again, a finding of acting in concert would trigger a mandatory tender offer. Moreover, JP Morgan was advising SAI on its offer, while Commerzbank had a cross-shareholding with Generali. In May 2002, Consob capitulated and found that the consortium of banks were not acting in concert with SAI and Mediobanca, therefore depriving minority shareholders of the acquisition premium.

With the aid of the five banks, SAI now had de-facto control of Fondiaria with 22% held by the banks, 14% held by Mediobanca and its remaining stake of 7%, for a combined total of 43% of the stock. Under pressure from the banks, Fondiaria's board was forced to accept SAI's hostile deal, which involved a share exchange on terms far less attractive to minority shareholders than a tender offer. See figure 6 below for the new corporate structure.

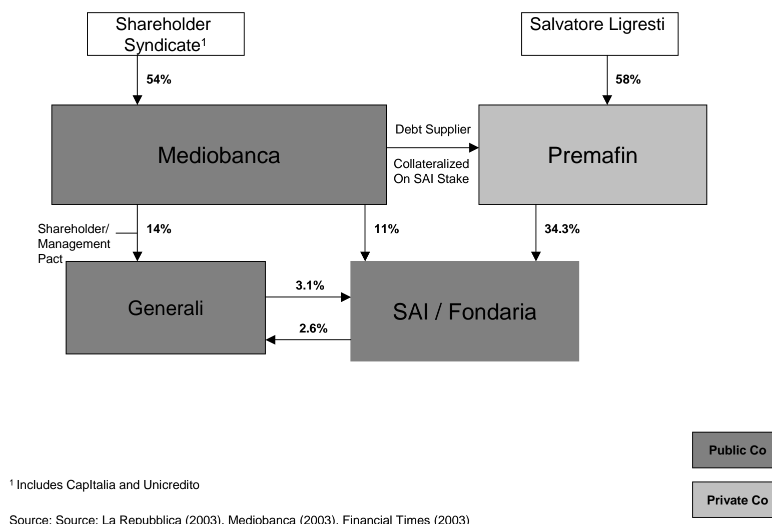

Figure 6: SAI/Fondaria Post Merger Structure

However, a serious problem remained. The deal also needed the consent of Italy's Antitrust authorities as it essentially gave Mediobanca control of both Assicuranzoli Generali, Italy's largest insurer and Europe's third largest, and the combined SAI Fondiaria, Italy's largest casualty insurer. Mediobanca was effectively in a dominant

position in the Italian insurance market and so in violation of both Italian law and Pan-European regulations.[43]

After an extensive investigation, the Italian antitrust authorities accused Mediobanca of misrepresenting its role in SAI's takeover. It found that it had control of Generali, in which it had a 14% stake, and joint control of SAI Fondiaria. Moreover, in its investigation, it discovered a secret accord between Mediobanca and Generali, giving the bank oversight of the insurers strategic decisions. This finding, along with a ruling of the administrative court of Lazio against it, led Consob to reopen its investigation.

In late December 2002, the Antitrust authorities officially ruled against Mediobanca. By way of remedy it required the freezing of 2% of Mediobanca's voting rights in Generali, and prevented SAI Fondiaria voting it's 2.4% stake in Generali and from participating in shareholders meetings. This was an attempt to push Mediobanca's weight in shareholder meetings to less than 50% of shares present. This decision was immediately followed by a Consob ruling that Mediobanca and SAI had made illegal secret pacts. It ordered the bank and SAI to reduce their combined stake of 43% below 30% and imposed fines.

However, from the minority shareholder perspective, the ruling did little to improve their position. Since Mediobanca had already pushed through the merger of SAI and Fondaria, it needed a far smaller stake to exert combined control over the new entity. More importantly, Consob did not require a mandatory tender offer for all minority shareholders of Fondaria, despite finding the parties in violation of the Draghi Decree.[44]

In conclusion, the controlling shareholders of SAI, illegally acting in concert, were able to push through a merger with Fondaria on terms which were not benefical to minority shareholders. Again this case illustrates the difficulties of implementing the MBR to prevent financial tunnelling in Italy.

Case IV: T-Online/Deutsche Telecom – Minority Freeze-Out

The final case examined is the freeze-out of minority shareholders in T-Online by the parent company, Deutsche Telecom, to increase its control of the firm. In October 2004, T-online (TOI), the German internet services provider, and its parent company Deutsche Telecom (DT), entered into merger discussions. At the time of writing, DT intends to reintegrate its partially floated internet unit to bolster its fixed line business and reap cost savings of up to €1 bn. To achieve these ends, DT has made a de-facto two-tier offer to T-Online's minority shareholders. Up until 04 February 2005, investors could sell their shares back to Deutsche Telecom in a tender offer for €8.99 in cash, a sum considerably below the 2000 IPO price of €27 and independent estimates of the fundamental value of the firm.

The inadequacy of this offer was confirmed by independent valuations prepared for T-Online by the German audit firm Warth&Klein and a fairness opinion commissioned from the investment bank Rothschild. Based on this analysis, the board of TOI stated that, "the offered purchase price per TOI share is significantly below the per share company value of TOI established by performing a discounted future earnings valuation or on the basis of other internationally recognized valuation methods." Therefore, the management board was neither able to recommend or reject the offer, although none of the board members tendered their own shares.

Despite the inadequacy of the offer, DT has tried to force T-Online shareholders to take up the cash offer, by stating that they would be subject to a statutory merger under German law compelling them to tender T-online shares for DT shares at an exchange ratio of between 0.45 and 0.55 a DT share. This range values TOI shares below the €8.99 cash offer and leaves considerable uncertainty for the investor about the effective merger price. Essentially, DT structured the transaction as a two-tier offer similar to now infamous and outlawed practices during the heydays of hostile takeovers in the 1980s in America.

Prior to the tender offer, Deutsche Telecom held 73.93% of TOI, Lagardere, the French family controlled defence contractor and media group, owned 5.69% and minority investors approximately 20%. By the end of December, DT had increased its

stake to 73.98%, as investors were expecting – wrongly – an improvement of DTs offer. Therefore, only by securing a portion of the Lagardere stake could it be absolutely certain of its ability to force through a statutory merger against the will of minority shareholders. Under German law, statutory mergers allow a parent to buyout minority shareholders in a subsidiary at a value set by an independent expert, while taking the share price as the lower bound.

On 07 February, after the cash offer had expired, Lagardere announced that it had sold the majority of its stake back to DT at an undisclosed price. This places the German company in a position to acquire minority stockholders shares, through the statutory merger process, at a discount to the cash offer already rejected by most minority shareholders, and the advisors of TOI, as inadequate.

In our view, Deutsche Telecom is in violation of both German and European corporate governance standards on a number of basic issues. Firstly, Germany's Cromme Corporate Governance Code (Article 3.7) states that shareholders must have full disclosure of all material facts and circumstances when making a decision on a public tender offer. At the very least, DT's failure to define a fixed exchange ratio for the statutory merger deprives minority shareholders of a basis on which to make their decision to tender or not. Moreover, the parties also failed to disclose whether Lagardere had sold its shares until after the closing of the offer period, and the price the shares were tendered to DT at.

In addition, the failures of both T-Online's Management and Supervisory boards to make recommendations on the offer are a dereliction of their fiduciary responsibilities of loyalty and care to minority shareholders, particularly after receiving independent advice of the inadequate nature of the offer. The failure of the Supervisory board to recommend the offer is especially ironic, since it has no real representation of minority shareholders. Of the 12 board members, one is from the company, four are representatives of DT, five are trade union representatives and one is from Lagardere. The final board member is a civil servant representing the interests of the German state, which is the largest shareholder in Deutsche Telecom with a 38% stake, and a clear beneficiary of under-pricing the offer.

Ultimately, Deutsche Telecom has attempted to force minority shareholder to sell into an under-priced tender via a de facto two-tier offer. Such offers are essentially outlawed in the better regulated US and UK markets. For example, in the US, SEC regulations prevent this as does the ability of the board to activate a poison pill defence in relation to under priced offers and fair price provisions in corporate charters. As discussed, Germany's takeover regulations are based on the European Takeover Directive. The directive introduced mandatory bid thresholds to prevent shareholders being subject to two tier offers. On all these grounds DT violates the spirit, if not the letter of the takeover code.

This case again highlights the inadequacies of minority shareholder protection in Germany, a civil law country, despite the much trumpeted introduction of new securities laws. While this deal is most likely well within the letter of the law, it nevertheless violates many Corporate Governance principles.

Conclusions

In this paper, we have used four case studies to establish the following propositions. Firstly, that financial tunnelling is still prevalent in high profile deals in Continental Europe even after the latest capital market reforms that were designed to eliminate it.

Second, unlike the straightforward asset expropriation described by Johnson *et al.* (2000), financial tunnelling as practiced in many cases is not legal under both European and domestic law. Moreover, the approach of both civil and common law systems is intended to be the same, with the clearly stated and fundamental intention of protecting the rights of minority shareholders. This makes it very different from classic tunnelling, which as Johnson *et al.* (2000) demonstrate is sanctioned by the courts, domestic legislation and long-standing legal precedents.

Third, the above case studies illustrate that capital market reforms such as the introduction of takeover regulations with mandatory bid thresholds and corporate governance codes are not in themselves enough to ensure the rights of minority investors. National elites often benefit from such reforms, which lower the costs of capital for their firms and strengthen competitiveness, and to this extent support reform. However, the litmus test of corporate governance reforms for any country is whether the rules are applied objectively when powerful elites find themselves in a situation in which they perceive they are disadvantaged under new regulations. For example, Beiersdorf and SAI/Fondaria are clear cases of powerful national capital market participants deciding that because the rules are not in their favour, they do not need to be applied to them, with the decision actually sanctioned by the Federal Regulator in the German case.

Fourth, the cases also highlight the lack of minority shareholders protection on corporate boards in Europe. In the cases of Beiersdorf, Telecom Italia[45] and T-Online, one explanation would be the lack of truly independent directors to protect the interests of minority shareholders. As a result, these boards were captured by dominant shareholders and sanctioned transactions which allowed the controlling shareholders to gain or increase control in a manner disadvantageous to minorities.

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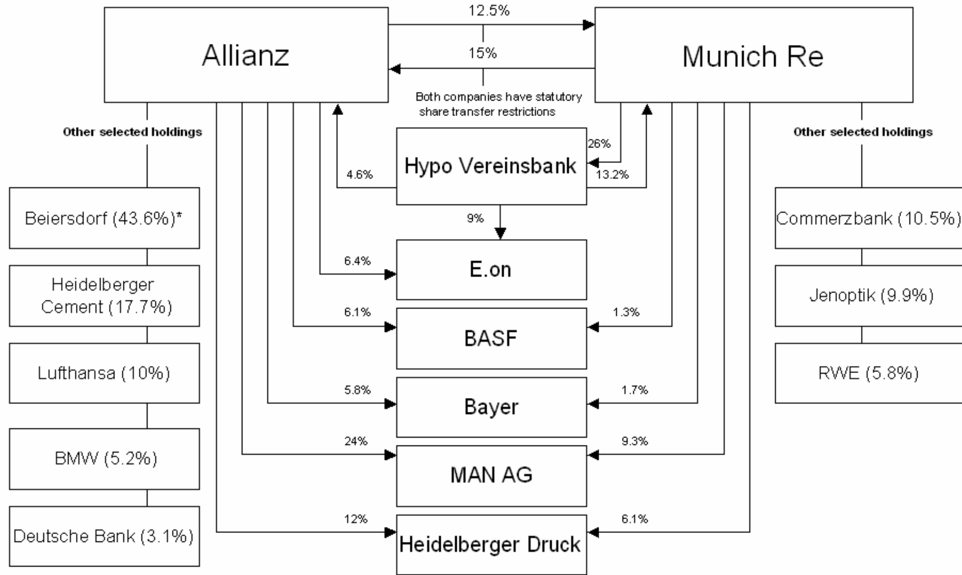
Appendix 1:



Appendix 2: The City of Hamburg and State Aid:

Although not directly connected with corporate governance, another major issue relates to the City of Hamburg's acquisition of a 10% stake with taxpayers money. It is surprising that the heavily indebted city should be supporting such a bid.[46] Its share of the transaction cost it over €1.2bn. Hamburg has indicated that it will dispose of the stake at a future date, and as noted above Beiersdorf could repurchase some of the stake in buyback. However, the control premium reflected in the price paid is unlikely to be recovered in any future placement. Hamburg's losses on the transaction currently stand at over €450mn of taxpayers' money at the current share price.[47] Ultimately, Hamburg has entered into a situation in which it is faced with a major conflict of interest between its role as a shareholder and as a guardian of tax revenues and employment.

There is also the very important question as to whether Beiersdorf and Hamburg have breached European Union regulations on state aid. While examination of the issue is beyond the scope of this paper, it is interesting to note that none of the firm's competitors, such as L'Oreal, has brought a complaint to the European Commission. It is possible that this reflects the fact that Beiersdorf's competitors would view the firm as much less of a competitive threat now under Tchibo`s ownership than otherwise.

Appendix 3: Mechanics of the Pirelli /Telecom Italia Deal

The Discount: Partly due to the events of September 11th, 2001, Olivetti's share price fell by over 50% between July and September. Therefore, Pirelli renegotiated the deal. According to the Financial Times Lex Column, Bell was "so desperate that Pirelli not renege on the deal to buy their stake that they agreed to subsidise the acquisition …… Pirelli will still pay €6.6bn for Bell's 1.55bn Olivetti shares but Bell will now give Pirelli €1bn cash back, in the form of a soft loan that converts into 263m Olivetti shares in six years' time. This gives Pirelli a partial refund without diluting its control."[48] Ultimately, Olimpia/Pirelli got a refund worth €694m (Wood, 2002).

The Subsidy: Olimpia also secured €740 mm in other bank loans. The privately held Olimpia, was using the publicly held assets of Pirelli to guarantee its debt, which lowered its borrowing costs by about 2%. (Wood, 2002).

The Capital Increase: The improved cash position of Olimpia allowed a subsequent round of cash raising by Olivetti to reduce its debt burden. Olivetti issued Euro 3.8 bn of equity and convertible bonds in a capital increase, for which Olimpia took up all its rights so as not to have its control diluted. The reduction of Olivetti's debt was positive for Olimpia/Pirelli, because it increased the capacity for dividend payouts, which would be used to pay off Olimpia's debt.

The Poison Pill: So as not to leave themselves as vulnerable to takeover as Roberto Colannio and defection of partners, Pirelli (Tronchetti Provera) and Benetton created a poison pill at the Olimpia holding company level.[49] An agreement was signed that if Benetton was no longer to appoint board members of Edizione Holdings (EH), Pirelli could put their stake to EH for a price "twice the sum of the price of the company shares and its premium". Equally, if Tronchetti Provera ceased to manage Pirelli, EH could put their shares in Olimpia to Pirelli for the same price. If there was boardroom deadlock between the 2 parties, EH would have the right to put its shares in Olimpia to Pirelli at a valuation determined by 2 investment banks. Equally, Pirelli could call the shares for the same valuation. Similar agreements were signed with Intesa Bci and Unicredito.

Endnotes

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1 The term tunnelling is derived from a case in the Czech Republic, where assets were physically removed from the premises of a company via an underground tunnel.

2 See Dyck and Zingales (2004) for an extensive discussion of private control benefits.

3 These are calculated as the percentage of market capitalisation captured by dominant shareholders beyond their equity stake.

4 In this case, Volkswagen made two-tier offers to various shareholders of Audi over the period 1964-66.

6 There is a controversy as to whether MBRs are positive for minorities ex-ante, as it is argued that they could decrease value enhancing takeovers in aggregate (see Bebchuk, 1994; Högfeldt, 2004; and Enriques, 2004).

7 "The European corporate and investment community considers the UK – not the US – as their model for capital markets", European Corporate Governance: A Changing Landscape? – MIT Sloane School of Management 50th Anniversary Report, October 2002, p.1.

8 KonTraG Law (1998) – Control and Transparency Act -Increased regulation of financial markets. Limited proxy voting by banks, increased power of board. It removed golden shares, public dual share classes (although not private ones), voting caps and discouraged cross shareholdings. It also legalised share buybacks and options grants.

9 This stake would eventually rise to 43.6% of the company.

10 In September 2003, Herz stood down from the board to make way for Tchibo Holdings Chairman, Dieter Ammer.

11 The free float of Beiersdorf amounted to only 17% of the share capital.

12 This was under the supervision of Allianz's CFO and former Goldman Sachs investment banker Paul Achleitner.

13 This account is based on Taylor and Ellison (2004).

14 This can be contrasted to Mannesmann/Vodafone, where the supervisory board (including the workers representatives) created no real roadblocks to a hostile bid by an aggressive foreign firm.

15 See Forbes Magazine – The Torn Herz Family (David Dukcevich, Feb, 2001).

16 The transaction was funded by the sale of a stake in Reetsma Tobacco, held by Tchibo, to Imperial Tobacco for approximately €5bn.

17 Comments to 'Der Spiegel' as reported in Graham (2003).

18 Losses to minority shareholders were immediate with Beiersdorf's share price plummeting 13.5% to euro 100 with the announcement of the deal on October 23rd, 2003. Beiersdorf's share price currently stands at euro 79.70, a further decline of 20%.

19 HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsverwaltung mbH

20 The buyback was launched on the 22 December 2003, with notification to US investors in the Wall St Journal on Christmas Eve.

21 Beiersdorf/Tchibo was able to achieve this result, because the consortium members (and the Claussen Family) transferred their buyback rights to Allianz.

22 Therefore, ultimately Allianz sold 40% of Beiersdorf's share capital at an average price of euro 130, whilst holding on to 3.5%. It then agreed to purchase a 4% stake in Beiersdorf at the inflated price euro 135.41, taking its overall stake down from 43.5% to 7.4%. On December 11th, 2003 part of this agreement was fulfilled when 150,000 shares were purchased from Carl Albrecht Claussen by Allianz, creating a loss for the insurer to date (24/08/04) of euro 8.4 million. Source: Statement of Claims against the City of Hamburg filed in German Court System by Dr. Carola Stenger 2004.

23 Source: Conversation between Dieter Ammer and one of the authors, St Gallen, Switzerland, 14th May 2004. The conversation took place after a seminar in which Mr Ammer was highly critical of German society's failure to restructure to meet the competitive challenges of globalization.

24 On file with the authors.

25 Source: Statement of Claims against the City of Hamburg.

26 An equitable price is defined in Article 5 of the European Takeover Directive as, "Highest price paid for the same securities as the offeror, or by persons acting in concert with him, over a period of between 6 and 12 months prior to the bid."

[27] Note that this was the day that the Beiersdorf buyback offer expired. This is a "coincidence" that would have benefited the consortium since it severely limited the time which minority shareholders could tender into the buyback offer.

[30] The creation of core shareholders was modelled on the privatization structures in France and Spain (see Grant and Kirchmaier, 2004 for a general examination of corporate control devices in Europe).

[31] Golden Shares are now illegal under European Law.

[32] These included the Lonati family, a textile manufacturer, and Emilio Gnutti, a financier close to former and subsequent Prime Minister Silvio Berlusconi.

[33] Olivetti was required to divest its telecoms interests by the Italian antitrust authorities. It deployed the proceeds as part of its cash offer for TI.

[34] Ironically, Tecnost was in the business of manufacturing gambling machines.

[35] Olivetti's debt financing was contingent on the tendering of at least 50% of the ordinary shares. If it received less than 67% (a percentage that would allow it to dominant an extraordinary general meeting) it also had the option of not going through with the offer.

[36] The Italians did this before it was required under European law, with the passing of the Takeover Directive by the European Parliament this year. That said a takeover directive had been on the legislative agenda of the Parliament for 14 years.

[37] Two banks, Intesa Bci and Unicredito Italiano each took 10% stakes.

[38] By mid-September 2001, Olivetti's share price had tumbled by over 50%. Pirelli renegotiated the deal, and via a series of complex transactions ended up paying only Euro 3.30 per share – see Appendix 2 for further explanation.

[39] In the US, the SEC regards a holding of 20% of the voting rights of a widely held firm as constituting control.

[40] In fact, despite this, Pirelli and Edizione/Benetton, in the subscription agreement to a subsequent capital increase of Olivetti, claimed that they did not control Olimpia, and in turn Olimpia did not control Olivetti. In an attempt to shape legal precedent, they stated that Pirelli exercises joint control with Edizione Holdings, therefore the legal definition of control under Article 93 of the Draghi Laws did not apply. Later, Consob, the Italian stock market regulator required Pirelli to amend the prospectus for the issue, stating that in its analysis it had de facto control of Olivetti. On this issue the UK Law firm Freshfields commented: "The fact that there can be a seriously argued debate on these facts signifies that, although Italian public company law and practice is developing, there is still some distance to travel before the more transparent approach adopted in other markets is fully effective." (Freshfields, 2001, p 3.)

[41] Neither the Draghi Decree nor the European Takeover Directive deals with partial bids below the threshold, or the acquisition of control of a private holding company that in turn controls a publicly listed one. The latter is a loophole, particularly in relation to countries such as Italy, France and Germany where pyramid corporate structures are common. (Enriques, 2004).

[43] Art 82 European Communities Treaty prohibits the abuse of a dominant position. The Merger Regulation has since been amended. The criterion for assessing mergers has been modified. Mergers which "would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position" would now be held unlawful.

[44] This is also in violation of European Law. The European Takeover Directive states that in this situation an equitable price must be paid to minority shareholders.

[45] Subsequent to its acquisition by Pirelli, Telecom Italia has undertaken significant governance reforms, including increasing the number of independent directors to ten out of 19.

[46] Hamburg has debts of over €20bn. and has one of the highest per head debt ratios amongst the German Länder.

[47] Based on the closing price of Beiersdorf stock on the Frankfurt Stock Exchange on August 24th, 2004.

[48] Financial Times – Lex Column, September 20, 2001.

[49] These are detailed in TI's US SEC 13-D filings.