

# ***S P O T L I G H T   O N   V A L U E***

***economic and market ideas and how they may benefit our investors***

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***18th June, 2002***

**Golden Shares, Poison Pills and other impediments to capital allocation – the European Commission’s battle continues .....**

Long before the euro was anything other than a remote dream, even before the six founder members of the EEC (as it was then) had allowed into their ranks countries like Britain and Spain and Sweden, there was a European aim to bring about a single market for goods, services, labour and capital which would knit together the European economy indissolubly. While progress has not been all that fast, and a cynic might wonder whether there will ever be a single market, there is in Brussels a commissioner, Frits Bolkestein, whose job it is to work at confronting the many, many ways in which national governments seek to impede the single market. One of the easiest ways in which national governments thwart the aims of the single market is by imposing special requirements. For example, the rights of other EU citizens to work in any particular country can be thwarted by requiring them to have the qualifications of that country; goods can be kept out or made more expensive by imposing special environmental or safety requirements.

## **The need for a single market in financial services .....**

It is possible that there are more impediments in the area of financial services than anywhere else. EU citizens cannot buy insurance outside their own country of residence. Europe may have a single currency but when someone living in Paris wants to send money to someone in Berlin it will cost him far more than it would if he wanted to send money to someone in Bordeaux. When it comes to firms or investors trying to take over companies in other EU countries the portcullis often comes down with a bang. Much of Frits Bolkestein's work involves winning agreement - either through directives, or under the single market legislation that EU states have signed up to, or simply on a voluntary basis - to common EU-wide patterns of behaviour. He has an uphill fight.

One area where Bolkestein has been working for some time is on achieving a common code of practice for takeovers and mergers. This is essential if capital market efficiency is to be improved. Most of the EU does not have a culture of predatory mergers which makes for a cushy climate where poor management frequently flourishes. Opening up the market to potentially hostile bids would almost certainly mean that some firms will be swallowed up if they were exposed to such market discipline. National self interest fights hard against this possibility. Recently the MEP, Christa Randzio-Plath, who is on the European Parliament's Economic and Monetary Affairs Committee, sought to force the Commission to take into account when company mergers are vetted by the Commission a whole raft of jobs and social issues. However MEPs decided that merger watchdogs should concentrate solely on the impact on fair competition when vetting company mergers.

A year ago Bolkestein's efforts to bring about a common EU-wide code for takeovers of firms were shot out of the water by the German government defending German political and business interests. It was the provision in the directive which banned defensive measures intended to frustrate a bid to take over a company that the German government could not swallow. These defensive measures, poison pills and the like, damage shareholder value and allow inefficient businesses to rumble on with impunity. But opponents of Bolkestein's takeover code argued that the code would fail while some EU governments retain golden shares in certain businesses and that the level playing field that the code aimed to create would not exist while governments could use their

privileged share holdings to the open acquisition of shares in those businesses. Golden shares allow governments to veto takeovers.

This was a major setback for Bolkestein because he has long argued that without a single market for financial services EU citizens will never be able to enjoy the full advantages of the single currency. The ways in which countries ring-fence national practices tends to mean that the only real advantage that the single currency currently provides is that people can travel round Europe without changing the actual notes and coins that they use, but in all sorts of other ways they do not have a common money. No one should doubt the will to achieve the single market in financial services. The euro is here and Bolkestein is right that the euro would be emasculated if financial services are not opened up across Europe. The Commission may well not be able to bring about change quickly but it will grind on until it does break down the opposition. Almost immediately after the takeover directive had been weakened, Frits Bolkestein signalled his intention to continue the fight by announcing that the Commission would investigate Spanish and Italian laws which impede cross-border investment and that the Commission would bring cases to the European court.

## **Resistance from national governments .....**

National governments defend their use of golden shares by arguing that certain businesses are of such strategic importance that they require unusual protection from predators or asset strippers. This might be a “justifiable” argument if the attackers came from outside the EU. But if the EU is working towards a unified state then it would be wrong to regard investors from elsewhere within the EU as foreign. But the whole issue is rather more complicated than that, since there is also a general feeling that the process of privatising state-owned monopolies is in general beneficial. It is sometimes argued that governments would be less willing to privatise state owned companies if they did not

have the safeguard of golden shares. Under these circumstances it may then be preferable to allow governments those safeguards.

## **The implications of the ruling on golden share by the European Court of Justice .....**

In the first week in June the European Court of Justice ruled on three cases involving golden shares. The European Commission brought the cases to the court in the 1990s, - one against the French government because under French law any foreign investor with an interest in TotalFina (which has combined with Société Nationale Elf-Aquitaine to become TotalFinaElf) must get permission from the government before buying or trading shares in TotalFina; one against the Portuguese government where by law foreign ownership of banks, insurers and energy and transport companies is restricted to 10%; and one against the Belgian government where the law allows the government to oppose share transactions in the gas company Distrigaz, but only after they have been completed. Still pending in the court are similar cases involving Spain's Repsol, Telefonica, Tabacalera and Endesa and also Britain's airport authority, BAA. The Commission is considering action against the Dutch telecom group, KPN, and the Dutch logistics company, TPG.

The court's ruling was that the French and Portuguese governments "ease their rules on government control of public companies via so-called golden shares". The court labelled the French and Portuguese rules as "unlawful" and as constituting a "serious impairment" on the free flow of capital in Europe. The court allowed the Belgian case because it considered the Belgian rules a reasonable mechanism to maintain minimum energy supplies. The court has not outlawed golden shares but it has imposed certain principles with regard to their use. They cannot be justified on the grounds of aiding economic performance and they should not be unduly restrictive; they should also provide legal certainty. To claim that golden shares enhance economic performance is almost always special pleading – indeed, more often than not the exact opposite is the case. They usually shelter managements from market pressures and they thwart cross-border

restructuring of industries. But much remains to be clarified and it would seem likely that the impending cases may well go further down the road of defining exactly when they may be used.

### **But there is still a long way to go ...**

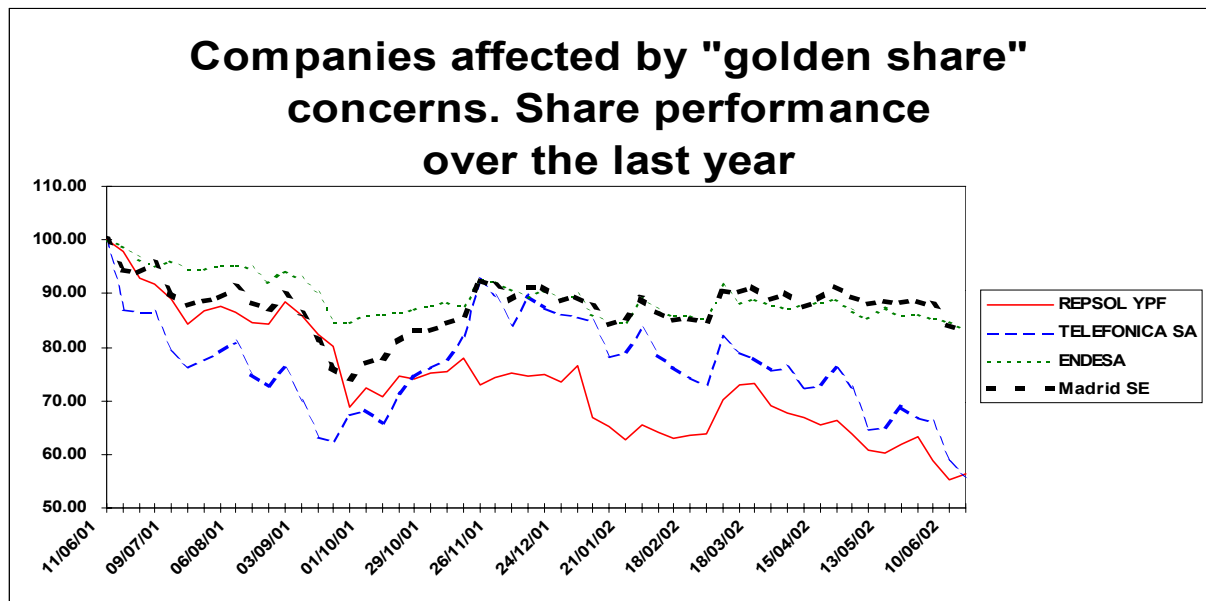
But this leaves the Commission still having to fight the defensive mechanisms that companies use to protect themselves in a piecemeal, bit-by-bit way. The Commission has also said that the court's decision means that its proposals for a Europe-wide takeover code remain on track. In a perfect world this would mean that firms would defend themselves in a contested bid situation using the same rules across the EU. It would also go some way to protecting the rights of minority shareholders, whose interests are frequently ignored in your average EU takeover.

Although the application of a common set of rules for takeovers might un-nerve some stakeholders, it should bring some benefits to shareholders, and this can also include governments. A more level playing field means that there could well be more competition to buy up state owned assets, and this could raise the value of these assets to tax payers and to the government. It will ultimately contribute to a more a competitive, and hence more efficient internal European market.

The spotlight at present tends to fall on on energy and transport firms; also banks and insurance. The latter sector will need at some point to consolidate in Europe and when it does so there is likely to be a fair amount of pain, and not just of employees finding that their slots are no longer secure.

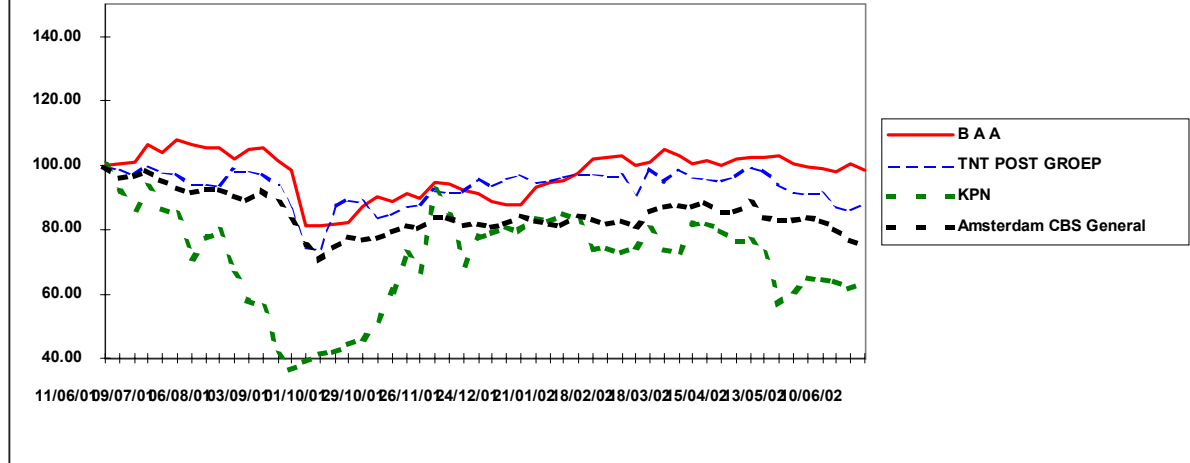
## How does this look from a corporate point of view ?

Earlier we mentioned several companies, and the following graphs give an indication of what has been happening to their share price. Generally, despite the perceived protection these companies enjoy through their “golden share”, it has worked against rather than for their shareholders. All three of the Spanish companies mentioned have recently under-performed the Spanish stock market, which itself has been declining in value. Although all 3 companies recent financial performance has been reasonably good, the depressed share price is taking on board a much less buoyant view of the future. It may also be that the concerns on the “golden share” issue are also weighing on sentiment. Reasons for investors to stay away a little longer before jumping back in.



A slightly different picture emerges if you look at the non-Spanish companies mentioned.

## "Golden Share" companies recent performance



When compared with the Amsterdam index, TPG has actually done rather well, which may reflect its progress on the Value Based Management Front. KPN on the other hand has languished reflecting its poor underlying profitability. BAA shares have also maintained value relatively well in a bear market. Perhaps investors should regard efforts to break up this company's market position less favourably, since a weakening of its monopoly position as owner of the UK's two largest airports would dent cash flows.

**Elizabeth Legge/Andrew Black: June 18<sup>th</sup> 2002**