Oxera

Special rights of public authorities in privatised EU companies: the microeconomic impact

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Executive summary

A common feature of privatisations in Europe during the privatisation wave of the 1980s and 1990s was the retention of special rights by public authorities in the privatised companies. The rights—also referred to as 'golden shares'—preserve the influence of governments over the companies they privatised and grant the governments powers that are otherwise only available to, or go beyond those of, a majority shareholder.

The compatibility of special rights with the EC Treaty has long been contested by the European Commission, and the European Court of Justice (ECJ) has reached several judgments confirming that, in most cases, the measures are infringements against the freedom of capital movement. Many special rights have since been abolished.

Oxera was commissioned by the European Commission to provide a systematic overview of special rights retained by public authorities in privatised companies in the EU, and an evaluation of their economic impacts on the performance of affected companies, direct and portfolio investment, and EU financial market integration more generally. The study does not assess in any detail the wider social benefits or costs that may arise from special rights.

The findings contained in this report can be summarised as follows.

Classification of special rights

Special rights include all legal arrangements with the purpose of preserving the influence of a public authority on a privatised company beyond the extent to which such influence would be afforded under general company law. They take many different forms and, depending on their nature, vary in their likely impact. Using as examples the special rights that are, or were, observed in EU companies and that were the subject of infringement proceedings by the Commission, the report provides a systematic classification of special rights along several relevant dimensions, including the following.

– **Direct or indirect investment restrictions**—special rights can give a public authority the rights to control changes in ownership and influence the shareholder structure of a company. Alternatively, they can grant the authority influence over a company's management decisions. While the former presents a direct restriction on investment in the company, the latter influences investment decisions only indirectly (eg, by making the investment less attractive). Examples are shown in Table 1.

Table 1 Examples of special rights

Direct investment restrictions	Indirect investment restrictions
Caps restricting substantial blockholdings	Requirements for approval of, or rights to veto, certain strategic management decisions
Requirements for approval of, or rights to veto, changes in ownership by the government	Rights to approve or appoint members of the company board
	Limitations of other shareholders' voting rights

Source: Oxera.

The two types of special rights differ not only in their likely impact on investment decisions, but also in the way they affect company performance.

  - Direct investment restrictions in the first instance shelter the company from being taken over. This in turn may affect company performance if a lower likelihood of takeover increases managerial slack or prevents the realisation of synergies.

  - The performance impact of indirect restrictions comes from, and depends on the quality of, public intervention in management decision-making.

- **Discriminatory and non-discriminatory restrictions**—among the direct investment restrictions, a distinction can be drawn between those that explicitly discriminate against foreign investment and those that do not. The former are likely to have a more significant impact on cross-border investment. However, even restrictions that are not discriminatory on paper can be applied in a discriminatory manner to prevent takeovers by foreign bidders.

Other dimensions for classification include the severity of a restriction, the stated public policy justification for maintaining the rights, whether the rights are time-limited or permanent, and whether they have been exercised in practice.

Impact assessment based on the existing literature

The assessment of the economic impacts of special rights can draw from existing empirical research findings. Although direct evidence is limited, academic studies have addressed questions that are relevant when evaluating the impact of special rights on company performance and investment decisions.

- Existing research documents significant improvements in company performance following the transfer of ownership (and control) from the state to the private sector. These improvements relate not only to share prices and the financial performance of companies following privatisation, but also to productivity and operating performance.

  One study explicitly examines the impact of golden shares on performance, and presents findings that are consistent with the view that failure to transfer complete control to the private sector, combined with uncertainty surrounding the exercise of golden shares, has a detrimental effect on performance.

- A prominent motive for the retention of special rights in the form of direct investment restrictions is to block hostile takeovers. There is a large body of literature establishing a negative relationship between anti-takeover provisions and company performance—ie, when managers are insulated from takeovers, overall performance tends to decline.

- It is well established that shareholders in firms that become takeover targets receive large premia relative to the pre-announcement share price. Special rights that prevent takeovers therefore have a negative impact on shareholders in potential target companies who would otherwise have been able to realise premium returns on their investment.

- There is widespread evidence that voting rights and control powers carry significant market value, with higher share prices being observed for shares with increased voting rights and in acquisitions of control blocks. Special rights grant disproportionate control to the public authority and hence can be expected to have an adverse impact on market valuation.

- Special rights that restrict the free movement of capital across borders are likely to have effects that are similar to those examined in the literature on international investment restrictions. Such restrictions have been found to impose costs on affected companies and investors. They segment financial markets and distort the allocation of savings and capital across markets.

Impact assessment based on empirical analysis

The report contains new empirical evidence on the impact of special rights on privatised EU companies, to complement the existing evidence. The first set of evidence is obtained from a detailed case study analysis for a sample of six companies affected by recent Commission infringement proceedings.[1]

– Evaluating the impact of special rights on company performance requires an assessment of the counterfactual—ie, what would the performance have been if the companies had not been subject to special rights? One approach is to compare performance of the same company before and after the abolition of special rights and to assess any resulting performance improvements. However, in the case study sample, most special rights were abolished only very recently or were still in place (eg, because infringement proceedings were ongoing at the time of analysis). It was therefore too early to assess the longer-term impact of the abolition of special rights.

– Instead of using before-and-after comparisons, the case study analysis therefore focuses on benchmarking the companies' performance against that of comparable companies not subject to special rights. Other things being equal, any observable difference between the case study firm and comparators may be attributed to the existence of special rights.

  The results of the benchmarking analysis show some underperformance of case study firms relative to their chosen comparators, in particular in operating performance. However, the results are disparate and overall not conclusive—while some of the case study firms tended to underperform consistently, others outperformed the benchmarks at least along specific dimensions of financial performance.

  The lack of conclusive evidence may be largely due to data and methodological problems. In particular, given the nature of the industries in which the case study firms operate, the choice of comparators was restricted to companies operating in other countries, subject to a different regulatory regime, or indeed still partly state-owned. Any differences in these or other company-specific factors are likely to influence comparative performance, thereby clouding the measured performance impact of special rights. Conclusions that can be drawn from case study analysis are necessarily limited. More conclusive results might be obtained if the impact assessment were based on a larger sample of firms and applying techniques that control for other factors influencing company performance, and allow the impact of special rights to be isolated from these other factors. Notably, one study in the existing literature adopts such techniques and, for a large sample of international companies, reports a statistically significant negative impact of golden shares on long-term share price performance.

– The case study analysis also considers share price reactions around the dates when it was announced that the special rights in the companies were to be removed. If the special rights were considered binding by the market, a positive share price reaction upon announcement of abolition would be expected. This approach critically relied on the identification of dates when the market learned, for the first time, that the special rights would be abolished. The event dates available, however, related to official announcements of infringement proceedings, ECJ rulings or actual abolition, which may have long been anticipated by the market. This is likely to explain the general lack of

[1] Cimpor (Portuguese cement manufacturer); Volkswagen (German automobile manufacturer); Repsol YPF (Spanish oil and gas company); KPN (Dutch telecoms company); Portugal Telecom; and British Airport Authority (BAA, the UK airports operator).

share price responses. Overall, no evidence was available to conclude that the market reacted positively to the official measures taken to abolish special rights.

– Evidence was available from the case study analysis to suggest that special rights have a negative impact on investment decisions—eg, a takeover bid which was made conditional on the government abolishing the special right in the target and which triggered a significant share price appreciation.

The second set of new evidence is obtained from an event study analysis around the abolition of golden shares held by the UK government in privatised companies in the water and electricity sectors until 1995. The golden share constituted a direct restriction on investment in the companies; it effectively meant that no shareholder was allowed to control more than 15% of voting shareholdings and so prevented hostile takeovers.

– The golden share redemption triggered a surge in takeover activity in both sectors. Within two years of redemption all but one of the 12 regional electricity companies had been merged or acquired, in most cases by foreign companies. In water, the first takeover bid for a water and sewerage company occurred just two months after the golden share redemption. This provides support for the view that special rights in the form of direct investment restrictions restrict the market for corporate control and have a binding, negative impact on takeover activity in the market.

– The takeovers announced as a result of the golden share redemption were associated with significant takeover premia. It therefore appears that special rights of this type prevent shareholders in target companies from realising large premium returns.

– The event study analysis does not allow conclusions to be drawn about the impact of the golden share redemption on the longer-term performance of UK water and electricity companies. Nonetheless, the positive share price reactions—not just of the target companies but also of the other companies in the sector—are consistent with the hypothesis that the market expected significant synergies or other benefits from takeovers in the sectors. To the extent that these benefits would have been prevented if the golden shares had not expired, special rights of the UK type are likely to have adverse long-term consequences on the performance of companies.

Conclusions

Special rights held by public authorities tend to have a negative impact on the longer-term economic performance of EU privatised companies. The new empirical analysis conducted as part of this study provided some evidence consistent with a negative performance impact, although further research would be required to allow stronger conclusions to be drawn from the data. Importantly, existing research in the academic literature supports the conclusion of a negative impact of special rights on the financial and operating performance of companies.

Both existing and new empirical research provide strong evidence that special rights can constitute important barriers to direct investment. They have an adverse impact not only on the market for corporate control, by restricting takeover activity and distorting the level playing field in the market, but also on portfolio investors. To the extent that they restrict the free movement of capital across EU borders, they impede further financial market integration.

Despite these negative impacts, it could be argued that maintaining public control of companies might be justified in some circumstances. In particular, governments may deem it necessary to impose special rights following privatisation, given concerns about a divergence between social objectives and the private goals of unconstrained private companies. Such concerns apply in particular to enterprises providing public services, where there may be considerations of security of supply or universal access to a service. These are of little relevance for companies in other industries where special rights have been observed.

Moreover, the public policy argument may be relevant when justifying the need to maintain control over certain company decisions that would risk the public policy objectives, but it provides little justification for special rights that constitute a direct investment restriction and an outright blocking of a takeover of utilities.

Special rights are only one of a number of mechanisms that can be employed by public authorities to retain control in companies following privatisation. In particular, regulation that addresses economic efficiency and often wider aspects such as security of supply and universal access is now an essential part of most governments' approach to privatised companies in the public utility sectors, often underpinned by Community secondary legislation. Regulation may be seen as a potentially less restrictive and more transparent means of achieving public policy objectives, especially if carried out by an arm's-length regulatory authority.

An alternative would be not to relinquish ownership in the first place. Indeed, in some instances governments may be less likely to sell their ownership stakes and fully privatise a company if they did not have the possibility of retaining special control rights. This is important since, despite the significant privatisation wave in the last two decades, many EU governments still retain large stakes in companies and, as major shareholders, can use that ownership power to block acquisitions or influence management decisions. This provides more reason to continue work on refining alternative methods of control that would safeguard public policy concerns without directly interfering in corporate control and restricting direct investment.

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1 Introduction

Oxera was commissioned by the European Commission to conduct a *Study on Public Investment Restrictions in EU Companies* (tender no. ECFIN/E/2004/03). This report summarises the main findings of the research.

1.1 Summary of research

The last two decades have witnessed a significant privatisation process in Europe, launched by the UK government's privatisation of British Telecom in November 1984,[2] and adopted by other European governments as part of the gradual liberalisation of public utility sectors. All privatisation programmes tended to share similar objectives:

– to raise revenue;
– to promote increased efficiency;
– to reduce government interference in the economy;
– to promote wider share ownership;
– to provide opportunity to introduce competition;
– to expose state-owned enterprises to market discipline; and
– to develop national capital markets.[3]

Although other privatisation methods were used, some of the largest and most economically significant privatisations involved secondary share issues that were immense, both in terms of absolute size and relative to other share issues in the market. They typically involved politically motivated features such as share tranches being reserved for sale to employees at reduced prices or even free; advertising campaigns to overcome the reluctance of ordinary savers to invest in stock; and the use of fixed-price rather than competitive-bid share offers, with the offer price usually set sufficiently low to assure high demand and immediate trading profit for small shareholders favoured with share allocations.

Importantly, one characteristic common to almost every privatisation was the retention of some form of public control over the fully or partly privatised companies, in the form of special rights retained by public authorities in respect of those companies. The list of special rights includes, in particular:

– caps on the maximum number of shares held by investors in the privatised company;
– authorisation procedures for significant investments in the company;
– veto rights on important decisions of management;
– limitation of voting rights; and
– privilege to appoint management.

Such public measures—often generalised under the term 'golden shares'—have been much debated in recent years, and the European Court of Justice (ECJ) has delivered several judgments confirming that the measures constitute a restriction on the free movement of capital and are therefore generally incompatible with the EC Treaty.

[2] Privatisations in the UK started in 1977 but gained momentum in 1979 when the Conservative government came to power under Margaret Thatcher. The BT issue in 1984 was by far the largest equity offering in history at that time. It was met with strong demand by domestic and foreign investors, and can be regarded as having launched the privatisation programmes internationally.
[3] Price Waterhouse (1989), *Privatisation: Learning Lessons from the UK Experience*, London: Price Waterhouse.

The overall aim of this research study is to provide the Commission with a systematic assessment of special rights retained by public authorities in privatised companies in the EU, and an evaluation of their economic impacts. These impacts may be wide-ranging. In particular, special rights may have a negative impact on the economic performance and competitiveness of individual privatised companies, direct and portfolio investment, and EU financial market integration. However, the study does not assess in any detail the wider social benefits or costs that may arise from special rights.

The research study encompasses the following main elements.

– **Review of existing research**—the study presents an overview of research relevant to evaluating the potential impact of special rights of public authorities on firm performance and on direct and portfolio investment decisions.

– **Typology of special rights**—the study establishes a systematic classification of the types of special rights according to their potential impacts on firm performance and investor behaviour. The typology provides the basis for selecting specific cases of special rights in privatised companies to be examined in the empirical analysis. It also provides the conceptual framework for deriving the set of hypotheses to be tested empirically.

– **Empirical analysis**—the study provides an empirical analysis of the performance of companies in different economic sectors, which have been affected by special rights of public authorities since privatisation, or continue to be affected. Using a range of suitable performance indicators, empirical evidence is gathered to evaluate whether the data supports the notion that investment restrictions in the form of special rights have had a significant impact on firm performance, and to measure that impact. The analysis also considers how such restrictions have affected investors and their investment decision-making.

– **General conclusions**—the study provides a summary of implications that emerge from the research and draws general conclusions with regard to the impact of special rights.

1.2 Structure of the report

The report is structured as follows.

– Section 2 presents background information and an overview of the main issues to be addressed in the research.
– Section 3 contains a review of the academic literature.
– Section 4 describes the typology of special rights. Appendix 1 contains a summary table describing special rights in a sample of privatised EU companies.
– Section 5 presents the main results of the case study analysis conducted to assess the impact of special rights on the performance of a sample of six privatised EU companies. Further results are contained in Appendix 2.
– Section 6 presents results of the separate event study analysis proposed by Oxera as a complement to the case study analysis specified in the original tender. It focuses on the redemption of the UK government's golden share in the regional electricity companies and the water and sewerage companies in 1995, and assesses the impact on the companies' takeover activity and share price performance.
– Section 7 summarises the findings and draws conclusions.

2 Background and research issues

Special rights are legal arrangements that affect the governance structure of privatised companies. They allow public authorities to retain considerable influence, despite having surrendered a majority of shares following privatisation. The rights preserve the influence of a public authority on the shareholder structure and/or the management of the privatised company beyond the extent to which such influence would normally be afforded under general corporate law.

Based on a 2004 survey of Member States,[4] the Commission identified special rights in 141 EU companies, covering significant sectors of the economy, from enterprises providing public services in telecommunications, electricity, gas, energy and postal services, to banking, insurance and other industries outside the public utility sector. In some countries this includes regional companies; in others, the scope of the companies is national. The count follows a period of considerable scaling-down and abolition of special rights, resulting from the voluntary initiative of governments or fostered by Commission action and rulings of the ECJ.

The compatibility of these public measures with the EC Treaty has long been contested by the Commission,[5] and the ECJ has delivered several judgments confirming that the measures are generally incompatible with the EC Treaty. In the first judgment, *Commission v Republic of Italy* in 2000,[6] the ECJ found that, by adopting the 1994 Law on Privatisation and Decree Laws on ENI and Telecom Italia, Italy had failed to fulfil its Treaty obligations.[7] On June 4th 2002, the ECJ made a first wave of landmark judgments relating to three cases involving similar types of restriction, including, for example, caps restricting foreign investments in Portugal, caps restricting substantial shareholdings in Portugal and France, rights to appoint management in Belgium, and exclusive veto rights in France and Belgium.[8] In 2003, the ECJ ruled against legal arrangements in Spain that require prior authorisation for certain decisions of the board of directors, including merger or break-up of the privatised companies,[9] and against provisions in the UK that limit the possibility of acquiring voting shares in airports operator, BAA, and require consent for disposal of the company's assets.[10] In 2005, the ECJ ruled against Italy regarding a law restricting investment in energy companies.[11] The Commission has started proceedings against further cases of public investment restrictions in other EU Member States, and decisions on these cases are pending (see section 4).

In the ECJ judgments, the court relied on the concept of free movement of capital to scrutinise the national arrangements. [12] It found arrangements that contained an element of

[4] European Commission (2005), 'Special Rights in Privatised Companies in the Enlarged Union: A Decade full of Developments', Commission Staff Working Document, July 22nd.

[5] See Communication of the Commission on certain legal aspects concerning intra EU-investments, OJ C 220, 19.07.1997, p. 15.

[6] Case C-58/99.

[7] In the meantime, those special powers had also been introduced in the bylaws of FINMECCANICA S.p.a (defence) and ENEL S.p.a, as well as in the companies it controls.

[8] Cases C-367/98, C-483/99, and C-503/99.

[9] Case C-436/00.

[10] Case C-98/01.

[11] Case C-174/04.

[12] EC Treaty, Art. 56, para. 1.

discrimination against foreign investors to be incompatible with the Treaty, such as the caps on foreign investment in Portugal. It also judged against many non-discriminatory arrangements, including caps restricting substantial blockholdings and rights of appointing management or vetoing management decisions.

It may not seem obvious why non-discriminatory arrangements constitute a restriction on the movement of capital, given that they do not explicitly address the acquisition of shares by foreigners or even directly impede the acquisition of shares. For example, passive portfolio investors—the predominant type of investor in the market—will normally not reach the relevant threshold of a cap restricting substantial blockholding and will not be interested in an active role regarding the composition and the decisions of the board which a Member State seeks to influence through special rights.

However, such non-discriminatory special rights may directly affect strategic investors seeking an active role in the decision-making process. In other words, the markets in which transactions are being restricted are, in the first instance, the European markets for corporate control (or direct investment): the special rights restrict the freedom to acquire and make use of controlling stakes in privatised companies and thus change the way economic resources are put to use in these businesses.

If special control rights directly restrict strategic investors, they almost invariably have an additional impact on the market for portfolio investments. Where national laws deter a bidder from gaining control of a corporation, the potential target's shareholders are deprived of an opportunity to dispose of their portfolio investments. Usually, a takeover bid is an exceptionally attractive opportunity to do so because bidders usually pay premia above market prices. Where there is no potential market for corporate control, the market for non-controlling stock is therefore also affected.

Thus, special rights retained by the state can be seen as having the potential effect of deterring cross-border investment in the markets for both corporate control and portfolio investment. The arrangements tend to shield the exposure of privatised companies from integrated financial markets. They also tend to impede efforts to establish a level playing field in a European market for corporate control, since the companies they protect are no longer potential takeover targets but may still act as bidders. The arrangements may therefore present barriers to the full integration of the EU's financial markets.

At the level of individual companies, special rights that provide a shield from takeovers may adversely affect the performance of the protected companies. They may thwart cross-border restructuring of industries and shelter management from market pressures. Any reduced fear of hostile takeovers may mean that the disciplining device that the market for corporate control would otherwise create has become less effective, and that overall corporate governance has been reduced. Poorer corporate governance may in turn result in managerial slack and deterioration in economic performance. In addition to reducing market discipline, any direct interference of public authorities in the management of the privatised companies may have a negative impact on the performance of the firms.

Special rights retained by public authorities may therefore have wide-ranging negative implications for firm performance and competitiveness, direct and portfolio investment, and EU financial market integration. By not consistently privatising and retaining some state control, governments may in selected cases also have forgone revenue from the sale of the state-owned companies. Abolishing investment restrictions could promote the level playing field, which in turn could mean more competition to buy up state-owned assets, which could raise the value of these assets to taxpayers and to the government. This could ultimately contribute to a more competitive, and hence more efficient, EU market.

Although potentially important in theory, the question is how relevant and significant these economic implications are in practice. Moreover, special rights in privatised EU companies take many different forms, and their economic impacts are likely to differ appreciably.

The main aims of this research study are therefore to identify and describe any direct or indirect negative economic impacts of special rights in privatised companies. The analysis focuses on the following specific research questions.

– Do special rights have a measurable adverse impact on the financial and operating performance of privatised companies?

– What evidence is available to suggest that special rights affect the market for corporate control in the EU (ie, direct investment decisions), and to what extent do they affect portfolio investors?

If the empirical analysis reveals a significant adverse impact on performance and/or investment, it would still remain important, in a general economic assessment, to set this impact against the possible social benefits that may arise from the retention of some state control. For example, following privatisation, governments may have introduced special rights because of concerns about national security, security of supply, universal access, etc.

3 Review of the relevant literature

Empirical evidence on the economic impact of special rights of public authorities in EU companies is limited. Nevertheless, academic studies have addressed research questions that are directly relevant when evaluating the potential impact of special rights on firms' performance and on international direct and portfolio investment decisions.

Four broad areas of the academic literature are particularly relevant for this study:

- privatisation and the impact on firm performance;
- corporate control and the impact on firm performance;
- the voting rights premium and the valuation of blockholdings;
- restrictions on international direct and portfolio investment flows.

3.1 Privatisation and the impact on firm performance

Academic research documents significant improvements in company performance following privatisation. This area of the literature is relevant to the extent that it sets out the performance improvement that can be expected as a result of selling state-owned companies and transferring ownership (and control) to the private sector. Moreover, one of the studies surveyed has explicitly addressed the impact of retained golden shares on the post-privatisation performance of companies.

The performance effects of privatisation have been examined by Galal et al (1994), La Porta and Lopez-de-Salines (1999), Megginson et al (1994), Shleifer (1998), Jones et al (1999) and others.[13] For example, Megginson et al (1994) examine the pre- and post-privatisation financial and operating performance of 61 companies from 18 countries and 32 industries that experienced full or partial privatisation through public share offerings between 1961 and 1990. The authors find that firms showed strong performance improvements, with 69% of the firms in the sample experiencing increased profit margins after privatisation. Profitability was reported to increase significantly after privatisation, with the mean increase in the return on sales after privatisation approximating 2.5 percentage points. Firms also increased their sales and capital investment spending, which led to improvements in their operating efficiency and the size of their workforce. Furthermore, Megginson et al (1994) find that privatised companies significantly lowered their debt levels and increased dividend payouts, with average dividend payouts rising from 23% of profits to 46% after divestiture. The authors also document changes in the size and composition of corporate boards of directors after privatisation.

The results of Megginson et al (1994) are supported by evidence from Ehrlich et al (1994), who find a significant link between ownership and firm-specific rates of productivity growth.[14] The authors report that private ownership leads to higher rates of productivity growth and

[13] Galal, A., Jones, L., Tandon, P. and Vogelsang, I. (1994), *The Welfare Consequences of Selling Public Sector Enterprises*, Oxford: Oxford University Press; La Porta, R. and Lopez-de-Salines, F. (1999), 'Benefits of Privatisation: Evidence from Mexico', *Quarterly Journal of Economics*, **114**, 1193–242; Megginson, W.L., Nash, R.C. and van Randenborgh, M. (1994), 'The Financial and Operating Performance of Newly Privatised Firms: An International Empirical Analysis', *Journal of Finance*, **49**, 403–52; Shleifer, A. (1998), 'State versus Private Ownership', *Journal of Economic Perspectives*, **12**, 133–50. Jones, S.L., Megginson, W.L, Nash, R. and Netter, J.M. (1999), 'Share-issue Privatisations as Financial Means to Political and Economic Ends', *Journal of Financial Economics*, **53**, 217–53.

[14] Ehrlich, I., Gallais-Hamonno, G., Liu, Z. and Lutter, R. (1994), 'Productivity Growth and Firm Ownership: An Empirical Investigation', *Journal of Political Economy*, **102**, 1006–38.

declining costs in the long run. Their estimates indicate that the move from complete state ownership to private ownership in the long run would increase productivity growth by around 1.6% to 2% each year, with costs declining by 1.7% to 1.9% each year. However, a partial change from state ownership to private ownership was found to have little effect on long-run productivity growth. The finding in Megginson et al (1994) of a negative relationship between state ownership and profitability is supported by evidence from Gugler (2001).[15]

A comprehensive review of the literature on the impact of privatisation on company performance is provided in Megginson and Netter (2001).[16] Of the empirical studies reviewed which examine changes in output, efficiency, capital investment spending and gearing following privatisations in developed countries, almost all document significant increases in the first three indicators and significant declines in gearing. Privatisations are also shown to deliver high returns for investors, in particular in the first few years following privatisation. In addition, the literature review documents performance improvements in studies that examine empirical evidence for transition economies and developing countries.

Direct empirical evidence on the impact of golden shares

In the privatisation literature, one publication could be identified that explicitly examines the impact of golden shares—Boardman and Laurin (2000) empirically evaluate the factors affecting the share price performance of share-issued privatisations for a sample of 99 international companies during 1980 and 1995.[17] The retention of a golden share by the government is one of the factors examined;[18] other factors include the share of retained government ownership, the size of the issue relative to the domestic stock market, the timing of the privatisation, the country of origin, and the industry.

The authors find that shareholders in many privatisations enjoyed substantial increases in the value of their investments in the first three years. Most of the superior returns to UK privatised utilities were attributed to the electric and water utilities, which reported significant positive returns of 116% and 76% respectively over this period. Other (non-utility) UK companies and non-UK companies earned returns in excess of 50%. Adjusting returns by general market movements reduces the three-year returns by about 30 percentage points on average, but market-adjusted returns remained significantly positive. Particularly high returns are reported for the third year, suggesting that, even two years after privatisation, the market underestimated the total efficiency gains due to privatisation.

Using regression analysis, Boardman and Laurin establish the factors determining the three-year buy-and-hold returns. Issue size, country and industry are all found to be significant determinants. As regards government ownership, the regression results suggest a significantly positive relationship between the percentage of shares held by the government and share price performance, which appears to be in conflict with some of the other findings discussed above. However, one of the explanations provided by the authors is as follows: the government may have reliable inside information on which firms are likely to have the best long-run, post-privatisation performance. As a consequence of this informational asymmetry, the government may retain larger shareholdings in those firms expected to yield better performance. Importantly, the positive relationship between state *ownership* and returns is not attributed to benefits of state *control*.

[15] Gugler, K. (2001), *Corporate Governance and Economic Performance*, Oxford: Oxford University Press.

[16] Megginson, W.L. and Netter, J.M. (2001), 'From State to Market: A Survey of Empirical Studies on Privatisation', *Journal of Economic Literature*, **39**, 321–89.

[17] Boardman, A.E. and Laurin, C. (2000), 'Factors Affecting Stock Price Performance of Share-issued Privatisations', *Applied Economics*, **32**, 1451–64.

[18] Boardman and Laurin obtained information on whether a golden share applied for a company in their sample from the issue prospectuses and the data in Jones et al (1999), op. cit. The definition of golden share in the study may not include special rights that are not vested in a share.

Rather, when it comes to state control—ie, in the form of retained control rights provided by a golden share—Boardman and Laurin show that the effect on share price performance is negative. After controlling for other factors in the regressions, the existence of a golden share is found to have a significantly negative impact. More specifically, the presence of a golden share is estimated to result in a statistically significant decline in three-year buy and hold returns of between 53 and 62 percentage points. According to the authors, this:

> supports the hypothesis that failure to transfer complete control to the private sector, combined with uncertainty surrounding the exercise of the golden share, has a detrimental effect on long-run share price performance (p. 1461)

Overall, therefore, the results of the Boardman and Laurin study and other studies in the privatisation literature suggest that the retention of state control—via golden shares or state ownership—is likely to have a negative impact on company performance.

3.2 Corporate control and the impact on firm performance

A large body of academic literature has examined the influence of corporate governance arrangements, with a view to assessing the impact on corporate performance and valuation. Most empirical studies concentrate on a particular aspect of governance, such as ownership structure and shareholder activism, board structure, compensation, anti-takeover provisions and investor protection. It is beyond the scope of this report to review all the academic papers. As one of the main motives for the retention of golden shares and other special rights is to block hostile takeovers, this section focuses on the corporate governance literature that addresses the relationship between the performance of companies and the likelihood of takeover.

Gompers et al (2003) link firm performance with anti-takeover provisions, which are related to management's ability to resist a hostile takeover (eg, supermajority requirements to approve mergers, reductions in cumulative voting and the use of anti-greenmail and poison pills).[19] Based on a sample of US firms, the authors show that the stronger the anti-takeover provision or the weaker the rights of shareholders relative to those of management, the worse the firms' operating performance will be in terms of equity and sales growth. They also report that firms with stronger anti-takeover provisions have lower market valuation.

Sundaramurthy et al (1995)[20] support the Gompers et al (2003) research, as the authors report that stock prices reacted negatively to the introduction of anti-takeover provisions between 1984 and 1988, with the firms' reactions depending on the structure of the board. For example, the authors find that separating the positions of chief executive officer and chair of the board reduces the negative effect. This is supported by Jarrell and Poulsen (1989) and other authors, who find that the establishment of anti-takeover provisions usually coincides with a reduction in share value, with abnormal returns (ARs) approximating –2%.[21]

The negative impact can be interpreted as evidence that shareholders fear that managers may take advantage of the increased lack of control and therefore do not maximise

[19] Gompers, P., Ishii, J. and Metrick, A. (2003), 'Corporate Governance and Equity Prices', *Quarterly Journal of Economics*, **118**, 107–155.

[20] Sundaramurthy, C., Mahoney, J. M. and Mahoney, J.T. (1995), 'Board Structure, Anti-takeover Provisions and Stockholder Wealth', Federal Reserve Bank of New York Research Paper No. 9516.

[21] Jarrell, G. and Poulsen, A. (1989), 'The returns to acquiring firms in tender offers: Evidence from three decades', *Financial Management*, **18**, 12–19, and Ryngaert, M. (1988), 'The effect of poison pill securities on shareholder wealth', *Journal of Financial Economics*, **20**, 377–417.

shareholder value.[22] In addition, the reduction in the share price may reflect the decline in the probability that shareholders will receive a takeover premium.

The existence of a takeover premium is well established in the literature—shareholders of target firms invariably receive large premia (on average between 20% and 40%) relative to the pre-announcement price.[23] Mulherin and Boone (2000) report abnormal announcement returns in the USA of 21%.[24] Goergen and Renneboog (2003), focusing on large domestic and cross-border takeovers in Europe during 1993–2000, report large announcement effects of 9% for target firms and a cumulative abnormal return (CAR) that includes the price increase over the two-month period prior to announcement of 23%.[25] When a UK target or bidder is involved, the ARs are almost twice as high as bids involving both a Continental European target and bidder. The role of takeovers in influencing firm performance is also examined in Bertrand and Mullainathan (2003), Mikkelson and Partch (1997) and Denis and Kruse (2000), among others.[26] Bertrand and Mullainathan suggest that if managers are insulated from takeovers, overall productivity and profitability declines. They report that, in the USA, the return on capital falls by nearly 1% following the introduction of anti-takeover legislation. Strong anti-takeover laws are expected to increase the moral hazard problem, as managers bear little financial cost if they pursue their own goals rather than maximising shareholder wealth. Easterbrook and Fischel (1991) analyse stock price reactions around the time a new anti-takeover law is introduced.[27] They report that the value of firms covered by these laws falls on average by 0.5%, which would imply a loss of between $10 billion and $20 billion for all firms listed on the New York Stock Exchange.

These empirical findings are in contrast to the models proposed in Shleifer and Summers (1988), Stein (1988) and Blair (1995), which suggest that a reduction in takeover threats may actually enhance productive efficiency and hence increase firm value.[28] For example, the threat of takeover bids may make existing stakeholders less willing to risk firm-specific investments, and it may lead managers to sacrifice long-term interests in order to boost current profits. Some authors have also questioned existing empirical evidence in support of the view that takeovers act as a disciplining device for management and therefore have a positive impact.[29]

While there is some conflicting empirical evidence, overall the consensus among most authors in the literature is that a reduction in the probability of takeovers is likely to be associated with poorer corporate performance. It is also well-established that takeover restrictions prevent shareholders in potential target companies benefiting from takeover premia. To the extent that golden shares and other special rights influence the governance of firms and restrict changes in control, such arrangements are likely to have similar impacts.

[22] See, for example, Correia da Silva, L., Goergen, M. and Renneboog, L. (2004), *Dividend Policy and Corporate Governance*, Oxford: Oxford University Press.

[23] Goergen, M. and Renneboog, L. (2003), 'Shareholder wealth effects of European domestic and cross-border takeover bids', European Corporate Governance Institute, Working Paper 08/2003, January.

[24] Mulherin, J. and Boone, A. (2000), 'Comparing acquisitions and divestitures', *Journal of Corporate Finance*, **6**, 117–39.

[25] Goergen and Renneboog (2003), op. cit.

[26] Bertrand, M. and Mullainathan, S. (2003), 'Enjoying a Quiet Life? Corporate Governance and Managerial Preferences', *Journal of Political Economy*, **111**, 1043–75; Mikkelson, W. and Partch, M. (1997), 'The Decline of Take-overs and Disciplinary Managerial Turnover', *Journal of Financial Economics*, **44**, 205–28; Denis, D.J. and Kruse, T. (2000), 'Managerial Discipline and Corporate Restructuring following Performance Declines', *Journal of Financial Economics*, **55**, 391–424.

[27] Easterbrook, F.H. and Fischel, D.R. (1991), *The Economic Structure of Corporate Law*, Cambridge: Harvard University Press.

[28] Shleifer, A. and Summers, L.H. (1988), 'Breach of Trust in Hostile Takeovers ', in A.J. Auerbach (ed), *Corporate Takeovers: Causes and Consequences*, Chicago: Chicago Press; Stein, J.C. (1988), 'Takeover Threats and Managerial Myopia', *Journal of Political Economy*; **96**, 61–80; Blair, M.M. (1995), *Ownership and Control: Rethinking Corporate Governance for the Twenty First Century*, Washington: Brookings Institution Press.

[29] See, for example, O'Sullivan, M.A. (2000), *Contests for Corporate Control. Corporate Governance and Economic Performance in the United States and Germany*, Oxford: Oxford University Press.

3.3 The voting rights premium and the valuations of blockholdings

Part of the corporate control literature focuses on research conducted on the voting rights premium. This refers to the empirical regularity of shares with superior voting power having a higher price. Although academic studies primarily assess voting premia in private companies, the findings are of relevance for this study to the extent that they provide an explanation, both theoretically and empirically, of the value of special rights and control powers in companies.

The theoretical starting point for explaining the voting premium is the study by Grossmann and Hart (1988), which shows that a deviation from one share/one vote has associated costs.[30] One share/one vote maximises the importance of benefits to security holders relative to benefits to the controlling party, and encourages the selection of an efficient management team. In the presence of securities with differentiated voting rights, the voting premium reflects the expectation that voting rights become valuable in the case of a battle for control, where the private benefits of control enjoyed by the incumbent management are contested. If an acquisition is contested, the superior voting shares should receive a differential premium that is a function of the size of the private benefits of control and the proportion of the outstanding superior voting rights.

In general, empirical studies have supported the existence of a voting premium. In almost all markets where there is one class with more votes than another, the superior voting class is found to have a substantial premium, varying from 5% in the USA to 80% in Italy. Since the initial discussion in 1983 by Lease et al based on the US market,[31] the voting premium has been examined in studies such as:

– DeAngelo and DeAngelo (1985) and Zingales (1995) for the US market;[32]
– Zingales (1994) for the Italian market;[33]
– Bechmann and Raaballe (1998) for Denmark;[34]
– Muus (1998) for France;[35]
– Rydqvist (1987) for Sweden;[36]
– Megginson (1990) for the UK.[37]

Nenova (2003) provides cross-country estimates on the value of corporate voting rights, specifically on the control blocks of votes.[38] Based on a sample of 661 firms with dual-class shares in 18 countries in 1997, the value of control block votes is inferred from the prices of

[30] Grossman, S. and Hart, O. (1988), 'One Share-One Vote and the Market for Corporate Control', *Journal of Financial Economics*, **20**, 175–202.

[31] Lease, R.C., McConnell, J.J. and Michelson, W. (1983), 'The Market Value of Control in Publicly Traded Corporations', *Journal of Financial Economics*, **11**, 439–71.

[32] DeAngelo, H. and DeAngelo, L. (1985), 'Managerial Ownership of Voting Rights. A Study of Public Corporations with Dual Classes of Common Stock', *Journal of Financial Economics*, **14**, 33–69. Zingales, L. (1995), 'What Determines the Value of Corporate Votes?', *Quarterly Journal of Economics*, 110:4, 1046–73.

[33] Zingales, L. (1994), 'The Value of the Voting Right: A Study of the Milan Stock Exchange Experience', *Review of Financial Studies*, **7**, 125–48.

[34] Bechmann, K. L. and Raaballe, J. (1998), 'Regulatory Restrictions on Bids for Dual Class Shares: Two Shares—One Price', working paper, University of Århus, December.

[35] Muus, C. K. (1998), 'Non-voting Shares in France: An Empirical Analysis of the Voting Premium', working paper 22, Johann Wolfgang-Goethe-Universidad Frankfurt am Main, Fachbereich Wirtschaftswissenschaften, October.

[36] Rydqvist, K. (1987), 'Empirical Investigation of the Voting Premium', working paper 35, Northwestern University.

[37] Megginson. W.L. (1990), 'Restricted Voting Stock, Acquisition Premiums, and the Market for Corporate Control', *Financial Review*, **25**, 175–98.

[38] Nenova, T. (2003), 'The value of corporate voting rights and control: A cross-country analysis', *Journal of Financial Economics*, **68**, 325–51.

the firms' multiple and limited-voting right shares, after making adjustments. Table 3.1 presents Nenova's estimates of the value of control blocks for eight European countries.

Table 3.1 Value of control block of votes as a % of firms' market value, 1997

Country	Mean	Median	Number of observations
Denmark	0.008	0.003	30
Finland	–0.050	0.005	21
France	0.281	0.275	9
Germany	0.095	0.049	65
Italy	0.294	0.299	62
Norway	0.058	0.044	15
Sweden	0.010	0.004	43
UK	0.096	0.072	27

Source: Nenova (2003).

Cross-country evidence is also presented in Dyck and Zingales (2004), who examine the valuation of the benefits of control blocks in 39 countries between 1990 and 2000.[39] Unlike Nenova, Dyck and Zingales measure the benefits by the difference between the price paid for a control block and the share price two days after the announcement of the block transaction, relative to the share price. On average, they estimate the value of control to be 14%. Table 3.2 below presents their estimates of the benefits for a sample of EU countries.

Table 3.2 Premium for blockholdings as a % of firm equity, 1990–2000

Country	Mean	Minimum	Maximum
Austria	0.38	0.25	0.52
Denmark	0.08	–0.01	0.26
Finland	0.02	–0.07	0.13
France	0.02	–0.10	0.17
Germany	0.10	–0.24	0.32
Italy	0.37	–0.09	1.64
Netherlands	0.02	–0.07	0.06
Portugal	0.20	0.11	0.30
Spain	0.04	–0.03	0.13
Sweden	0.06	–0.01	0.22
UK	0.02	–0.06	0.17

Source: Dyck and Zingales (2004).

Sudarsanam (1996) finds that block sales are usually accompanied by positive abnormal price performance.[40] Barclay and Holderness (1989) support this finding by suggesting that

[39] Dyck, A. and Zingales, L. (2004), 'Private benefits of control: An international comparison', *Journal of Finance*, **59**, 537-600.
[40] Sudarsanam, S. (1996), 'Large shareholders, takeovers and target valuation', *Journal of Business Finance and Accounting*, **23**, 295–314.

price reaction is positive, regardless of the price paid for the share block.[41] The authors suggest that the market reacts positively because changes in control improve corporate governance, particularly if the firm is performing poorly and needs substantial reorganisation. This is validated by evidence from Bethel, Liebeskind and Opler (1998), who find that acquisitions of blocks by activist shareholders in the USA are usually followed by an increase in asset divestitures, a decline in mergers and acquisitions, and abnormal share price appreciation.[42] However, the authors report that block purchases by financial and strategic investors cause no significant market reaction. In contrast to the evidence from Sudarsanam (1996), Banerjee, Leleux and Vermaelen (1997) show that block deals do not generally trigger any positive abnormal performance for listed French firms.[43]

Estimates of voting premia and the value of control blocks differ depending on various factors, including the method of calculation; the degree of competition in the market for corporate control; the size of the blocks sold; the concentration and dispersion of shares in the firm; the inequality of voting power across shareholders; the financial condition of the firms involved; and shareholder protection in the country. Overall, however, the evidence confirms that the market does value control—premia are paid for shares with greater voting rights and blocks of control.

To the extent that special rights allow public authorities to influence managers' ability to govern firms and imply that control is not fully transferred to the private sector, these arrangements are likely to have a similar impact on firm valuation. Put differently, if public authorities withdrew the special rights and transferred control, a corresponding reaction can be expected in the market value of the equity of companies affected by those rights.

3.4 Restrictions on international direct and portfolio investment flows

Distinct from theories that base price differentials on the benefits of corporate governance and control are theories and empirical studies based on market segmentation. For example, if, through government regulation or the corporate charter, there are restrictions on the quantity of shares owned by foreigners, markets for domestic and foreign investors will become separate. This implies that prices may differ across these markets.

The typical empirical finding is that stocks available to foreign investors are priced higher than the corresponding stocks available only to domestic investors.[44] This is supported by the analysis of Ødegaard (2002) in Norway between 1989 and 1993, who finds that shares more easily available to foreign investors were priced higher than shares with superior voting power, but which were not as accessible to foreign investors.[45] Over a later period between 1995 and 1997, when regulatory restrictions on foreign investment had ended, shares with superior voting power traded at a premium to limited-voting shares in Norway.

Bailey et al (1999) adds support to the market segmentation hypothesis.[46] The authors find evidence of large price premia associated with unrestricted shares, relative to otherwise

[41] Barclay, M. J. and Holderness, C.G. (1989), 'Private benefits from control of public corporations', *Journal of Financial Economics*, **25**, 371–95.

[42] Bethel, J., Liebeskind, J. and Opler, T. (1998), 'Block Share Purchases and Corporate Performance', *Journal of Finance*, **53**:2, 605–34.

[43] Banerjee, S., Leleux, B. and Vermaelen, T. (1997), 'Large shareholders and corporate control: An analysis of stake purchases by French holding companies', *European Financial Management*, **3**, 23–43.

[44] See, for example, Hietala, P. (1989), 'Asset Pricing in Partially Segmented Markets: Evidence from the Finnish Market', *Journal of Finance*, **44**, 697–715.

[45] Ødegaard, B.A. (2002), 'Price differences between equity classes. Corporate Control, Foreign Ownership or Liquidity', Norwegian School of Management, June.

[46] Bailey, W., Chung, Y.P. and Kang, J.K. (1999), 'Foreign Ownership Restrictions and Equity Price Premiums: What Drives the Demand for Cross-border Investments', *Journal of Financial and Quantitative Analysis*, **34**, 489–512.

identical shares, which are restricted to domestic investors. They suggest that the price premium is related to the flow of funds in and out of the country. The Nestlé case is an often-cited example of how changes in ownership regulations in the corporate charter affect price differences (see Loderer and Jacobs, 1995; and Stulz and Wasserfallen, 1996).[47] For Nestlé, price differences between two equity classes disappeared when the company lifted restrictions on foreign ownership, making the classes equally accessible to foreign and domestic investors.

Other parts of the literature on foreign investment flows are also relevant. For example, the literature on inward foreign direct investment has examined whether foreign-owned affiliates confer efficiency externalities on domestically owned firms, and how inward foreign direct investment affects competitive conditions in host countries.[48] Globerman (1999) assesses, at a sectoral level, the implications of foreign ownership restrictions for the Canadian economy.[49] He concludes that general restrictions on foreign direct investment at a sectoral level cannot be justified on welfare grounds.

Other studies have examined restrictions on cross-border investments (eg, taxation, capital controls, home bias of investors) with respect to their adverse impact on the allocation of savings and capital across countries, portfolio diversification, and the integration of financial markets.[50]

3.5 Summary

Empirical investigations have shown that firms' performance improves after privatisation when government transfers ownership and control to the private sector. The performance impact of special rights retained by the government following privatisation appears to be addressed in only one study (Boardman and Laurin, 2000). Importantly, the study finds that the presence of golden shares has a significant negative impact on long-run share price performance following privatisation.

The hypothesis of a negative impact of special rights is supported by the academic literature examining the empirical relationship between corporate control and firm performance. This part of the literature provides evidence to suggest that the stronger the anti-takeover provisions—ie, the less likely a takeover—the weaker the firms' performance. There is also widespread evidence to suggest that voting rights and control powers carry value in the market, with higher share prices being observed for shares with increased voting rights and with the sale of control blocks often leading to an appreciation in the share price.

The final section of the literature review has found that there are studies in support of the markets segmentation hypothesis—ie, restrictions on cross-border investment matter.

This literature is highly relevant for an economic assessment of the impacts of special rights. It sets out, and in many cases quantifies empirically:

[47] Loderer, C. and Jacobs, A. (1995), 'The Nestlé Crash', *Journal of Financial Economics*, **37**, 315–39. Stulz, R.M. and Wasserfallen, W. (1996), 'Foreign Equity Investment Restrictions, Capital Flight, and Shareholder Wealth Maximization: Theory and Evidence', *Review of Financial Studies*, **8**, 1019–57.

[48] Reviews of this literature can be found in Caves, R.E. (1996), *Multinational Enterprises and Economic Analysis*, Cambridge: Cambridge University Press, and Kokko, A. and Globerman, S. (1998), 'The Welfare Effects of Foreign Investment in Host Countries', mimeo, Stockholm School of Economics.

[49] Globerman, S. (1999), 'Implications of Foreign Ownership Restrictions for the Canadian Economy—A Sectoral Analysis', *Discussion Paper Number 7*, Western Washington University, April.

[50] For example, Cooper, I. and Kaplanis, E. (1986), 'Costs to Crossborder Investment and International Equity Market Equilibrium', in J. Edwards et al (eds), *Recent Developments in Corporate Finance*, Cambridge: Cambridge University Press, or Stulz, R.M. (1981), 'On the Effects of Barriers to International Investment', *Journal of Finance*, **36**, 923–34.

- the benefits of privatisation in terms of improving corporate performance;
- how performance improvements can be adversely affected by retained government control following privatisation;
- how voting and control rights in general affect the market performance of companies;
- how cross-border investment restrictions impose costs on affected firms, affect investor behaviour and segment financial markets.

Even if these findings do not directly evaluate the impact of special rights, overall they support the view that special rights are likely to have negative implications for the performance of privatised companies, for investors and for market integration more generally.

4 Typology of special rights of public authorities in privatised EU companies

This section contains a typology of special rights of public authorities in privatised EU companies. It provides a systematic description and assessment of the types of special rights observed in the EU, focusing on those rights that have been subject to scrutiny by the European Commission and the ECJ. The typology also sets the context for the empirical analysis, in particular allowing those special rights that will be the focus of the case study analysis in section 5 to be identified.

4.1 Overview of special rights and typology

Special rights of public authorities in privatised EU companies include all legal arrangements that have the purpose of preserving the influence of a public authority on a privatised company beyond the extent to which such influence would be afforded under general company law.[51] These rights grant the authority powers that are otherwise available only to, or indeed go beyond that of, a majority shareholder.

Special rights can be granted by a general privatisation law or a specific privatisation Act or decree. Alternatively, they are directly inserted into a company's articles of association. They can be attributed to the government directly or to any other entity of public authority. When a special right is granted in connection with a share, this is referred to in English as a 'special' or 'golden' share, in French as an 'action spécifique', or in German as a 'Spezialaktie'. The nominal value of the share is not important since the right it confers is not related to its nominal value, and might even take the form of an absolute right of veto by the public authority owning the share. Although often vested in a share, special rights can also be stipulated without the requirement for a public authority to hold a single share.

In general, special rights allow the public authority to retain control over the shareholder structure and/or the management of a company following privatisation. These rights can take different forms, but the main examples of retained public control observed in privatised EU companies include:

– limits on the maximum number of shares that may be held by foreigners;
– caps restricting substantial blockholdings, but irrespective of investor domicile;
– requirements for the approval by a public authority of the acquisition of shares if this would result in the creation of a blockholding in excess of a certain threshold;[52]
– rights to approve or appoint, outside the shareholders' assembly, members of the company board;
– rights to approve or veto certain management decisions, such as mergers and acquisitions or the disposal of strategically important assets;
– limitations of other investors' voting rights to enhance the voting power of the public authority.

[51] See Adolff, J. (2002), 'Turn of the Tide? The Golden Share Judgments of the European Court of Justice and the Liberalisation of the European Capital Markets', *German Law Journal*, **3**.
[52] Another means of influencing ownership structure is the allotment of shares to investors carefully chosen at the time of privatisation, such as the 'noyaux durs' in France.

These special rights differ in their nature and are likely to vary in impact. The purpose of the typology is to provide a systematic description and classification of the types of special rights observed in privatised EU companies.

Special rights can be classified along different dimensions. The first dimension is a legal one, which examines special rights with respect to their legal basis or their compatibility with EU law. There has been considerable legal analysis of special rights, not least in the context of the recent landmark decisions on special rights in which the ECJ ruled that legislation liable to deter potential direct investment restricts the Treaty freedoms of capital movement and establishment. Section 4.2 below summarises some of the existing legal analysis and describes different legal classifications of special rights.

For an assessment of the economic impact of special rights on company performance and investment decisions, legal classifications are less relevant. The typology therefore focuses on a second dimension of classifying special rights that is more relevant for economic analysis. Unlike legal analysis, there has been little analysis of the economics of special rights and their impacts. The 'analytical' or 'economic' typology in sections 4.3 to 4.5 provides a conceptual framework for assessing the economic impact of special rights.

Although largely conceptual in nature, the typology draws from examples of special rights that are, or have been, observed in EU companies. These examples all relate to cases where the Commission opened and pursued infringement proceedings against the relevant EU Member State in the sense of Article 226 EC—ie, by means of a letter of formal notice, a reasoned opinion and a decision to take the Member State to the ECJ. Only those cases for which information was available from press releases announcing the infringement proceedings were considered.

The cases are listed in Appendix 1, together with a short description of the nature of the special rights and other background information. A selection of these cases will also be used in the empirical analysis, as described in section 5. The case information generally reflects the status quo as at the end 2004.[53] Many of these cases have now been settled and the special rights abolished as a result.

4.2 Legal classification of special rights

The following provides an overview of two approaches to a legal classification of special rights: the first seeks to classify special rights according to the legal instrument in which the special rights are embedded; the second considers special rights in relation to their compatibility with EU law.[54]

4.2.1 Legal instrument in which special rights are embedded

Special rights are established under different legal frameworks. In some EU Member States (eg, the UK and the Netherlands), general company law might allow the introduction of golden shares or other special rights by stipulation of the corporate charter; in others, company laws are more restrictive or even prohibitive of the granting of additional voting rights to specific shares. Hence, the possibility of introducing special rights is commonly provided by a general privatisation law or a specific privatisation Act.

[53] During 2005, when this report was prepared, there were further developments on cases, such as the June 2005 ECJ ruling against Italy for maintaining investment restrictions in energy companies (Case C174/04).

[54] A more detailed discussion can be found, for example, in Grundmann, S. and Möslein, F. (2004), 'Golden Shares. State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects', *European Banking and Financial Law Journal*, **1**, and Adolff (2002), op. cit.

Special rights can therefore be classified into two broad groups according to their legal basis. In both groups, the special right may or may not be vested in a special share held by the public authority, so a further classification along this dimension could be undertaken. The following provides examples of special rights falling into each group, with reference to cases listed in Appendix 1.

– *Stipulation in the corporate charter*—the prime example of this form of special rights can be found in the UK, which pioneered golden shares. (90% of privatised companies had golden shares,[55] most of which have now been redeemed.) According to UK company law, one special class of shares can be created (sometimes only one £1 share) to grant (absolute) veto powers to the owner of the special share, as written down in an agreement in the corporate charter. For example, the UK government retained a special £1 share in airports operator, BAA. This share gave control over major management decisions, such as the winding-up of the company or the disposal of assets. Other provisions of the articles of association prevented any person from holding more than 15% of shares.

  Another example is the Netherlands, where a special state measure provides for the possibility to create specific preference shares in which the corporate charter may vest special rights, such as veto rights for particular strategic decisions and appointment rights for members of the management or the board. Advantage was taken of this possibility in the privatisations of TNT (postal services) and KPN (telecoms) in 1994.[56]

– *General privatisation law or specific privatisation acts*—in jurisdictions where golden shares or other special rights cannot be granted under general company law, specific legislation is required. In France, golden shares were introduced under provisions of the Privatisation Act 1993. These were relevant for example in the case of petroleum company, Elf Aquitaine, and gave the French state the right to oppose the sale of strategic assets and the transfer of share capital beyond a 10% threshold.

  In Belgium, specific privatisation laws applying to privatised canal transport company, Société National de Transport par Canalisation (SNTC), and gas company, Distrigaz, established golden shares that, for example, carried the right to oppose retroactively transactions concerning the disposal of core assets.

Appendix 1 also lists examples for other countries, such as Italy, Spain and Portugal, where special rights were granted under privatisation legislation, without being vested in a share. The Italian framework law of 1994 provided at the outset the government with veto rights concerning certain strategic management decisions and the acquisition of shareholdings above a threshold. These general provisions were relevant in the case of Telecom Italia, for example. Similar provisions applied in the framework laws and specific decrees in Spain, and affected privatised companies in different industry sectors. In Portugal, the general privatisation law and specific decrees provide the basis for limiting total participation of foreign investors in privatised companies.

4.2.2 Infringements of EC Treaty provisions

The compatibility of special rights with EU law has long been contested by the Commission.[57] In its legal analysis, the Commission found that many special rights arrangements violated

[55] See Jones, S.L., Megginson, W.L., Nash, R.C. and Netter, J.M. (1999), 'Share Issue Privatizations as Financial Means to Political and Economic Ends', *Journal of Financial Economics*, **53**, 217–53.
[56] Another example, listed in Appendix 1, is found in Denmark, where the Articles of Association of Copenhagen Airport restricted ownership to 10% of shares. This restriction was abolished in 2004.
[57] See Communication of the Commission on certain legal aspects concerning intra-EU investments, OJ C 220, 19.07.1997.

the Treaty as unjustifiable restrictions on the free movement of capital and the freedom of establishment, for both discriminatory and non-discriminatory measures:[58]

– *discriminatory* measures applying exclusively to foreign investors (such as caps restricting foreign investment) are generally considered incompatible with the Treaty;

– *non-discriminatory* measures are only permitted in so far as they are based on a set of objective and stable criteria that have been made public and can be justified on grounds of imperative general interest. Moreover, the measures taken must adhere to the principle of proportionality.

On the basis of its analysis, the Commission decided to challenge a number of special rights, including those listed in Appendix 1.

In recent landmark decisions concerning special rights, the ECJ endorsed the analysis of the Commission outlined above, ruling that legislation liable to deter potential direct investment restricts the Treaty freedoms of capital movement and establishment. It also decided that special rights should be prohibited unless they fulfil a four-part test—they must:

– be applied in a non-discriminatory manner;
– be justified by imperative requirements in the general interest;
– be suitable for attaining the objective they pursue;
– not go beyond what is necessary to attain this objective and be subject to legal remedy.

The landmark decisions, also listed in Appendix 1, include the following.

– **Commission against Portugal, C-367/98, June 4th 2002**

  Because of the discriminatory nature of the Portuguese legal provisions precluding foreign investors from acquiring more than a given number of shares in certain Portuguese companies, and because no justification was being advanced, the ECJ confirmed the illegality of the provisions. The additional non-discriminatory obligation to obtain prior authorisation for the acquisition of shares in excess of a threshold level was deemed illegal owing to lack of valid justification.

– **Commission against France, C-483/99, June 4th 2002**

  The French legislation at issue vested the state with a golden share in Elf Aquitaine, which, as noted above, gave the Minister for Economic Affairs the right to authorise larger shareholdings and to oppose decisions to transfer, or use as security, certain assets. The ECJ found that the need to safeguard energy supplies might justify the special rights in some circumstances. However, in the absence of any condition limiting the government's discretionary power in this respect, the measures were deemed to go beyond what was necessary to attain their objective and therefore infringed EU law.

– **Commission against Belgium, C-503/99, June 4th 2002**

  Belgian laws granting golden shares in SNTC and Distrigaz were accepted as being both justified and proportionate, and hence compatible with EU law. Reasons for this ruling included that the special rights were limited to certain decisions concerning the strategic assets of the companies in question (eg, the veto right does not affect share ownership in the companies); were aimed at maintaining minimum supplies of gas; and were applied ex post and within strict time limits (ie, no authorisation was required).

[58] For a more detailed discussion, see, for example, Adolff (2002), op. cit, and Grundmann and Möslein (2004), op. cit.

– **Commission against Spain, C-463/00, May 13th 2003**

The ECJ ruled as unlawful provisions contained in Spanish privatisation legislation, which subjected major corporate decisions, such as winding up the company, mergers and changes of shareholder, to a regime of prior approval by the Spanish government. The provisions affected companies in different industry sectors, including Endesa (energy), Telefónica, Repsol (petroleum), Tabacalera (tobacco) and Argentaria (banking). In the last two cases, the Court did not accept that the legislation was justified for general interest reasons since the companies do not provide public services. The justification in terms of general interest was accepted in the other cases, but the ECJ judged that the provisions did not adhere to the principle of proportionality—for example, because they grant very broad discretion over management decisions.

– **Commission against the UK, BAA, C-98/01, May 13th 2003**

The ECJ ruled against the stake held by the UK government in BAA, which empowers it to grant consent to major decisions such as selling an airport, and blocks other investors from owning more than 15% of shares in the company. The ECJ rejected the government's arguments that the provisions did not present a restriction on the freedom of capital movement since access to the market was not affected and BAA's articles of association are governed by private company law, not by public law. The issue of justification was not further examined.

This overview suggests that, although most special rights examined have been considered incompatible with EU law, certain types of special rights may be acceptable. Such an assessment is beyond the scope of this study. Instead, the study seeks to establish whether special rights have important effects from an economic point of view, regardless of whether they are compatible with EU law. The above overview of legal analysis is nevertheless relevant for the economic assessment, not least because some of the concepts and issues are similar—for example, the distinction between discriminatory and non-discriminatory restrictions, or the evaluation of special rights in relation to their objectives.

4.3 Analytical/economic classification of special rights

The typology for the purpose of economic analysis categorises special rights along the dimensions that are most relevant for the empirical evaluation of the impact of these rights. It is structured as follows.

– *High-level classification*—special rights are grouped according to, first, whether they constitute direct or indirect barriers to investment in the affected companies, and, second, whether they present discriminatory or non-discriminatory investment restrictions. The classification criteria are explained in sections 4.3.1 and 4.3.2, respectively. The criteria are then applied to the sample of special rights listed in Appendix 1 in order to generate a high-level classification of these rights into different groups (section 4.3.3).

– *Ranking by likely severity of impact*—within each group, special rights can be ranked according to their restrictiveness and hence their likely economic impact. Section 4.3.4 discusses aspects that are relevant to the ranking by likely impact. The actual impact will be tested in the empirical analysis.

– *Classification by objective*—since the special rights may be justified by public interest objectives, the rights in each category can then be set against, and compared with, their stated objectives (section 4.3.5).

– *Other classifications*—the typology considers classifying each special right in the sample according to two further criteria: whether the right has been actually exercised by the public authority; and whether the right is redeemable or has been redeemed (section 4.3.6).

4.3.1 Direct versus indirect restrictions

The first criterion for the high-level classification distinguishes between two types of special rights, depending on whether the right constitutes a direct or indirect restriction on investment in the company.

– *Direct*—special rights that give the public authority exclusive rights to control changes in ownership and influence the shareholder structure of the company are classified as direct investment restrictions. The main examples of special rights presenting a direct investment restriction include:[59]

  – general caps restricting substantial blockholdings of investors in excess of a certain threshold ('caps restricting substantial blockholdings');

  – specific limits on the maximum number of shares that may be held by foreign investors ('caps restricting foreign investment');

  – authorisation requirements whereby any investment or change of ownership above a certain threshold must be approved by a public authority ('authorisation rights for shareholdings').

– *Indirect*—there are special rights that grant the public authority influence over the decision-making process within parts of the company and limit the ownership control that can be exercised by private shareholders. Such rights can be classified as 'indirect' investment restrictions, since they deter investment only indirectly through the government's influence on the management and operation of the company. The main examples of special rights presenting an indirect investment restriction include:

  – rights to veto certain decisions of the company board or management. Different decisions may be subject to veto rights: in some cases it is only the merger or dissolution of the company, or the creation of new classes of shares; in others, however, decisions involving the sale of a substantial part of the company's assets or of specific assets may be subject to veto, or the veto could apply to corporate financial policy. In addition, instead of a veto right, government interference in corporate decisions can take the form of an ex ante authorisation requirement ('approval or veto rights for corporate decisions');

  – rights to approve or appoint, outside the general meeting, board members ('appointment rights');

  – general limitations of voting rights which reduce the power of other shareholders to increase control by the public authority, other than the above and not relating to specific corporate decisions. For example, there may be a requirement that voting rights exceeding a certain threshold are not exercised ('limitation of voting rights').

[59] A further means of influence over the shareholder structure of privatised companies is through the creation of 'hard cores' (*noyaux durs*) of investors to whom a proportion of the capital is allocated by the government at the time of privatisation. Allocation of shares to specified investors that have been carefully chosen has been an important feature of privatisations in France, for example, where the French Minister for Economic Affairs had the power to choose purchasers after a hearing of the privatisation commission, instead of offering the shares to the wider public. The creation of noyaux durs reflects the lack of large institutional shareholders in France, compared with the UK for example, since, if all the shares had been disposed of in the financial markets, control would have been divided among a large number of small holdings, leaving the company exposed to takeover.

Direct and indirect restrictions are likely to have different impacts. For example, rules that curtail shareholders' voting power and influence management or board decisions, but do not bar access to the investment (simply making it less attractive), have only an indirect impact on investment in EU companies. Being indirect in nature, they are likely to be less intrusive and therefore have a potentially less significant impact on investment decisions than provisions that cap investment by certain investors (eg, large block holders or foreign investors), or that give government other rights to control shareholder structure.

The two types of special rights also differ in the way they affect company performance. *Direct investment restrictions* may affect performance by sheltering management from market pressures; any reduced fear of hostile takeovers may lead to less-disciplined corporate control and reduced overall corporate governance, which in turn may result in managerial slack and a deterioration in economic performance. *Indirect investment restrictions* give public authorities powers to influence the corporate decision-making process, so the potential impact on firm performance, at least in the first instance, comes from (and depends on the quality of) public intervention in management decisions.

4.3.2 Discriminatory versus non-discriminatory restrictions

The second criterion for the high-level classification is the extent to which the measures are explicitly discriminatory. Under this classification, there are two types of special rights: those that explicitly discriminate against foreign investment and those that do not. For example, limits on the maximum number of shares held by foreign investors can be classified as a discriminatory investment restriction. In contrast, general caps restricting substantial blockholdings, irrespective of investor domicile, are, in theory, non-discriminatory. Similarly, requirements for the approval of the acquisition of shares for all investors, regardless of domicile, are non-discriminatory, but if those approval requirements were to apply to foreign investors only, they would be classified as discriminatory.

The distinction between discriminatory and non-discriminatory restrictions is important in the legal analysis concerning the compatibility of special rights with EU law, as summarised above. The distinction is also important for the economic impact assessment: restrictions that cap foreign investment, or impose other investment barriers that are more burdensome for foreign investors than domestic investors, are likely to have a more significant impact on cross-border investment than rules with no element of discrimination. Similarly, rules that, at most, make a single investment option in a market not available for investors, or make it less attractive, without discriminating between investors, are likely to have a comparatively minor impact on financial market integration.

The typology classifies special rights according to whether the discrimination is stated explicitly in the relevant legal provision. However, even if a particular special right does not appear to contain a discriminatory element on paper, the restriction may have a discriminatory effect in practice. For example, any provision that gives a government the general right to block a takeover may be discriminatory in practice if the right is applied with respect to foreign bidders, but disregarded if the takeover bid is domestic. Thus, to the extent that special rights are used to prevent takeovers by foreign investors, they can all be classified as being discriminatory, even if this is not made explicit in the relevant legal provision.

4.3.3 Application of the high-level classification to special rights in select EU companies

The above two classification criteria can be combined to provide a high-level classification of special rights, distinguishing first between those rights that constitute direct or indirect investment restrictions, and then further differentiating between those that are explicitly discriminatory and those that are not. The outcome of this methodology generates a classification that can be presented in matrix form, as shown in Table 4.1.

Table 4.1 Outcome of high-level classification

	Discriminatory	Non-discriminatory
Direct	Caps on foreign investment	Caps restricting substantial blockholdings Authorisation or veto rights for shareholdings
Indirect		Approval or veto rights for corporate decisions Appointment rights Limitation of voting rights

Source: Oxera.

Table 4.2 summarises the results of applying the classification methodology to the special rights observed in the EU companies listed in Appendix 1 (irrespective of whether the rights still apply or have been phased out). For the purposes of brevity, the table reports only the name of the companies affected by a particular type of right and, in brackets, the EU Member State implementing the right. For a more detailed description of the specific rights, see Appendix 1. Some companies are affected by multiple types of special rights; for example, the competent authority may have implemented direct and indirect restrictions on the investment in a company. Thus, their names are repeated in different categories in the table.

Table 4.2 Application of the high-level classification to special rights in sample of EU companies

DIRECT Discriminatory	Non-discriminatory	INDIRECT Non-discriminatory
Caps on foreign investment Banco Totta & Acores (Portugal) Petrogal (Portugal)	**Caps restricting substantial blockholdings** BAA (UK) Copenhagen Airport (Denmark) Cimpor (Portugal) Electricidade de Portugal (Portugal) Portugal Telecom (Portugal) **Authorisation or veto rights for shareholdings** Argentaria (Spain) Banco Totta & Acores (Portugal) Cimpor (Portugal) Electricidade de Portugal (Portugal) Elf Aquitaine (France) Endesa (Spain) ENEL and ENI (Italy) Petrogal (Portugal) Portugal Telecom (Portugal) Repsol (Spain) Tabacalera (Spain) Telecom Italia (Italy) Telefónica (Spain)	**Approval or veto rights for corporate decisions** Argentaria (Spain) BAA (UK) Cimpor (Portugal) Copenhagen Airport (Denmark) Distrigaz (Belgium) Elf Aquitaine (France) Endesa (Spain) ENEL and ENI (Italy) KPN (Netherlands) Petrogal (Portugal) Portugal Telecom (Portugal)Repsol (Spain) SNTC (Belgium) Tabacalera (Spain) Telecom Italia (Italy) Telefónica (Spain) TNT (Netherlands) **Appointment rights** Distrigaz (Belgium) KPN (Netherlands) Petrogal (Portugal) TNT (Netherlands) Volkswagen (Germany) **General limitation of voting rights** Cimpor (Portugal) Electricidade de Portugal (Portugal) Endesa (Spain) ENEL and ENI (Italy) Repsol (Spain) Volkswagen (Germany)

Notes: Special rights are classified irrespective of whether they are still in place or have since been abolished.
Source: Oxera.

Table 4.2 also suggests that special rights with an explicit discriminatory element are rare.[60] In the sample of EU companies, they have only been implemented in privatised companies in Portugal, and even in Portugal, the discrimination no longer applies—following the infringement proceedings, the provision contained in the Portuguese privatisation law which limited foreign investors to hold no more than a certain number of shares was abolished in October 2003.[61]

4.3.4 Ranking by likely severity of impact

The classification in Table 4.2 masks the considerable variation observed within each category as regards the extent and scope of the special right. Thus, special rights in the same category can differ in their degree of restrictiveness, and hence potential economic impact, depending on their design and application. Important aspects that need to be considered in a ranking of special rights according to their likely severity of impact include the following.

- Among the direct investment restrictions, provisions which explicitly cap an investor's shareholdings to not exceed a certain threshold are likely to present a more binding investment restriction than a requirement to obtain approval from the public authority before the investment can be made, or a provision which gives the authority the right to veto the investment, should shareholdings exceed the threshold. In the case of authorisation or veto rights, the degree of restrictiveness depends on the authority's discretion to use the rights, whereas an explicit cap imposes an absolute barrier to investment beyond the threshold level. For the same threshold, the likely impact of caps may therefore be considered stronger than the impact of authorisation and veto rights.

- The impact of direct investment restrictions also depends on the threshold level at which shareholdings are capped or authorisation or veto rights apply. For example, caps on blockholdings of 5% are more stringent than caps of, for example, 15%. Similarly, authorisation requirements that apply for shareholdings above 5% are more restrictive than those for 10% or more of the shareholdings. None of these threshold levels is likely to be binding for portfolio investors in the market, but they restrict transactions in the market for corporate control. Based on the description provided in Appendix 1, Table 4.3 below summarises the thresholds for non-discriminatory direct investment restrictions that apply in the sample of EU companies.

[60] With the exception of the defence industry, where there are several examples of direct restrictions on foreign ownership.

[61] There are other examples of discriminatory investment restrictions that were relevant in the past. For example, although some foreign participation in French privatisations was permitted, in 1986 legislation prevented the French state from transferring more than a 20% stake in privatised firms to foreign investors. This discriminatory limit was removed in 1993. See Parker, D. (2003), 'Privatisation in the European Union', in D. Parker and D. Saal (eds), *International Handbook on Privatization*, Cheltenham, UK: Edward Elgar.

Table 4.3 Threshold for direct investment restrictions

Caps restricting substantial blockholdings		Authorisation or veto rights for acquisitions	
Name of company (country)	**Threshold (%)**	**Name of company (country)**	**Threshold (%)**
BAA (UK)	15	Elf Aquitaine (France)	10 (20, 33)[3]
Copenhagen Airport (Denmark)	10	ENEL, ENI, Telecom Italia (Italy)	5
Cimpor (Portugal)	5 (10)[1]	Banco Totta & Acores, Cimpor, Electricidade de Portugal, Petrogal, Portugal Telecom (Portugal)	10
Electricidade de Portugal (Portugal)	10	Argentaria, Endesa, Repsol, Tabacalera, Telefónica (Spain)	10
Portugal Telecom (Portugal)	10 (5)[2]		

Notes: Restrictions are reported irrespective of whether they are still in place or have since been abolished. Only the non-discriminatory restrictions shown in Table 4.2 are considered. [1] 5% cap in first stage of privatisation (1994–96); increased to 10% in second and third stages. [2] 10% cap in the first and second stages of privatisation; reduced to 5% cap in third stage. [3] Separate authorisations are required to own more than 10%, 20% and 33%.
Source: Oxera.

– Special rights that grant a public authority influence or allow it to take decisions in a company and in the general meeting (ie, indirect investment restrictions) may also be ranked according to their impact. For example, an approval or veto right with respect to a very specific business decision may be considered less influential than rights that relate to a broad range of fundamental decisions. Appendix 1 lists the main decisions to which the relevant authority's intervention rights apply.

– The impact of indirect restrictions is likely to depend on the degree to which other investors' voting rights are limited relative to those of the public authority. If a public authority is granted absolute veto power, this may be considered more significant in terms of likely impact than increased voting rights of the shares held by the authority, which grant disproportionate but not absolute voting power. In most cases in the sample of EU companies (listed in Appendix 1 and in Table 4.2), the approval or veto right granted to the relevant authority is absolute. One example where there is limitation of voting rights is Volkswagen, where a German law applying exclusively to that company provides for a special blocking minority right on any shareholder with 20% of voting rights.[62] However, while less restrictive in that they do not grant absolute veto powers, general limitations of voting rights may be considered more restrictive to the extent that they apply to all rather than specific company decisions.

– The impact of special rights is also likely to be affected by the way in which they are exercised and when. Provisions which give the state a right of prior authorisation may be considered more intrusive and hence potentially more important in terms of impact than an ex post opposition right. For example, a requirement always to obtain approval for a specific corporate decision is likely to limit management decision-making power more than if that same decision could be taken without approval, only with the risk of being forbidden later and depending on the authority's decision to take action. The ECJ decisions on special rights in France and Belgium also indicate that a system of ex post opposition is generally preferable to one of prior authorisation.[63]

– As shown in Table 4.2 above, in some companies the relevant authority retains multiple types of control rights. Other things being equal, the impact of state intervention on firm performance and investment would be expected to be more significant the more control

[62] General limitations of voting rights were also introduced in Italy and Spain, mainly to suspend the voting rights of holdings in privatised energy companies by state-owned companies.
[63] For a discussion, see Grundmann and Möslein (2004), op. cit.

rights are implemented. For example, where both indirect and direct investment restrictions apply, a public authority can influence both shareholder structure and corporate decision-making, which gives the authority more control over the privatised company and which is potentially more intrusive than a right to influence the company at one level only.

– The impact of a special right depends on whether state intervention is limited by explicit conditions for the intervention. Where there are no specified conditions, the potential impact of special rights is likely to be greater than where narrow borderlines have been established for the exercise of control rights. The ECJ decision against France in relation to Elf Aquitaine is illustrative in this respect: the intervention of the authority did not depend on any condition and was therefore possible in any situation, even if not necessary for the safeguarding of the supply of petroleum products. This was a reason for the ECJ to reject such a broadly designed provision. In contrast, the parallel Belgian case was ruled acceptable because administrative action relating to Distrigaz and SNTC is allowed only for specified purposes and only if it meets specified objective criteria. These limits reduce the extent to which the state may exercise its control rights and are therefore likely to lessen the potential impact.

– The impact of a special right also depends on the extent to which the exercising of that right can be challenged in court. In particular, the possibility of judicial review may limit the discretion of the public authority to intervene in acquisitions or corporate decision-making. This aspect was also considered by the ECJ in its rulings—the fact that the Belgian provisions were subject to a system of effective review by the national courts was another reason why the special rights in Distrigaz and SNTC were deemed compatible with EU law.

4.3.5 Classification by objective

Different factors motivate countries to impose special rights in companies following privatisation. These motives often relate to a divergence between the social objectives of the countries and the private goals of unconstrained private companies. For example, there may be concerns about national security, security of supply, distributional implications of pricing policy, universal access, etc.

Even if a specific control right has a negative impact on performance and/or restricts investment in a privatised company, the measure may still be justified if such public concerns outweigh these costs. In this context, measures affecting the utility sectors specifically may be more easily justified than those in non-utility sectors because, or in so far as, they protect the public interest.

This suggests the need to classify special rights according to the objectives stated by the public authority for retaining a particular control right, and, importantly, according to the objectives' plausibility—eg, taking into account the industry or type of service provided by the privatised company and the risks to the public interest if no control right applied. The risks or justifications could then be ranked and compared with the degree of intrusiveness and likely impact of the special right that affects the particular company.

Appendix 1 lists the industry sectors of the companies in the sample. Where possible, it also provides the stated objective for the introduction of the golden share or special control right.

The aim of the research study is to assess the impact of special rights on company performance and investor behaviour. It is beyond the scope of this study to conduct a full cost–benefit analysis of special rights. Nevertheless, if the evidence suggests that the impact on performance and investment is negative and significant, from a policy perspective, it is important to set the impact against the stated objectives and the possible social benefits in order to draw appropriate conclusions and policy implications.

4.3.6 Other useful classifications

At least two further classifications of special rights are useful for the economic analysis: the first is to identify those companies where public authorities have actually exercised their control rights; the second relates to the time period over which the special rights apply.

The first classification is useful to the extent that it provides an indication of the importance of special rights in practice. Have the special rights actually been exercised, and do they present a binding restriction on investment in EU companies? It is, however, important to bear in mind that the mere existence of a special right and the threat of its exercise may be sufficient to result in a significant economic impact.

While information on the actual exercise of special rights is not available in most cases (particularly because public authorities do not usually publicise the exercise), there is select anecdotal evidence on instances where public authorities have used their rights to block acquisitions in companies, described below.

– As reported in McHarg (1998),[64] the UK government has only once used the threat of exercise of its special rights to block a takeover altogether. In May 1996, it was announced that the golden shares in the electricity generating companies would be retained until competition in the industry was fully established, thus ending the mooted merger between National Power and a US company at an early stage of negotiations. In contrast, numerous other takeovers have been permitted, despite the existence of golden shares.[65] Although a takeover was not blocked, in 1987 the government is said to have used the threat of its golden share to favour Ford over General Motors in the acquisition of Jaguar.[66] The golden share held by the government in BT was dropped in 1997 to avoid political and regulatory problems in the company's attempted takeover of the USA's MCI.[67]

– Among the companies listed in Appendix 1, when Elf Aquitaine was in merger talks with Italy's ENI, these were said to be halted by the French government's threat to exercise its golden share, allegedly because of the government's preference for Elf to be taken over by another French company, Totalfina.[68] The Spanish government reportedly put pressure on Telefónica, leading to a breakdown of the takeover by Dutch KPN. The takeover of the Spanish power company, Hidrocantabrico, by Electricité de France (EDF) was also said to have been prevented by the French government.[69] Another example is the takeover bid for Cimpor, a Portuguese cement company, which was opposed by the Portuguese government in 2000—a decision that was subsequently ruled against by the Commission.[70]

Among the sample, there is also evidence of cases where the relevant public authority was not successful in using its special rights to prevent a takeover. For example, Italy's efforts allegedly failed when Olivetti took over Telecom Italia in 1999.[71] However, the evidence

[64] McHarg, A. (1998), 'Government Intervention in Privatised Industries: The Potential and Limitations of the Golden Share', *Utility Law Review*, **9**, 198–201. See also Helm, D.H. (2004), *Energy, the State and the Market: British Energy Policy since 1979*, revised edition, Oxford: Oxford University Press.

[65] For example, when Britoil was taken over by British Petroleum in 1987/88, the government held a golden share in Britoil but ultimately could not prevent the takeover, allegedly because of the poor drafting of the relevant clause in the Articles of Association. See Grundmann and Möslein (2004), op. cit.

[66] See Grundmann and Möslein (2004), op. cit.

[67] See Jones et al (1999), op. cit.

[68] See McCurry, P. (2001), 'Golden Shares Fail to Glisten', *Privatisation International*, January, 41–3.

[69] See Grundmann and Möslein (2004), op, cit.

[70] European Commission (2000), 'Commission rules against Portuguese measures in a takeover bid for cement company Cimpor', press release IP/00/1338, November 22nd.

[71] See Grundmann and Möslein (2004), op. cit.

applies to select companies only. Insufficient information is available to classify each company according to whether the special rights were actually used to block a takeover. Furthermore, no information is available on the extent to which public authorities have used their approval or veto rights to influence corporate decisions in the sample companies.

The second classification relates to the time period during which a special right applies. There is no general fixed time period for the ending of a special rights scheme. In many cases the law or articles of association do not specify a minimum period during which the government will not redeem its golden share or give up control rights. In other cases, the share may be redeemed or the right removed on request. Even where a time limit applies, some special rights have been retained beyond this limit.

A classification of special rights according to their timeframe is relevant for the impact assessment. If the timeframe is limited such that, for example, a special right only applies in the first few years following privatisation, the economic impact is likely to be of less concern than a right retained by a public authority to control a privatised company for an unlimited period of time. Information on the timeframe is also useful for the empirical analysis. In particular, for companies where special rights used to apply but have since been removed, it is possible to compare performance before and after the removal to assess the economic importance of the right.

Appendix 1 therefore reports, for those companies in the sample where the information is available, whether the special rights are limited in time, which rights no longer apply, and, if applicable, the expiry date of the rights.

4.4 Special rights in the context of alternative methods of public control

Golden shares or other special rights are only one of a number of controlling mechanisms employed by public authorities to retain control in companies following privatisation. Two alternative control mechanisms are outlined in the sub-sections below: control through retained ownership and control provided by general competition law and regulation.

These alternatives raise the following questions in particular.

– Given that special rights of public authorities in privatised companies may have a negative impact on performance and investment, are the alternative control mechanisms a less restrictive, or more effective, means of achieving a given public policy objective?

– In the absence of special rights, would the other control mechanisms be strengthened? For instance, would governments be less likely to privatise fully if they feel they cannot retain control through special rights?

Although highly relevant for drawing conclusions and assessing policy implications, these questions will not be specifically investigated in the empirical analysis. However, the analysis will need to take some account of alternative mechanisms of state influence on the affairs of privatised companies. In particular, one means of evaluating the performance of companies affected by special rights is to benchmark their performance against that of comparable companies—these may not be subject to special rights but instead (partly or fully) owned by the state or subject to control through the regulatory framework. Identification of alternative control mechanisms is therefore relevant to the selection of appropriate benchmarks.

4.4.1 Retained government ownership

As a way of ensuring state influence without special rights, governments can retain a significant or controlling shareholding in the companies they privatise. Indeed, it has been argued that, if it were not possible for governments to retain a golden share or implement other special control rights in privatised companies, governments would be less likely to sell their ownership stakes and fully privatise a company.[72]

Despite the significant privatisation wave in the last two decades, many EU governments still retain large stakes in companies and, as major shareholders, can use that ownership to block acquisitions or influence management decisions. For example, in the merger agreement between telecoms companies, Telia of Sweden and Sonera of Finland, neither government took a golden share, but both owned more than 50% of their respective companies.[73]

This situation has become particularly prevalent in the energy sector, where there have been concerns, for example, about state-owned EDF targeting companies in other EU markets, such as the UK, Italy and Spain, but being shielded itself from takeover bids.[74] Another example is the airport sector. The UK government's golden share in BAA (the fully privatised UK airports operator) was ruled against by the ECJ and, as a result, abolished. Arguably, however, BAA's ownership structure was still far more open than most of its counterparts in Europe, which are either state- or municipally controlled. Even those airports that are publicly listed often have significant local and central government shareholdings, such as Vienna, Rome and Copenhagen Airports (Copenhagen Airport is also listed in Appendix 1 because of the existence of special control rights until recently,[75] in addition to a significant shareholding by the state).

4.4.2 Regulation and control of privatised companies

Regulation is now an essential part of most governments' approach to privatised companies, at least in the public utility sectors of electricity, gas, water, telecoms, rail and air traffic services. Although regulatory frameworks differ across the EU Member States, governments have usually appointed regulators to oversee each of the privatised utilities following privatisation. These frameworks often distance regulation from central government and therefore differ from government control in nationalised companies. Nevertheless, even if carried out by an arm's-length regulator, regulation presents an important avenue of control over privatised companies.

The regulators' tasks usually go beyond promoting competition in the regulated industries and also relate to general non-competition objectives that are in the public interest, such as ensuring that a utility service is supplied and protecting the interests of domestic consumers. These objectives are similar to those stated by countries to justify the retention of special rights of public authorities in privatised companies (see Appendix 1). As such, the regulatory frameworks can be viewed as substitute mechanisms of control for special rights, in particular special rights that constitute indirect restrictions (eg, control or approval rights over the sale of strategic assets).

In addition to the regulatory frameworks applying to regulated utilities, governments may have control powers under general law, such as powers in relation to merger control. In the UK, for example, an important means of preventing unwelcome takeovers is a merger

[72] See, for example, McCurry (2001), op. cit.

[73] 'Golden Shares Struck Down', *European Finance Director,* **225**, June 13th 2002.

[74] 'Utility round-up', Energy and Utilities, *Financial Times*, December 14th 2001.

[75] The 10% ownership restriction for Copenhagen Airport was abolished in 2004 and the state's approval rights for certain business decisions was replaced by opposition rights in 2005.

reference to the UK Competition Commission.[76] Although the main consideration for making a merger reference is the potential effect on competition, the UK government has the ability to issue an intervention notice in the case of mergers that have public interest implications. If a reference is made on public interest grounds (with or without competition grounds), in particular national security,[77] the government also has the right to make the final decision following the Competition Commission's report. The government may also take certain steps in respect of mergers notified under EC Merger Regulation, which affect national security in the UK and other legitimate non-competition interests.

Although the research focus is on special rights, it is important to raise the question of whether these alternatives present equally effective (or indeed more effective) means of intervening in privatised companies to preserve public interest objectives.

For example, Graham and Prosser (1988) argue, with reference to the UK, that, instead of retaining golden shares, it would be preferable for government intervention to take place either through the regulatory regimes or via competition law.[78] McHarg (1998), however, argues that well-drafted golden shares can be a more straightforward and, hence, more effective form of intervention than either regulation or competition law. In particular, she argues that, if there is a justified aim to ensure that ownership does not fall into the wrong hands, it may be better to take direct steps to prevent this occurring, rather than hoping that the regulator or ministers will exercise their discretion appropriately should the need arise.

The general preference of regulatory frameworks over special rights is consistent with the Commission's view:[79]

> All the alternative public measures to regulate the provision of services by companies operating in specific sectors normally do not discriminate in terms of nationality of investors. They are more transparent and interfere, to a predictable degree, in the direct management and strategic decisions of the companies and only with regard to public policy objectives agreed at EU level. Special rights, on the other hand, introduce investor uncertainty about government intentions and can act as a deterrent of direct investment in practice. … Therefore, it is in the public interest to apply special rights only under narrowly specified conditions, where it can be shown that their justifications are in line with the EC Treaty and ECJ rulings.

4.5 Special rights in the context of other investment restrictions

Special rights are not the only impediment to an integrated European market for corporate control. A High Level Group of Company Law Experts, which was impanelled by the Commission in September 2001 to give advice on issues related to takeover bids, has drawn up a list of factors that influence and potentially hinder direct investment in EU companies. The long list of specific national measures which provide for a deviation from the proportionate allocation of control in EU companies encompasses, for example, restrictions on the transferability of shares; dilution of the shares acquired by a bidder or potential bidder (eg, poison pills); shares with double or multiple voting rights; shares with limited or non-existent voting rights; participation rights carrying no votes; time-lapse voting schemes; discriminatory quorum requirements; irrevocable proxies; binding voting agreements; voting trusts; supermajorities; codetermination; shares with special rights to appoint directors;

[76] See Office of Fair Trading (2003), 'Mergers—Procedural Guidance'.

[77] At present, only national and public security have been specified as public interest considerations in the UK, although the Secretary of State retains power to add further considerations by statutory instrument.

[78] Graham and Prosser (1988), op. cit.

[79] European Commission (2005), op. cit., p. 9.

staggered boards; fixed-term appointments to board members; golden parachutes and supermajority requirements.[80]

While it is not the purpose of this research study to examine these ‘private’ investment restrictions in EU companies, the existence of such restrictions raises questions about the appropriate benchmark against which to measure the impact of ‘public’ special rights on the performance of, and investment in, privatised companies. The appropriate benchmark may not be a free and unrestricted market for corporate control, but a market in which company performance and investor decision-making is influenced by a range of other restrictions.

[80] See The High Level Group of Company Law Experts (2002), ‘Report of the High Level Group of Company Law Experts on Issues Related to Takeovers’, January 10th, Brussels, Annex 4. For a recent assessment of deviations from the one-share/one-vote principle in a select number of EU Member States see, for example, Deminor Rating (2005), ‘Application of the one share – one vote principle in Europe’, a report commissioned by the Association of British Insurers, London.

5 Case study analysis: The impact of special rights on the performance of privatised EU companies

This section presents the empirical results of the case study analysis conducted to assess the impact of special rights for a sample of six companies affected by special rights. It is structured as follows.

– Section 5.1 describes the selection of the case study sample of companies and the methodology and data sources used to carry out the empirical analysis.

– Section 5.2 provides an overview of the structure of the case studies presented in the following sections.

– Sections 5.3 to 5.8 present the main empirical findings obtained for each of the case study companies.

– Section 5.9 summarises the key findings that have emerged from the case studies and, where possible, draws generalisations on the wider impact of special rights.

5.1 Sample selection, data sources and methodology

5.1.1 Selection of case study companies

The case study sample includes the following six companies:

– Cimpor (Portugal, cement industry),
– Volkswagen (Germany, automobile industry),
– Repsol (Spain, oil & gas industry),
– KPN (Netherlands, telecoms industry),
– Portugal Telecom (Portugal, telecoms industry),
– BAA (UK, airports operator).

The starting point for the selection of the case study companies was the sample of companies considered in the typology in section 4 (and Appendix 1). These companies were affected by infringement proceedings by the Commission and/or subject to ECJ decisions, and for these companies sufficient information was available on the existence and nature of special rights (eg, press releases or similar).

The six companies were selected from this sample on the basis of the following main selection criteria.

– *Typology of special rights*—companies are chosen such that the sample covers the main types of special rights, as categorised in the typology in section 4. The rights are likely to differ in terms of impact, as discussed in the typology, and this should be captured in the empirical analysis.

  The sample therefore covers both indirect and direct investment restrictions and, within these, rights with different degrees of stringency (or likely potential impact). The sample does not, however, include companies with discriminatory investment restrictions.

  The sample also differs according to the stated objectives of the special rights, ensuring that this dimension is also covered in the empirical analysis. Moreover, the sample includes companies with special rights that are known to have been exercised to prevent a takeover (eg, Cimpor). Finally, companies for which special rights have recently been abolished as a result of infringement proceedings are also included, as are companies for which special rights remained in place as at the end of 2004. Table 5.1 provides summary information about the special rights in the sample.

– *State ownership*—the sample was selected to exclude, as far as possible, companies that still have a large element of state ownership, so as to have a 'cleaner' test of the impact of government control in the form of special rights rather than through ownership. However, as shown in Table 5.1, three companies in the sample are still partly owned by the state.

– *Data availability*—several companies considered in the typology had to be deselected because of a lack of data from the main data source (ie, Financial Thomson's Datastream).

– *Merger activity and similar corporate events*—a number of companies were deselected because they were taken over during the period of analysis. For example, Elf Aquitaine merged with Totalfina in 2000, and Olivetti bought Telecom Italia in 1999.

– *Comparators*—part of the impact assessment requires the companies' performance to be benchmarked against that of a suitable set of comparators. Hence, companies had to be chosen bearing in mind the need to ensure that robust and comparable data was available for the benchmarking analysis. While comparators were available for some companies, for others the choice of comparators was more difficult. Comparator choice for the sample companies is further discussed below.

– *Industry*—the availability of comparators is closely linked to the industry sector. For example, in the public utility sector, many companies that could have been chosen as potential comparators are still subject to state ownership or operate in countries that maintain different regulatory frameworks. This is why the final sample includes companies in 'competitive' industries such as cement (Cimpor), automobiles (Volkswagen) and oil & gas (Repsol YPF), where the comparator choice was less problematic. Since it was not possible to identify three further case study companies in 'competitive' industries that also met other sample selection requirements, the final sample includes two companies in the regulated telecoms sector (KPN and Portugal Telecom) and one regulated airports operator (BAA).

– *Country*—the sample was constructed to cover, as far as possible, companies in different countries; hence UK company, BAA, and Dutch company, KPN, were included, despite the potential problems in finding suitable comparators.

Table 5.1 lists the six companies examined in the case study analysis below. It provides summary information on the country of domicile, the industry, the nature of special rights, and the extent of current state ownership of each company—ie, some of the main criteria that were considered in the selection process.

Table 5.1 Selection of six case study companies

			Special rights				
	Country	Industry	Direct	Indirect	Discr.	Summary of stated objective	State ownership (%)
Cimpor	Portugal	Cement	Y	Y	N	Safeguard financial interests of Portugal	0
Volkswagen	Germany	Automobile	N	Y	N	Protect minority shareholders and national and regional interests	20[1]
Repsol YPF	Spain	Oil and gas	Y	Y	N	Ensure continuity in public services of strategic importance	0
KPN	Netherlands	Telecoms	N	Y	N	Guarantee provision of universal service in telecoms sector	14
Portugal Telecom	Portugal	Telecoms	Y	Y	N	Safeguard financial interest of Portugal	>0[2]
BAA	UK	Airports	Y	Y	N	National interest in future operation of airports	0

Notes: [1] 20% of shares with voting rights held by the German state of Lower Saxony. [2] The company has 500 A shares (privileged shares), most of which are state-owned.
Source: Oxera.

5.1.2 Data sources

For the sample of six companies, information was gathered from the following data sources.

– *Accounting data*—using Financial Thomson's Datastream, a large database was created containing the main accounting items required to calculate indicators of the companies' financial and operating performance. The period covered is 1995–2004. Datastream has also been used to download accounting data for the sample of comparator companies in the benchmarking analysis.

– *Share price data*—for each company in the sample, daily share returns were downloaded from Datastream for the period 1995–2004. The returns database also contains the returns of the relevant stock market indices, which allows the individual company returns to be adjusted to take into account market-wide movements in share prices. Returns data was also downloaded for the sample of comparator companies used in the benchmarking analysis.

– *Annual reports*—although all main accounting data was available from Datastream, the companies' annual reports were obtained to allow more detailed analysis of company-specific information (eg, to facilitate the sample selection).

– *Details on special rights*—the data sources on special rights were those described in the typology in section 4, and include press releases, other published documents, and information provided by the Commission.

– *Credit rating agency and brokerage reports*—credit rating agency and brokerage reports were collected to provide further information on the companies' performance and to find out how analysts evaluate, if at all, the existence of special rights in these companies and whether any expected or actual changes in special rights arrangements alter analysts' evaluation of the companies.

– *Other information*—other sources used to obtain information on company-specific events included the websites of the companies and others, and a database called *Zephyr*, which contains information on the companies' merger and acquisition activity.

5.1.3 Methodology

The empirical assessment of the impact of special rights on the performance of case study firms is based on a large set of performance indicators. The main ones are summarised in Table 5.2. In broad terms, the indicators cover financial performance, using accounting- and market-based indicators, and operating performance.

Data to construct the performance indicators listed in Table 5.2 is available from Datastream. Two issues need to be addressed in this context.

– *Global versus domestic performance*—the performance indicators relate in general to the companies' consolidated operations. When assessing the impact of indirect investment restrictions (eg, veto rights in relation to sales of strategic assets), domestic performance may be the more relevant variable to consider. However, data on domestic operations is not readily available for companies that operate globally: Datastream does not provide data on disaggregated domestic and overseas activities; and the companies' annual reports do not contain sufficient information on the breakdown between domestic and overseas operations to allow construction of indicators of domestic performance. While this is not an issue for companies with largely domestic operations, the results based on 'global' performance indicators may not accurately reflect the impact of special rights on companies with overseas operations. While potentially problematic for assessing the impact of indirect investment restrictions, the focus on consolidated operations is largely irrelevant for the analysis of the impact of special rights that present direct investment restrictions (ie, special rights that constitute direct barriers to takeovers of the entire company).

– *Performance in terms of service delivery*—the performance indicators in Table 5.2 cover financial and operating performance, but the latter does not include indicators such as prices paid by consumers or the quality of service provision. Again, there are data limitations, and to collect data on service delivery would have required a different research approach. This means, for example, that it has not been possible to assess whether special rights have facilitated the achievement of public policy objectives focusing on service delivery to consumers. Instead, the impact assessment is largely concerned with assessing the impact on financial and productivity performance.

Table 5.2 Main performance indicators

	Definition
Financial performance	
Indicators based on accounting information	
Return on sales	Ratio of operating profit to turnover
Return on capital employed	Ratio of operating profit to capital employed, where capital employed is total assets less current liabilities
Post-tax return on equity	Ratio of post-tax income to shareholders' equity
Dividend payout ratio	Ratio of ordinary dividends to post-tax income
Gearing	Ratio of total debt to the sum of total debt and shareholders' equity
Indicators based on market information	
Market-to-book ratio	Ratio of market value of company shares to shareholders' equity
Dividend yield	Ratio of dividend per share to share price
Price–earnings ratio	Ratio of share price to earnings per share
Share price, total rate of equity return	A company's share price performance will be evaluated using the total returns earned by shareholders on holding the share, which captures both the capital gain and the dividend yield

	Definition
Operating performance	
Labour productivity	
Output per employee	Ratio of turnover to number of employees
Capital intensity and investment	
Output/total asset ratio	Ratio of turnover to total assets
Output/fixed asset ratio	Ratio of turnover to net property, plant and equipment
Capital investment intensity	Ratio of capital expenditure (net additions to property, plant and equipment) to the stock of net property, plant and equipment
Investment per employee	Ratio of capital expenditure (net additions to property, plant and equipment) to number of employees
Output growth rate	**Percentage change in annual turnover**

To evaluate the impact of special rights on performance, as measured by the indicators, the case study analysis adopts three types of empirical approach—a historical performance assessment, performance benchmarking and event studies using share price reactions.

Historical performance assessment

The companies' performance is examined over a ten-year period, from 1995 to 2004, to assess trends and changes in performance.

When examining the impact of special rights, it is useful to consider performance of the same company with and without special rights—eg, by comparing performance before and after the abolition of special rights and assessing performance improvements as a result of the abolition. However, this methodological approach is problematic for the selected companies since most special rights were abolished only very recently or indeed are still in place in some cases (eg, because the infringement proceedings against the relevant countries are too recent or ongoing). Even for companies where special rights were abolished in response to an ECJ judgment (say in 2003), improvements in performance may not be observed immediately; and even if an immediate improvement was observed in the first year (eg, 2004), it would be difficult to attribute this improvement to the abolition of the special rights—the improvement may only be temporary and due to factors that are unrelated to the change in control.

Performance benchmarking

Given that it is generally problematic to carry out a before-and-after comparison of performance indicators, in order to evaluate the impact of special rights, the assessment in the case studies largely relies on a benchmarking exercise. The performance of the six companies is benchmarked against that of comparable companies not subject to special rights over the same time period. The chosen time period in the analysis is 1995–2004 or, if earlier, the year before the special right was abolished.

The usefulness of the benchmarking exercise depends critically on the choice of comparators. If the only difference between case study companies and comparators was the existence of special rights, any significant differential performance between the case study companies and the comparators could be attributed to the presence and impact of such special rights. Comparator companies should therefore be identical, or at least similar, to case study companies in terms of the markets in which they operate, their size, ownership structure, risk characteristics, regulatory regime, and many other factors that may affect company performance.

The choice of comparators for the case study analysis largely relied on that of analysts and market experts: for example, the ratings and research service of Standard & Poor's produces regular reports on various industries in which the case study companies and their competitors operate.

Having identified companies that operate in the same industry (not necessarily in the same country), the next selection criterion was to check whether the comparators are publicly quoted such that the relevant data requirements are met in Datastream. Finally, some further research was undertaken to assess whether the comparators are suitable for the benchmarking analysis, focusing on the degree to which the companies are subject to state influence (eg, in the form of state ownership) or a different regulatory regime to the case study companies.

The aim was to find at least four benchmark companies per case study company. Given the nature of the industries in which the case study companies operate, it was not always possible to find companies that met all selection criteria.

– *State ownership*—in the case of BAA, for example, it was difficult to find comparators that are publicly listed and fully privately owned. Most European airports still have significant local and central government shareholdings, including the comparators that were ultimately chosen (eg, Fraport, Vienna Airport). In the case of the two telecoms companies (KPN and Portugal Telecom), a number of potential comparators were not considered because of state ownership (eg, Deutsche Telekom and France Telecom).

– *Regulatory regime*—three case study companies are subject to regulation (BAA, KPN and Portugal Telecom). To the extent that it was necessary to choose comparators from a different country, the outcome of the benchmarking analysis depends on the comparability of regulatory regimes across countries. Given the differences in EU regulatory regimes (eg, in the telecoms sector), this could weaken any conclusions that can be drawn about the performance impact that can be attributed to special rights alone.

Given the nature of the industries in which Cimpor, Volkswagen and Repsol operate, the selection of comparators was easier, at least to the extent that state ownership and regulation are not prominent in these industries. However, there are numerous other company-specific factors that affect performance. Also, to the extent that the comparators operate in different countries, many performance indicators may not be measurable on a fully consistent basis due to differences in accounting practices. This means that any results obtained from the benchmarking analysis must be interpreted with the necessary caution.

Table 5.3 summarises the comparators chosen for each of the six case study companies.

Table 5.3 Selection of comparator companies

Company	Industry	Comparators (country of domicile)
Cimpor	Cement	Lafarge (France), Holcim (Switzerland), HeidelbergCement (Germany), Ciments Français (France)
Volkswagen	Automobile	BMW (Germany), DaimlerChrysler (international), Fiat (Italy), Ford Motor (USA), General Motors (USA), Honda Motor (Japan), Peugeot (France), Renault (France)
Repsol	Oil and gas	BP (UK), Royal Dutch Shell (UK/Netherlands), Norsk Hydro (Norway), Statoil (Norway), ExxonMobil (USA), ChevronTexaco (USA), ConocoPhillips (USA)
KPN	Telecoms	BT Group (UK), AT&T (USA), Telstra (Australia), Vodafone Group (UK), mmO2 (UK)
Portugal Telecom	Telecoms	BT Group (UK), AT&T (USA), Telstra (Australia), Vodafone Group (UK), mmO2 (UK)
BAA	Airports	Fraport (Germany), Flughafen Wien (Austria), Unique Zurich (Switzerland), TBI (international), Aeroporti di Roma (Italy)

Event study of share price reactions

The third empirical approach considered in the case study analysis is based on event study methodology. This involves estimating the share price reaction of the companies' shares around specific events where the market learned that special rights arrangements for a company might change (eg, the dates when Commission infringement proceedings or ECJ judgments are announced). If the special rights are considered binding by the market, one would expect a positive share price reaction around the event date.

Such event study analysis of share price reactions can be considered a valuable tool for impact assessments. Importantly, the price reactions on the relevant event dates allow quantification of the market's valuation of the value (or cost) of the special rights. There is a large body of literature on event study methodology. The approach pursued in the case study analysis follows this literature,[81] and measures price reactions as abnormal returns (ARs) over a time interval before and after the event date. Specifically, ARs are calculated as the difference between each firm's raw share price returns (R_{it}) and those from a benchmark (RM_t) over a period 20 days before and 20 days after the event (see Equation 5.1). The subscript i denotes that the returns vary by firm and t describes the variation in returns over time.

$$AR_{it} = R_{it} — RM_t \qquad \text{Equation 5.1}$$

To analyse performance over the event window, the abnormal returns are aggregated from the beginning (t) to the end (T) of the event window (ie, ±20 days from the event) to obtain CARs, defined according to Equation 5.2.

$$CAR_{it} = \Sigma_t^T AR_{it} \qquad \text{Equation 5.2}$$

ARs should be zero on average, but on the day when the event takes place or is expected in the market (ie, an infringement proceeding is announced), the AR would be expected to differ significantly from zero, with the amount of the AR reflecting the market's evaluation of the event. CARs should behave correspondingly.

[81] See, for example, MacKinlay, C.A. (1997), 'Event Studies in Economics and Finance', *Journal of Economic Literature*, **35**:1, March, 13–39.

The event study methodology was applied for each case study company, but focusing on different event dates, as explained in the relevant sections below.

5.2 Structure of case studies

Sections 5.3 to 5.8 below present the main results of the analysis for each of the six case study companies. The sections have the following structure.

Background information—each case study starts with a short description of the company's business activities and then summarises the nature of special rights applying to the company, focusing on the elements discussed in the typology in section 4 as being most relevant for predicting the likely impact.

Overview of company performance over time—the case study then considers the performance of the company between 1995 and 2004. Only a sub-set of performance indicators is considered in the main part of the case study, with the results for the full set of performance indicators presented in Appendix 2.

Benchmarking analysis—the performance of the case study company is then benchmarked against the average performance of the chosen comparators, in order to examine any significant differences in performance that may be attributable to the existence of special rights. The first part of the benchmarking analysis covers *financial performance* indicators, while the second covers the indicators of *operating performance*.

Event-study analysis—for each case study company, the results of event studies are reported to assess movements of share prices around certain dates of interest.

Section 5.9 summarises the results of all case studies and provides conclusions on the measured impacts of special rights.

5.3 Case study 1: Cimpor

5.3.1 Background information

Cimentos de Portugal (Cimpor) is the largest cement group in Portugal. The company has been expanding its global reach and is operating in ten countries (Portugal, Spain, Morocco, Tunisia, Brazil, Mozambique, Egypt, South Africa, Cape Verde and Angola). The Group's principal activities are manufacturing, marketing, sale and export of cement, hydraulic lime, concrete and aggregates, precast concrete and dry mortars.

Cimpor was privatised in four stages, with the privatisation process beginning in 1994 when the Portuguese state sold 20% of the company's share. Subsequently, the government sold off the remaining 45%, 25% and 10% stakes in the company in the years 1996, 1998, and 2001 respectively.

Although the company was fully privatised by the year 2001, the state continued to hold special rights. These rights included both direct and indirect investment restrictions, as summarised in Table 5.4, and, as with other special rights in privatised companies, were retained to 'safeguard the financial interests of Portugal'. On June 4th 2002, the ECJ passed a judgment against the Portuguese privatisation law that led to the abolition of special rights in Cimpor and other Portuguese companies. Separate infringement proceedings were initiated by the Commission in 2000, when the Portuguese government used its rights to block a takeover bid.

Table 5.4 Summary of special rights

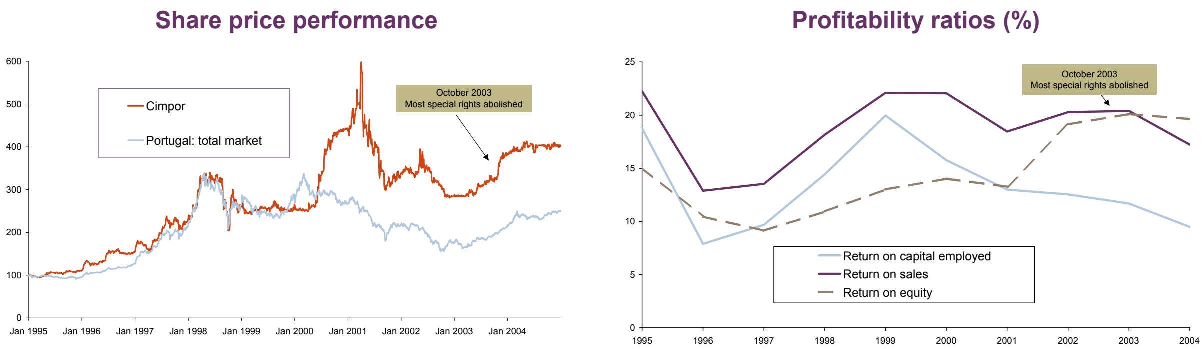
	Description
Direct investment restriction	Initially, there was a cap on foreign ownership of shares
	No shareholder can hold more than 10% (5%) of capital in the second and third (first) stages of privatisation
	Acquisitions of more than 10% require state authorisation
Indirect investment restriction	The state has the right to veto board decisions
	Shareholder voting rights limited to 10% by Articles of Association
Stated objective	Safeguard the financial interests of Portugal
Redemption date	October 2003: restrictions abolished other than the authorisation requirement and the voting right limit
	February 2004: authorisation requirement repealed
	Shareholder voting rights limit is maintained in Articles of Association

Source: Oxera based on various sources.

5.3.2 Overview of company performance over time

The first empirical approach for evaluating the impact of special rights on company performance involves looking at the performance indicators of Cimpor over time. Figure 5.1 presents an overview of Cimpor's share price performance during 1995–2004, and reports measures of company profitability. The other indicators of financial and operating performance are summarised in Appendix 2.

Figure 5.1 Share price and financial performance, 1995–2004



Notes: Share price performance is measured by Datastream's total return index for the company, compared with the index measuring returns for the market as a whole. Profitability ratios are calculated as in Table 5.2.
Source: Datastream and Oxera calculations.

Under the hypothesis of a negative performance impact of special rights, an improvement in company performance would be expected following the abolition of special rights. The special rights in Cimpor were abolished in October 2003, with the exception of the authorisation requirement for acquisitions, which was retained until 2004.

While share prices have increased since October 2003, there is no observable improvement in the profitability ratios (and the other performance indicators reported in Appendix 2) in the two years 2003 and 2004 when special rights started being abolished compared with the preceding years. The plausible explanation for the absence of a measurable impact on performance is that insufficient time has lapsed since the special rights were abolished. Moreover, special rights in the form of a voting rights limit for shareholders continued to be in place at the end of the period. Hence, it is not yet possible to draw any conclusions on the longer-term impact of the abolition on Cimpor's performance.

5.3.3 Benchmarking analysis

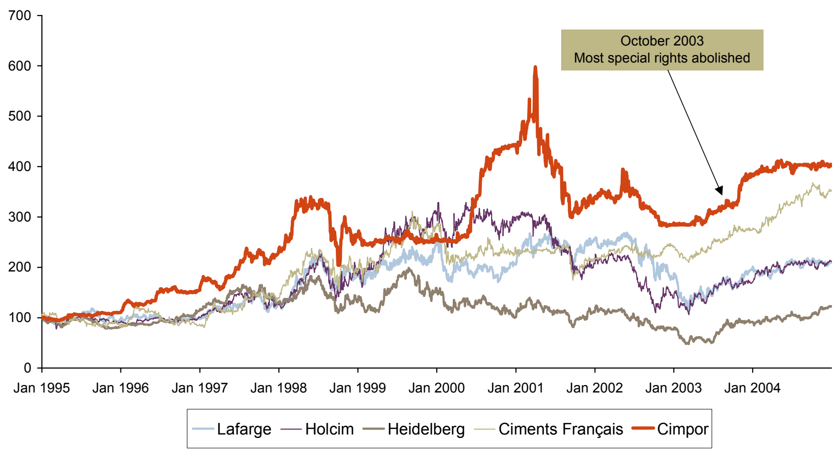
The second empirical approach for evaluating the impact of special rights on company performance involves benchmarking the case study firm against the performance of other firms operating in the same industry. The chosen comparators for Cimpor are private firms operating in the cement industry in other European countries—ie, Lafarge (France), Holcim (Switzerland), Heidelberg (Germany), and Ciments Français (France).

If the data were to support the hypothesis that special rights have detrimental effects on company performance, Cimpor would be expected to have underperformed relative to its comparators, at least until the date the special rights started to be abolished.

Financial performance

Figure 5.2 traces Cimpor's share price performance, as measured by the total return index, against the benchmarks. Contrary to the prediction, there are no signs of any underperformance by Cimpor—over the period as a whole, it has been outperforming the comparators.

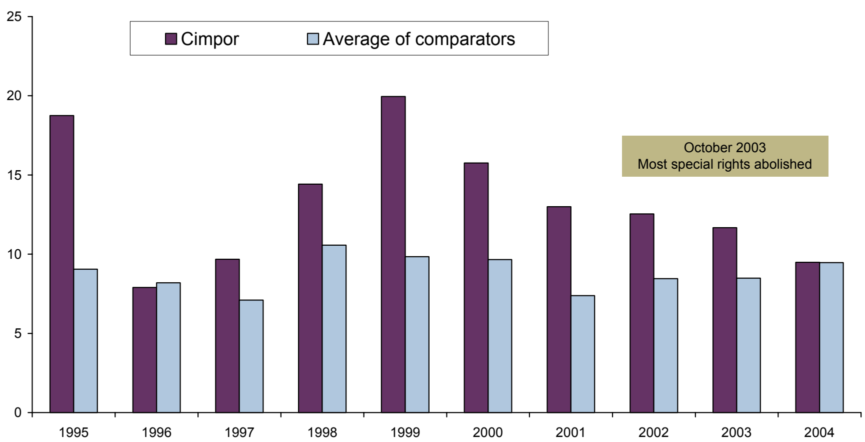
Figure 5.2 Comparison of Cimpor's share price performance, 1995–2004



Source: Datastream and Oxera calculations.

Figure 5.3 compares Cimpor's return on capital employed (ROCE) with the average performance of the benchmarks. There is no evidence to corroborate the hypothesis that Cimpor's position was adversely affected by special rights. On the contrary, the company has been historically outperforming the comparators.

Figure 5.3 Comparison of ROCE (%), 1995–2004



Note: ROCE is calculated as in Table 5.2. The comparator averages are calculated as the median in the year.
Source: Datastream and Oxera calculations.

Oxera calculated and compared annual financial performance for both Cimpor and its benchmarks using all financial performance indicators discussed in the methodology section and summarised in Table 5.2. Table 5.5 provides a summary of the results. For each indicator, it shows Cimpor's performance and the average performance of the comparators, averaged over the period 1995–2002 (the last accounting year before some of the special rights were abolished). However, as with the annual results presented for ROCE, Cimpor's performance was considerably better than that of its comparators.

Table 5.5 Summary of comparative financial performance, 1995–2002 averages

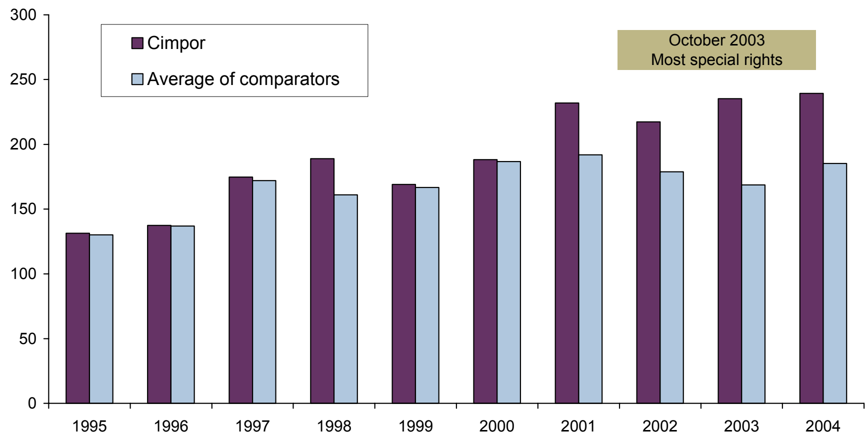
	Cimpor	Average comparators
Financial performance—accounting-based		
Return on sales (%)	18.7	12.6
Return on capital employed (%)	14.0	8.8
Return on equity (post-tax) (%)	13.1	11.5
Dividend payout ratio (%)	60.3	22.3
Gearing (%)	30.9	52.1
Financial performance—market-based		
Market-to-book ratio	2.1	1.4
Dividend yield (%)	3.5	1.8
Price–earnings ratio	17.0	13.5

Note: Performance indicators are calculated as explained in Table 5.2. The reported values are averages for the period from 1995 to the last accounting year before the special rights began to be abolished. The comparator averages have been calculated by first taking the annual median across companies and then averaging over the period.
Source: Datastream and Oxera calculations.

Operating performance

Figure 5.4 shows Cimpor's labour productivity performance during the ten-year period of analysis. In all years, labour productivity either matched or exceeded average productivity levels of the comparator companies.

Figure 5.4 Comparison of labour productivity (€'000), 1995–2004



Note: Labour productivity is calculated as in Table 5.2. The comparator averages are calculated as the median in the year.
Source: Datastream and Oxera calculations.

The comparison for the full set of operating performance indicators, averaged over the period from 1995 to the year before some of the special rights were abolished, is presented in Table

5.6. The results show that Cimpor also performed well in terms of operating performance, although the degree of outperformance is less than for the financial performance indicators. For example, Cimpor displayed a higher average output growth rate than its comparators, as well as greater investment activity. Overall, for both financial and operating performance, there is no evidence to support the view that, due to the existence of special rights, Cimpor has been underperforming relative to its comparators.

Table 5.6 Summary of comparative operating performance, 1995–2002 averages

	Cimpor	Average comparators
Labour productivity (output per employee) (€'000)	179.9	165.5
Output/total assets (%)	52.6	56.7
Output/fixed assets (%)	120.4	116.7
Investment relative to fixed assets (%)	13.5	11.1
Investment per employee (€'000)	20.4	15.2
Output growth rate (nominal) (%)	14.2	4.9

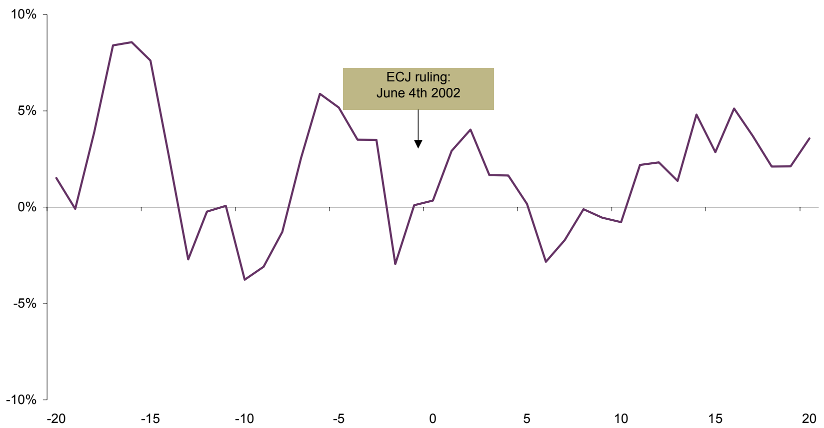
Note: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

5.3.4 Event-study analysis: share price reactions

The third empirical approach to evaluate the impact of special rights on performance is the event study analysis, which examines share price reactions around specific events where the market learned about changes in special right arrangements in Cimpor.

Figure 5.5 shows Cimpor's share price movements 20 days before and after one major event: June 4th 2002 when the ECJ ruled against Portugal for maintaining direct and indirect investment restrictions in Cimpor and other Portuguese companies. As described in section 5.1, the company's returns are measured as CARs, adjusted for the daily total market returns of Portuguese listed companies and cumulated over the event window.

Figure 5.5 CARs (%) around ECJ judgment against Portugal (June 4th 2002)



Notes: CARs in this and all following figures are calculated as discussed in section 5.1.
Source: Datastream and Oxera calculations.

Cumulative returns do not display the pattern that would be expected if the market changed its valuation of Cimpor as a result of the ECJ judgment. Although returns are positive in the first two days after the judgment and end positive over the 40-day period, they are highly volatile throughout the period, making inferences difficult. It seems that factors other than the announcement of the ruling were driving returns at the time.

Share price analysis around subsequent events—including, for example, the date when Portugal finally abolished the state authorisation requirement for acquisitions of more than 10%—also did not show positive abnormal price reactions. The results are omitted.

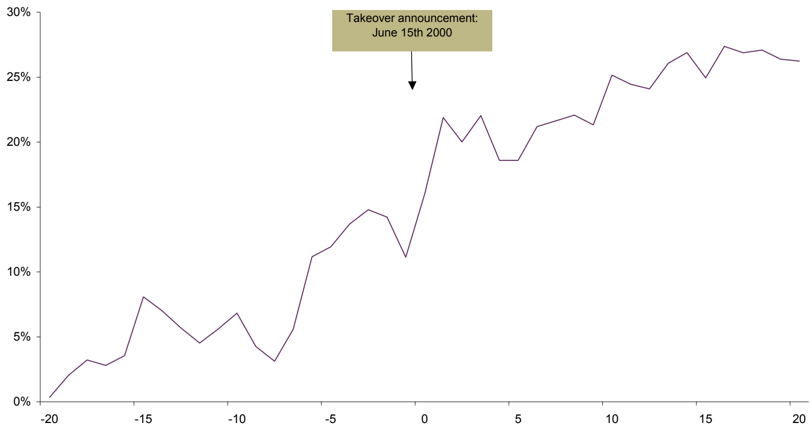
The ECJ judgment and abolition of special rights might have long been expected by the market, explaining the lack of share price reactions. This is likely since infringement proceedings against Portugal started as early as 1994, with the referral of the case to the ECJ in December 1997. Indeed, there is evidence that the market expected the special rights maintained by the Portuguese to cease well before the ECJ judgment, in particular those rights that effectively blocked Cimpor from being taken over.

Cimpor was subject to a joint takeover bid by Holderbank (now Holcim, a Swiss competitor of Cimpor and one of the benchmarks considered above) and Secil (Portugal's second-largest cement company) in June 2000. According to a brokerage report, this was:

> spurred by the government's indication it was planning to sell its 11% 'golden share stake in Cimpor. […] The 'surprised' Portuguese government said it was unwilling to sell its golden share stake. No reasons were given, but the refusal to sell makes it likely that the current bid will be blocked. […] The fact that the government is not selling its stake does not automatically make this particular bid unworkable. Holderbank has already said they would welcome the government as a shareholder as long as it relinquishes the golden share agreement.[82]

Figure 5.6 shows Cimpor's CARs around June 15th 2000, the day on which the takeover bid was announced. The share price had already started to increase prior to that date, partly due to news about a possible rival bid from Cemex.[83] Importantly, on the actual day of the announcement, share prices rose abnormally by 10%, leading to an increase in the CAR to above 20% during the 40-day window.

Figure 5.6 CARs (%) around takeover announcement (June 15th 2000)



Source: Datastream and Oxera calculations.

On June 16th 2000, Holderbel and Cimpor applied for prior authorisation from the Portuguese Minister of Finance to acquire the company, but the application was rejected on July 6th, as was a renewed application in August 2000. These decisions were separately

[82] Credit Suisse First Boston (2000), 'Cimpor', issued on June 16th 2000.

[83] See Credit Suisse First Boston (2000), op. cit.

investigated by the Commission, and declared illegal in November 2000.[84] The case was referred to the ECJ.[85]

The Cimpor case shows the importance of special rights for direct investors. Holderbank and Secil explicitly stated that their offer was conditional on the Portuguese government waiving its golden shares in the company.[86] Moreover, the results shown in Figure 5.5 confirm the significant premia attached by the market to takeovers, as discussed in section 3. They also suggest that special rights that block takeovers prevent shareholders from realising these gains. Thus, the results of the event study are consistent with the view that special rights of this kind have negative implications for both direct and portfolio investors.

If the takeover premium, as measured by the positive share price reactions in response to the bid announcement, reflects the market's expectation of synergies and other benefits to Cimpor, the results may also be indicative that special rights that prevent takeovers have a negative impact on longer-term performance. Although there is no evidence that Cimpor has underperformed relative to its comparators, the special rights could have acted to prohibit even better performance.

5.4 Case study 2: Volkswagen

5.4.1 Background information

Volkswagen's principal activities are the design, manufacture and distribution of cars and other vehicles worldwide. Its main products include the Volkswagen, Audi, Seat, Skoda, Lamborghini, Bugatti, Rolls Royce and Bentley range of vehicles. It also holds a 34% stake in Swedish truck maker, Scania. The Group operates plants in Europe, the Americas, the Asia/Pacific region and Africa. Volkswagen's other interests include consumer financing and Europcar International (car rental).

Volkswagen was privatised in 1961, but the German state of Lower Saxony continues to hold 20.94% of shares with voting rights. The special rights constitute both direct and indirect restrictions on investment in Volkswagen, as summarised in Table 5.7. By the end of December 2004, the special rights were still in place, with the decision of the ECJ against Germany pending.

Table 5.7 Summary of special rights

	Description
Direct investment restriction	No shareholder can acquire more than 20% of voting rights
Indirect investment restriction	20% blocking minority. 80% of votes required for major company decisions Mandatory representation of public authorities on the board
Stated objective	Protection of minority shareholders and national and regional interests
Redemption date	October 2004: Referral to the ECJ Special rights remain in place as at December 2004

Source: Oxera based on various sources.

[84] See Commission press release IP/00/1338 of November 22nd 2000.

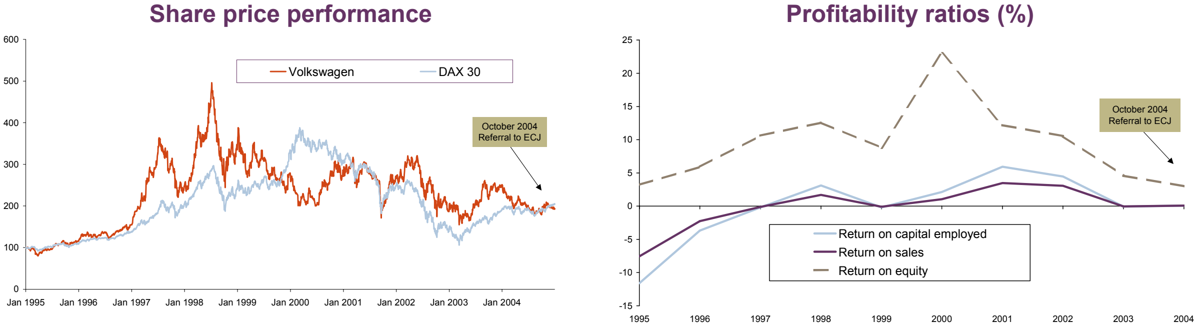
[85] Event study analysis was conducted on the days when the decisions and rulings were announced, but no significant share price responses were observed.

[86] Reuters News (2000), 'Holderbank says govt share could stop Cimpor bid', June 15th.

5.4.2 Overview of company performance over time

Figure 5.7 tracks the share price performance of Volkswagen. Over the ten-year period as a whole, an investment in Volkswagen delivered returns in line with the German market, as measured by the DAX 30.

Figure 5.7 Share price and financial performance, 1995–2004



Note: See notes to Figure 5.1.
Source: Datastream and Oxera calculations.

Figure 5.7 also shows three measures of company profitability during 1995–2004, with the complete set of performance indicators reported in Appendix 2. Profitability has fluctuated over the years, but it is difficult to draw inferences about what historical performance would have been had Volkswagen not been subject to special rights during the period. Special rights were still in place at the end of December 2004, so an impact assessment based on before-and-after comparisons of performance is not possible.

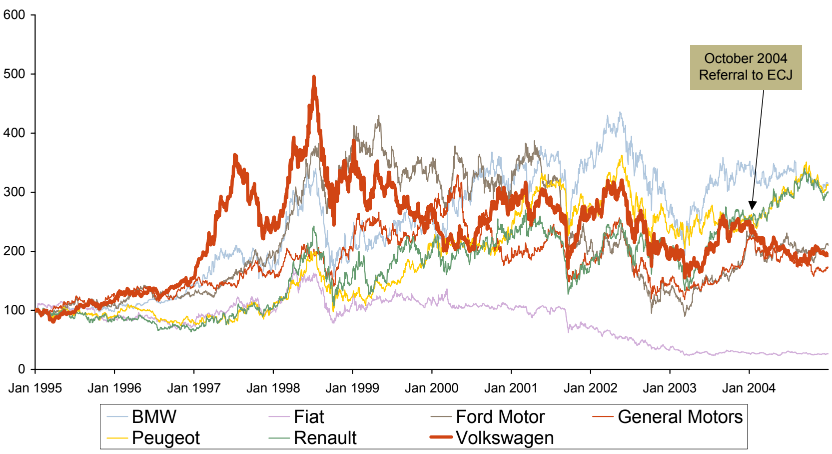
5.4.3 Benchmarking analysis

The benchmarks used for Volkswagen are seven other companies in the German and international automobile industry: BMW (Germany), Fiat (Italy), Ford Motor (USA), General Motors (USA), Peugeot (France), Renault (France), and DaimlerChrysler (International).

Financial performance

Figure 5.8 plots the total return index for all companies. Abstracting from Volkswagen's performance peaks in 1997 and 1998 and considering the ten-year period as a whole, Volkswagen turns out to be the average performer, with some companies having performed better (eg, BMW) and others worse (eg, Fiat) than Volkswagen.

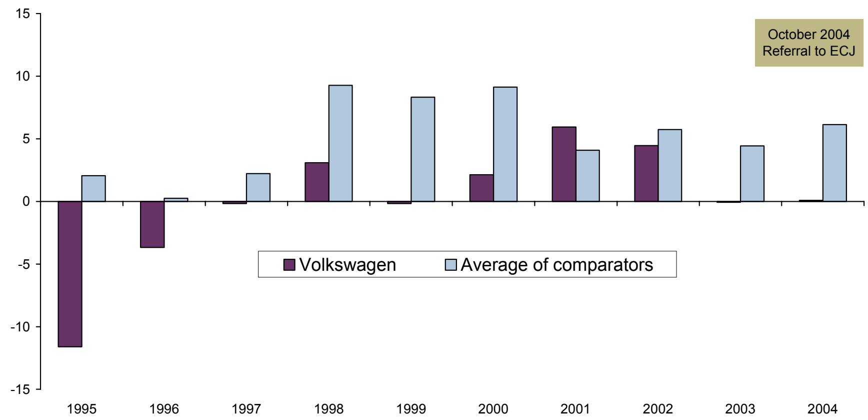
Figure 5.8 Comparison of share price performance, 1995–2004



Note: The return index for DaimlerChrysler was not available for the entire period.
Source: Datastream and Oxera calculations.

Figure 5.9 compares the annual accounting profitability, as measured by the ROCE, for Volkswagen against the average profitability of its benchmarks. Based on this measure of financial performance, Volkswagen has been underperforming relative to the comparator average over the entire period.

Figure 5.9 Comparison of ROCE (%), 1995–2004



Note: See notes to Figure 5.3.
Source: Datastream and Oxera calculations.

Table 5.8 summarises the comparative financial performance of Volkswagen, by considering all performance indicators averaged over the period 1995–2004. The results show that if performance is evaluated according to the three accounting-based measures of profitability, Volkswagen has been underperforming, while performance based on market valuations tended to be higher—ie, average returns on capital, equity and sales were lower but market-to-book ratio and price–earnings ratio were higher than that of comparator companies.

Table 5.8 Summary of comparative financial performance, 1995–2004 averages

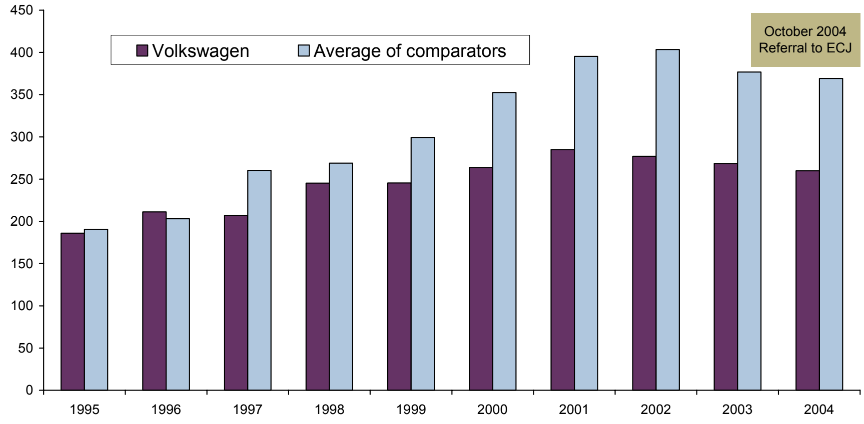
	Volkswagen	Average comparators
Financial performance—accounting-based		
Return on sales (%)	–0.1	3.7
Return on capital employed (%)	0.0	5.2
Return on equity (post-tax) (%)	9.4	11.7
Dividend payout ratio (%)	35.8	22.8
Gearing (%)	66.2	67.7
Financial performance—market-based		
Market-to-book ratio	1.7	1.5
Dividend yield (%)	2.0	2.4
Price–earnings ratio	22.3	10.3

Note: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

Operating performance

Turning to Volkswagen's operating performance, Figure 5.10 compares the company's labour productivity against that of other automobile manufacturers during 1995-2004. Volkswagen has been underperforming in all but one year, with the productivity gap being largest in the second half of the ten-year period.

Figure 5.10 Comparison of labour productivity (€'000), 1995–2004



Note: See notes to Figure 5.4.
Source: Datastream and Oxera calculations.

Table 5.9 summarises the operating performance of Volkswagen and its benchmarks, by considering all indicators averaged over the period 1995–2004. On average, Volkswagen's investment activity has been greater than that of its comparators, as has its output growth rate. However, production seems more labour-intensive, which is consistent with the lower average labour productivity as measured by the ratio of output per worker. These results are broadly consistent with the view that, due to the existence of special rights (coupled with the retained ownership stake of the Land of Lower Saxony), the company prioritised employment and growth, possibly at the expense of lower financial performance over the period. However, further analysis would be required to ascertain this hypothesis, including an assessment of changes in performance over the longer term, when, and if, the special rights are abolished.

Table 5.9 Summary of comparative operating performance, 1995–2004 averages

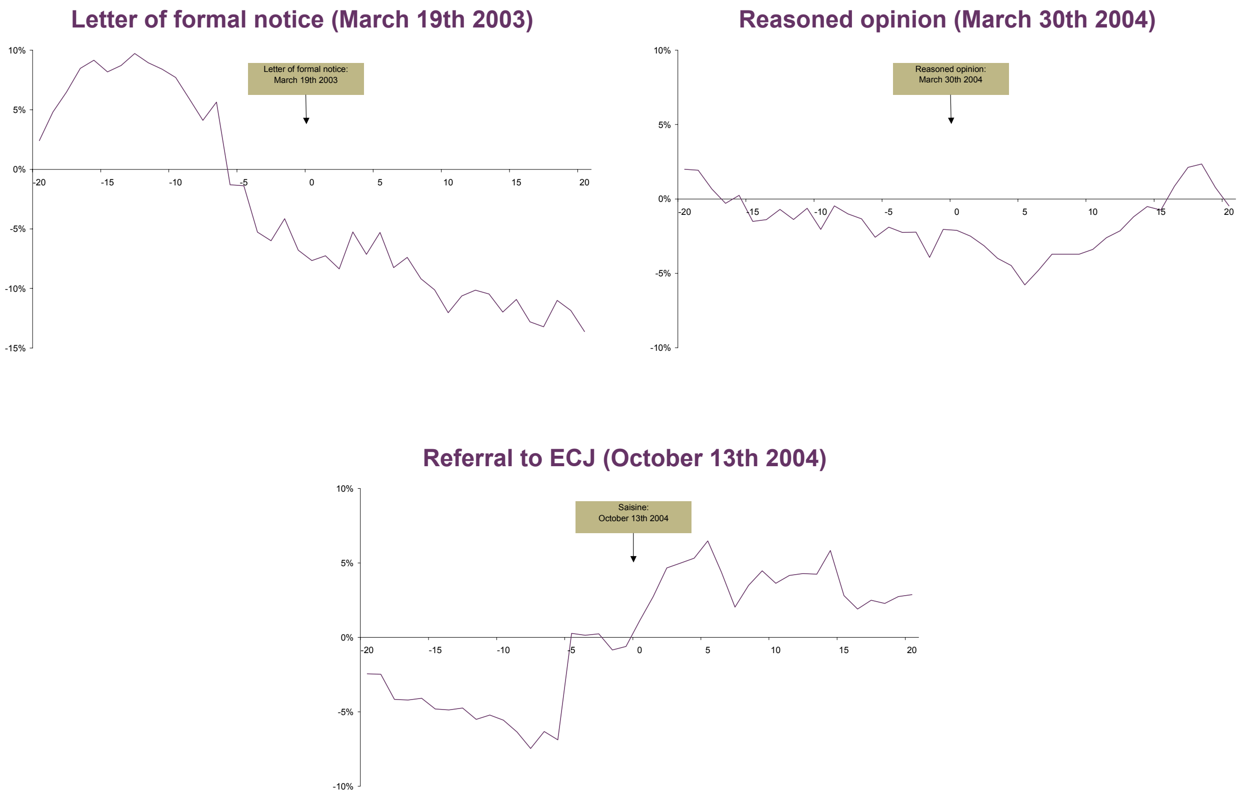
	Volkswagen	Average comparators
Operating performance		
Labour productivity (output per employee) (€'000)	244.8	312.0
Output/total assets (%)	97.7	80.7
Output/fixed assets (%)	304.5	278.5
Investment relative to fixed assets (%)	38.9	27.6
Investment per employee (€'000)	30.2	22.3
Output growth rate (nominal) (%)	8.3	4.7

Note: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

5.4.4 Event-study analysis: Share price reactions

Share price reactions for Volkswagen are examined around three event dates, when the European Commission initiated, and issued press releases of, infringement proceedings against Germany for maintaining special rights in the company—a letter of formal notice, a reasoned opinion and the referral of the case to the ECJ. The ECJ proceedings are ongoing in 2005. The results are summarised in Figure 5.11.

Figure 5.11 CARs (%) around announcement of infringement proceedings



Source: Datastream and Oxera calculations.

Starting with the date of referral to the ECJ, the pattern of CARs is broadly consistent with a positive share price impact on the event date. On the day of the referral, share prices rose by nearly 2%. However, share prices rose a few days later for reasons that are likely to be unrelated to the ECJ referral. For example, on October 6th, Volkswagen announced the appointment of a new management board member with expertise in restructuring and cost-cutting; abnormal returns on that day were 7%.[87]

The returns pattern on the earlier event dates casts further doubt that the initiation of infringement proceedings triggered significant abnormal share price movements. Following both the letter of formal notice and the reasoned opinion in March 2003, returns were actually negative rather than positive. Again, this may be largely due to other events occurring around the same time. For example, in March 2003, the company warned that it was unlikely to match the previous year's operating profit, and this news caused the share price to drop significantly for the next couple of months.[88]

It is possible that the event dates examined are not the relevant dates when the market learned about changes in special rights arrangements in Volkswagen. For example, the Volkswagen law was an issue debated at German national level, even before the Commission became involved. Moreover, the letter of formal notice in March 2003 was not the first proceeding by the Commission; a first investigation was opened in early May 2001. The Commission’s proceedings in 2003 were expected before March, as evidenced, for example, when a candidate for the upcoming elections in the German state of Lower Saxony

[87] Volkswagen Press Release (2004), ‘Dr. Wolfgang Bernhard to become member of the Board of Management’, October 6th.

[88] Associated Press Newswires (2003), ‘Volkswagen shares hit by 2003 profit warning’, March 11th.

said in January 2003 that he may increase the state's stake in Volkswagen to 25% if the law limiting voting rights was banned at EU level so as to prevent a takeover of the firm.[89]

Overall, the event study analysis did not generate results to suggest that the special rights in Volkswagen are perceived by the market as having a significantly negative impact on company performance. This may be due to methodological problems (ie, the lack of suitable event dates) rather than the actual absence of a negative impact.

5.5 Case study 3: Repsol YPF

5.5.1 Background information

Repsol is Spain's largest oil company and the main seller of liquefied petroleum gas. It is one of the ten major private oil companies in the world. Repsol operates in 28 countries, and owns 99% of YPF, Argentina's largest oil company.

The state began the privatisation process of Repsol in 1989, which was completed in 1997. Like other privatised Spanish companies, the state retained special rights in Repsol, taking the form of both direct and indirect investment restrictions (summarised in Table 5.10). The special rights are due to be phased out in 2006.

Table 5.10 Summary of special rights

	Description
Direct investment restriction	Government can oppose the acquisition of more than 10% of the company's capital Government can oppose the exercise of voting rights in excess of 3% where such holdings are acquired by public companies
Indirect investment restriction	The state has the right to veto certain management decisions
Stated objective	Public services of strategic importance require protection
Redemption date	May 2003: ECJ ruled against Spain 2006: Special rights are due to expire

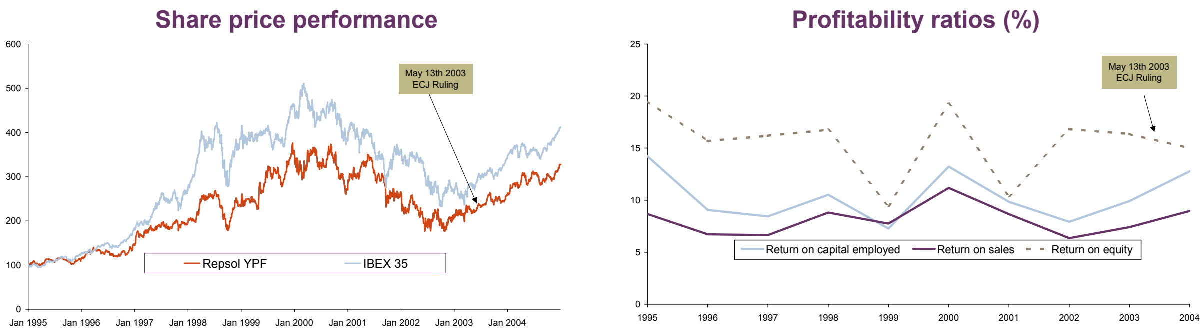
Source: Oxera based on various sources.

5.5.2 Overview of company performance over time

Figure 5.12 charts the return index of Repsol against the Spanish market, measured by the IBEX 35. Over the period as a whole, Repsol seems to have somewhat underperformed compared with the market. Figure 5.12 also shows how different measures of profitability fluctuated during the period 1995–2004. The full set of performance indicators is reported in Appendix 2.

[89] Reuters (2003), 'Lower Saxony may up VW stake if CDU wins election', January 16th.

Figure 5.12 Share price and financial performance, 1995–2004



Note: See notes to Figure 5.1.
Source: Datastream and Oxera calculations.

As with the other case studies, it is difficult to infer the impact of special rights by mere inspection of historical performance. The rights are still in place so it is not possible to conduct a pre-and-post performance analysis.

5.5.3 Benchmarking analysis

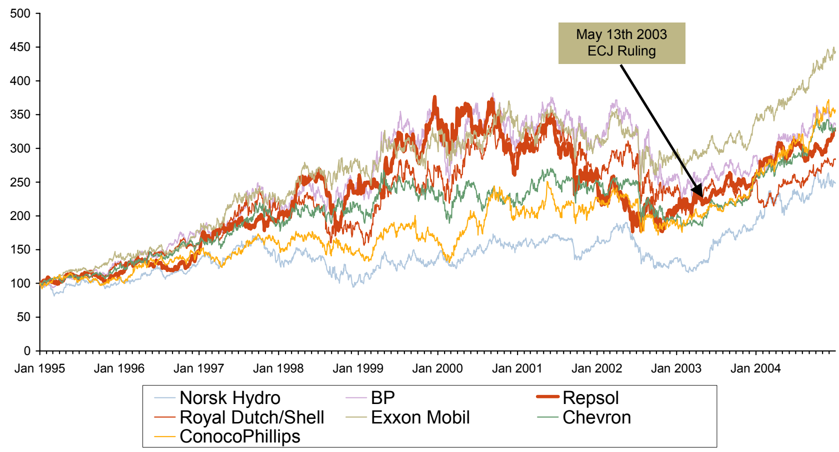
Instead of looking at historic performance, it may be possible to infer the impact of special rights by conducting a benchmarking analysis. If special rights had any detrimental impact on Repsol's performance, it might be expected that Repsol would underperform relative to the comparable companies.

The chosen comparators for Repsol include major European and US companies in the oil and gas industry: Statoil (Norway), Norsk Hydro (Norway), British Petroleum (UK), Shell Group (Global), Exxon Mobil (USA), ConocoPhillips (USA), and Chevron (USA).

Financial performance

Figure 5.13 compares the share price performance of Repsol and the comparators over the ten-year period 1995–2004. There is no evidence to conclude that Repsol has consistently underperformed; rather, it seems to have been the average performer in terms of market returns over the period.

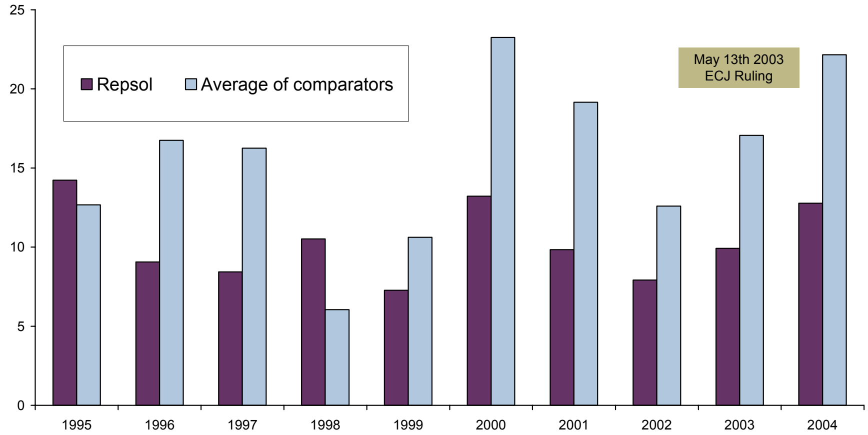
Figure 5.13 Comparison of share price performance, 1995–2004



Notes: The return index for Statoil was not available for the entire period.
Source: Datastream and Oxera calculations.

Figure 5.14 shows Repsol's ROCE in comparison with the profitability of other oil and gas companies. With the exception of two years in the first half of the ten-year period, Repsol's ROCE was lower than that of its comparators.

Figure 5.14 Comparison of ROCE (%), 1995–2004



Notes: See notes to Figure 5.3.
Source: Datastream and Oxera calculations.

Table 5.11 compares all the financial performance indicators of Repsol with the corresponding averages of the benchmarks for the period 1995 to 2004. Consistent with a negative impact of special rights, the company has been underperforming relative to its comparators along all but one dimension of financial performance (ie, return on equity).

Table 5.11 Summary of comparative financial performance, 1995–2004 averages

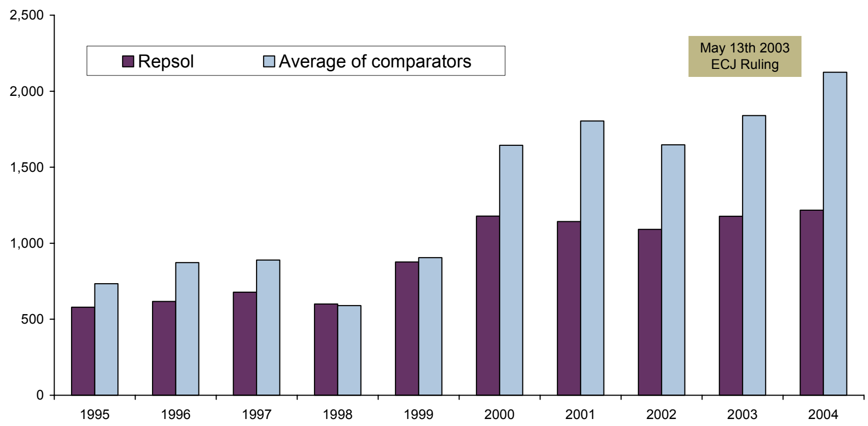
	Repsol	Average comparators
Financial performance—accounting-based		
Return on sales (%)	8.1	10.9
Return on capital employed (%)	10.3	15.7
Return on equity (post-tax) (%)	15.5	13.4
Dividend payout ratio (%)	38.8	60.7
Gearing (%)	46.2	29.6
Financial performance—market-based		
Market-to-book ratio	1.7	2.7
Dividend yield (%)	2.8	3.1
Price–earnings ratio	13.5	19.7

Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

Operating performance

Repsol has also in general underperformed in terms of operating performance. As shown in Figure 5.15, labour productivity during 1995-2004 has been below average productivity levels of the comparators.

Figure 5.15 Comparison of labour productivity (€'000), 1995–2004



Notes: See notes to Figure 5.4.
Source: Datastream and Oxera calculations.

The finding of underperformance also holds for the other indicators of operating performance, as summarised in Table 5.12. Although output has grown at a higher rate on average than for the comparators over the period 1995 to 2004, Repsol has not been performing as well as its comparators in terms of investment activity or output per employee or assets employed.

Overall, the evidence on both financial and operating performance could be interpreted as supporting the hypothesis of a negative impact of special rights on long-run company performance.

Table 5.12 Summary of comparative operating performance, 1995–2004 averages

	Repsol	Average comparators
Labour productivity (output per employee) (€'000)	915.6	1,305.0
Output/total assets (%)	90.3	109.7
Output/fixed assets (%)	157.7	183.6
Investment relative to fixed assets (%)	13.9	15.4
Investment per employee (€'000)	78.9	103.3
Output growth rate (nominal) (%)	18.7	13.4

Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

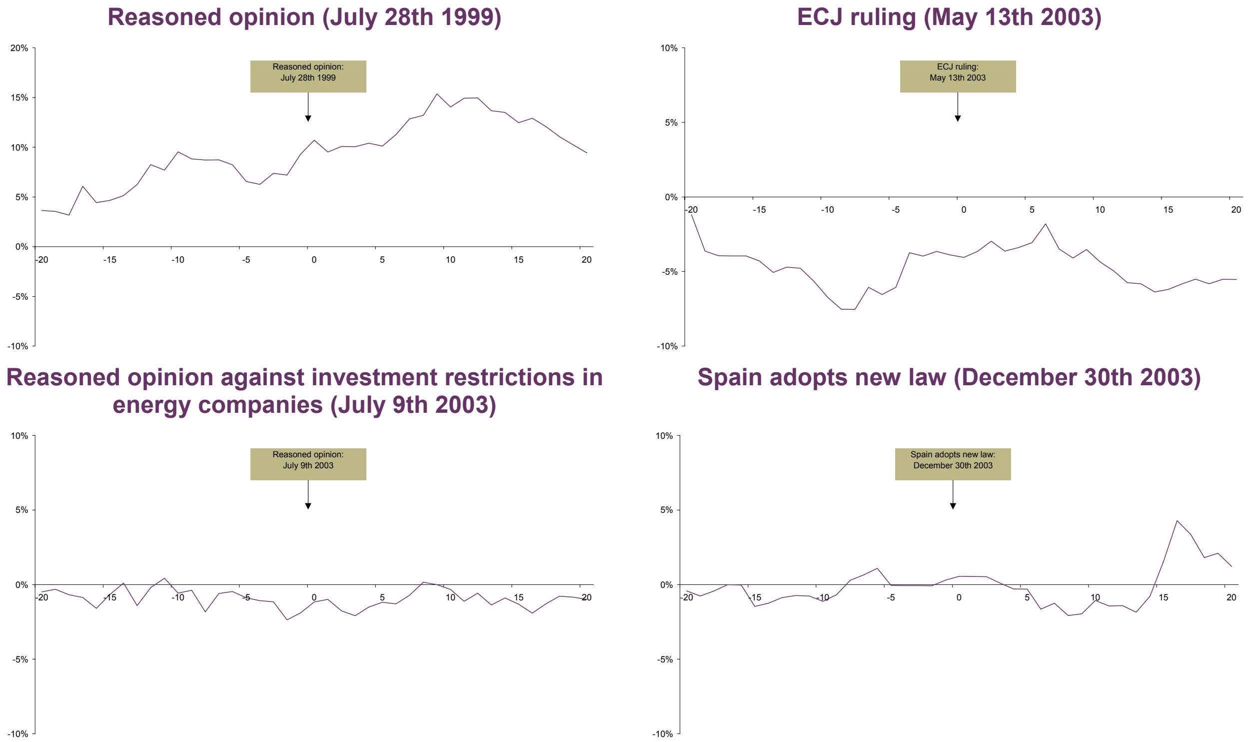
5.5.4 Event-study analysis: Share price reactions

A number of event dates were considered to assess whether announcements of changes in Spanish special rights arrangements affecting Repsol triggered share price reactions. The events include the stages of infringement proceedings against Spain for its privatisation law and a royal decree on Repsol, which specify a system of prior administrative approval, as well as the separate proceedings against provisions that limit investment in Repsol by state-owned companies. The events include the date on which Spain introduced a new law with modification to the special rights arrangements.

Figure 5.16 summarises the results of the analysis for a selection of four of the events considered. Overall, none of the events (including those omitted) was associated with ARs that would suggest significant positive reactions in share prices on the day when the

Commission infringement proceedings or the ECJ ruling were publicly announced or when Spain introduced its new law.

Figure 5.16 CARs (%) around announcement of infringement proceedings and changes in the Spanish law



Source: Datastream and Oxera calculations.

It was noted in the press that Repsol might receive acquisition offers after the special rights are fully phased out in 2006.[90] However, for the purpose of this event study analysis, it was not possible to identify any specific events (such as that in the Cimpor example) that would be suitable for assessing the share price response.

5.6 Case study 4: KPN

5.6.1 Background information

Koninklijke KPN N.V. (KPN) emerged from the 1989 privatisation of Koninklijke PTT Nederland N.V., the public telecoms and postal services operator in the Netherlands.[91] The company's core activities are telephony and data services through its fixed network in the Netherlands, mobile telecoms services in Germany, the Netherlands and Belgium, and data services in western Europe. KPN offers telecoms services to both customers and businesses.

By the end of 2004, the government continued to hold 14% of company shares. The special rights in the company give the state influence over management decision-making, but there are no special rights that constitute a direct restriction on investment. In 2003, the Commission referred the Netherlands to the ECJ for maintaining special rights.

[90] El Cronista Comercial (2004), 'Repsol YPF podría escuchar ofertas en 2006', February 25th.

[91] Postal services are now provided by TNT Post Group, which was separated from KPN in 1998.

Table 5.13 Summary of special rights

	Description
Direct investment restriction	—
Indirect investment restriction	The state has the right to appoint three members of the supervisory board The state has special rights with respect to certain strategic decisions (eg, dividend policy, issue of shares, veto decisions relating to company merger or dissolution)
Stated objective	To guarantee the provision of a universal service in the telecoms sector
Redemption date	Dec 2003: Referral to the ECJ Special rights remain in place as at December 2004

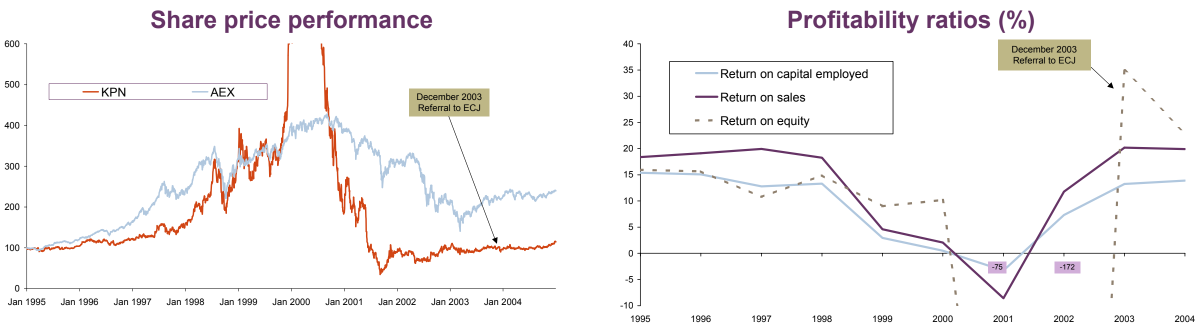
Source: Oxera based on various sources.

5.6.2 Overview of company performance over time

Figure 5.17 shows the share price performance of KPN relative to the Dutch market, as measured by the AEX. Barring the period around the telecoms and Internet bubble, KPN tends to have underperformed relative to the Dutch market.

Figure 5.17 also reports the time-series for three indicators of KPN's profitability performance, with the full set of performance indicators is shown in Appendix 2. The sharp decline in measured profitability in 2001 and 2002 is largely due to write-offs—in particular those relating to past acquisitions of mobile assets.[92] Given that the special rights were still in place by the end of the period of analysis, it is not possible to conduct before-and-after comparisons to infer the impact of those rights on company performance.

Figure 5.17 Share price and financial performance, 1995–2004



Note: See notes to Figure 5.1. The return on equity series is not fully reported due to the large negative returns in 2001 (–75%) and 2002 (–172%), as indicated in the figure.
Source: Datastream and Oxera calculations.

5.6.3 Benchmarking analysis

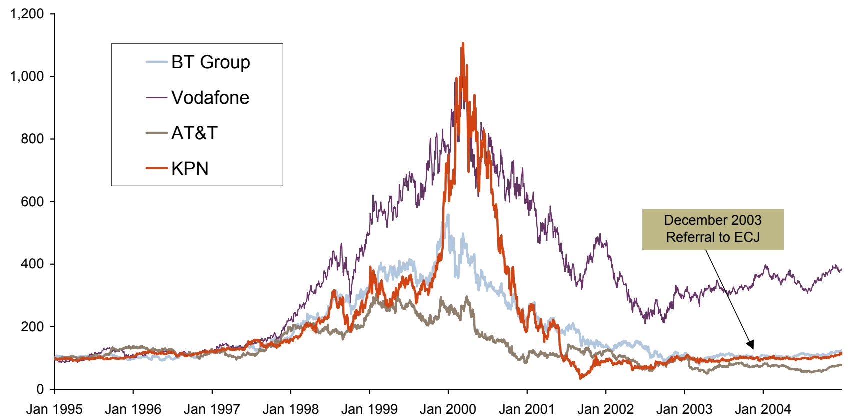
KPN is benchmarked against BT (UK), Vodafone (UK), O2 (UK), AT&T (USA) and Telstra (Australia). Other telecoms operators in Europe were not considered because they continue to have state ownership (eg, Deutsche Telekom) or were themselves subject to special rights (eg, Telecom Italia).

[92] See KPN annual report 2002.

Financial performance

In Figure 5.18, KPN seems to be the average performer in terms of stock returns measured over the period 1995–2004 as a whole. For example, apart from the sharper rise and subsequent fall around 2000 and 2001, KPN's share price performance is in line with those of BT and AT&T.

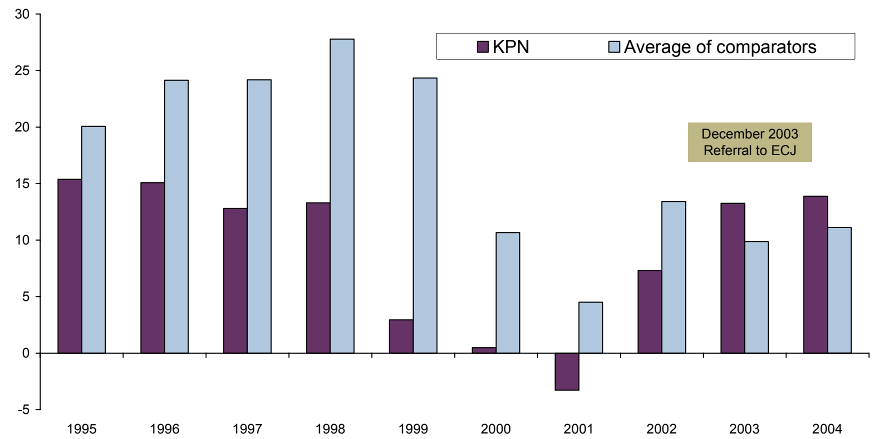
Figure 5.18 Comparison of share price performance, 1995–2004



Notes: The return index for O2 and Telstra was not available for the entire period.
Source: Datastream and Oxera calculations.

Figure 5.19 compares the profitability (ie, ROCE) of KPN with the average performance of the benchmarks. With the exception of the last two years, KPN was underperforming relative to its benchmarks in terms of profitability.

Figure 5.19 Comparison of ROCE (%), 1995–2004



Notes: See notes to Figure 5.3.
Source: Datastream and Oxera calculations.

Table 5.14 presents a summary of the performance benchmarking, using the full set of financial performance indicators averaged over the ten-year period 1995–2004. It appears that KPN has underperformed somewhat relative to its comparators on most of the dimensions of performance considered—except for dividend policy and the price–earnings ratio.

Table 5.14 Summary of comparative financial performance, 1995–2004 averages

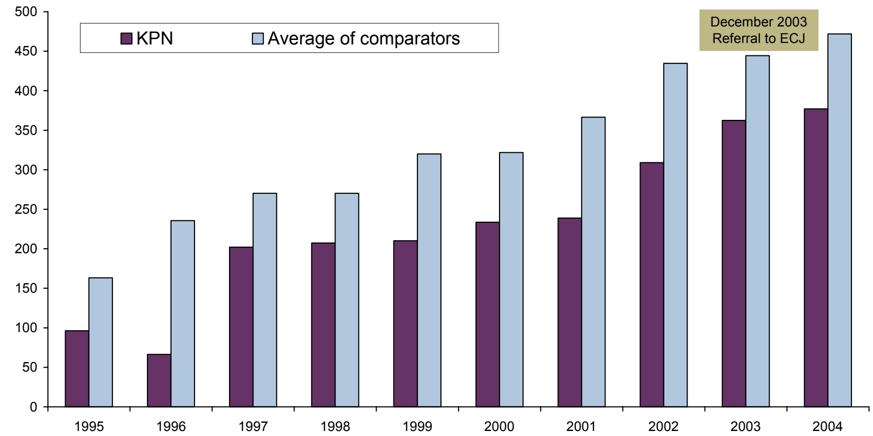
	KPN	Average comparators
Financial performance—accounting-based		
Return on sales (%)	12.6	18.7
Return on capital employed (%)	9.1	17.0
Return on equity (post-tax) (%)	12.8	13.7
Dividend payout ratio (%)	44.7	34.7
Gearing (%)	49.7	39.5
Financial performance—market-based		
Market-to-book ratio	2.7	3.6
Dividend yield (%)	2.9	2.5
Price–earnings ratio	14.5	14.4

Notes: See notes to Table 5.5. For KPN's return on equity, the period average is the median to reduce the impact of the large negative returns in 2001 and 2002 on the period average.
Source: Datastream and Oxera calculations.

Operating performance

Annual labour productivity of KPN and comparators is reported in Figure 5.20. In all years from 1995 to 2004, the company's output per employee was lower than that of other telecom operators.

Figure 5.20 Comparison of labour productivity (€'000), 1995–2004



Notes: See notes to Figure 5.4.
Source: Datastream and Oxera calculations.

Lower performance levels are observed not only for labour productivity but for the other indicators of operating performance, as shown in Table 5.15, which compares the ten-year average performance of KPN with that of the comparators. The benchmarking analysis of KPN was also made with the telecoms operators, after excluding the two mobile-phone operators, O2 and Vodafone. However, the picture remained the same.

Overall, while it is difficult to isolate the impact of special rights (eg, given the continued government stake in the company), the measured underperformance is consistent with the hypothesis of a negative impact of special rights on the company's performance, both as regards financial and operating performance.

Table 5.15 Summary of comparative operating performance, 1995–2004 averages

	KPN	Average comparators
Operating performance		
Labour productivity (output per employee) (€'000)	230.4	329.9
Output/total assets (%)	47.8	59.3
Output/fixed assets (%)	104.4	121.3
Investment relative to fixed assets (%)	21.3	22.7
Investment per employee (€'000)	46.5	51.9
Output growth rate (nominal) (%)	4.7	5.7

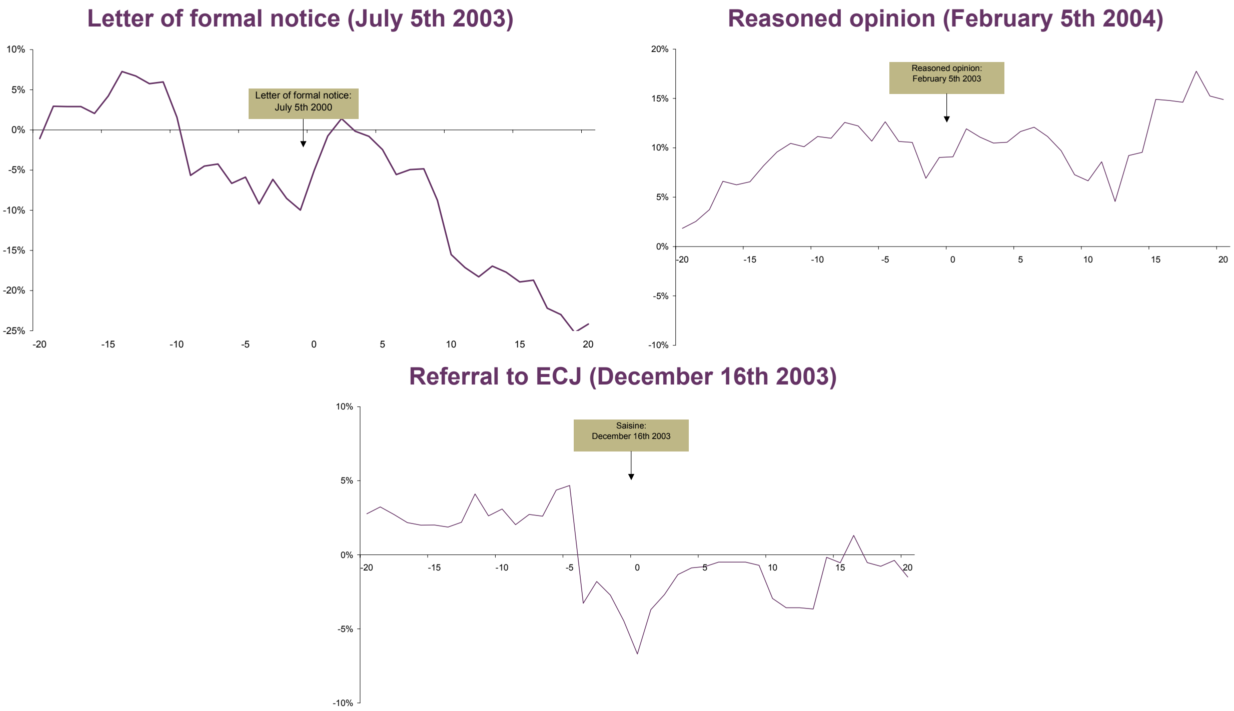
Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

5.6.4 Event-study analysis: Share price reactions

Unlike the other case study companies, KPN is affected by special rights that take the form of indirect investment restrictions only, rather than direct barriers to takeovers. Given the general absence of a measurable impact of infringement proceedings on the share prices of companies subject to direct investment restrictions, it is unlikely that the results for KPN would look any stronger.

Three events are considered: issuance of a letter of formal notice by the Commission, the reasoned opinion, and the referral of the Netherlands to the ECJ. Infringement proceedings against KPN are ongoing in 2005, and a decision by the ECJ is yet to be made. The CARs of KPN on these three event dates are summarised in Figure 5.21.

Figure 5.21 CARs (%) around announcement of infringement proceedings



Source: Datastream and Oxera calculations.

The results are not consistent with the hypothesis of positive share price reactions around the dates of infringement proceedings. For example, on the day the Commission referred the case to the ECJ, share prices actually fell by a further 2% relative to the Dutch stock market, although they rose the day after. There was a sharp appreciation in share prices around the issuance of the letter of formal notice, but this was followed by an even sharper fall in share prices over subsequent trading days. This fall in share prices was attributed to the company's dismissal that it was to expand company operations in Germany; there was also some negative press about ongoing technical problems.[93] Overall, it seems that KPN's share prices during the event windows of trading were driven by factors other than the infringement proceedings.

5.7 Case study 5: Portugal Telecom

5.7.1 Background information

The activities of Portugal Telecom cover all segments of the telecoms sector: fixed, mobile, multimedia, data and corporate solutions. The company is the domestic market leader for fixed-line and mobile-phone services. It also has a growing international presence.

The privatisation process of Portugal Telecom was initiated in 1995, and, by 1999, the process was completed, with the state selling its final stake of 13.5% of common shares. The Portuguese state retained special rights in the form of direct restrictions on investment in the company. Those special rights were abolished in 2003 and 2004, following a ruling by the ECJ on June 4th 2002 and subsequent infringement proceedings by the Commission. However, a right to veto certain management decisions is still maintained through government ownership of a majority of the company's 500 privileged A shares.

Table 5.16 Summary of special rights

	Description
Direct investment restriction	Initially, there was a cap on foreign ownership of shares Shareholdings capped at 10% (5%) in the first and second (third) stages Acquisitions of more than 10% require state authorisation
Indirect investment restriction	State has right to veto certain company decisions through ownership of privileged A shares (by Articles of Association)
Stated objective	Safeguard the financial interests of Portugal
Redemption date	October 2003: restrictions abolished other than the authorisation requirement repealed and the right to veto certain company decisions February 2004: authorisation requirement repealed Right to veto certain company decisions through privileged A shares is still maintained in Articles of Association

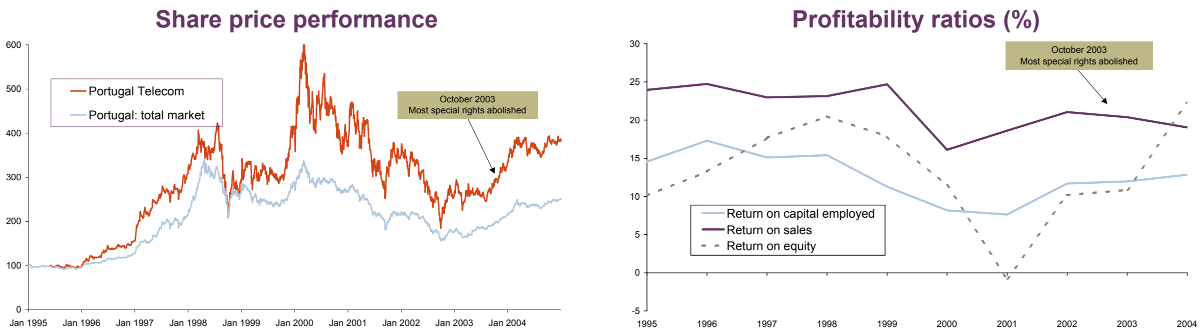
Source: Oxera based on various sources.

5.7.2 Overview of company performance over time

Figure 5.22 maps the share price performance of Portugal Telecom, showing some outperformance relative to the Portuguese total market index over the period 1995 to 2004. Historical performance in terms of accounting profitability is also reported in the figure. The history of all other performance indicators is shown in Appendix 2.

[93] AFX (2003), 'KPN's Scheephouwer says buying o2 Germany would mean 2 years of integration', July 14th. Dutch News Digest (2003), 'Dutch KPN Telephone Connections Problem in Apeldoorn, Hengelo Not To Be Solved for days', July 21st.

Figure 5.22 Share price and financial performance, 1995–2004



Notes: See notes to Figure 5.1.
Source: Datastream and Oxera calculations.

An analysis of the changes in the share price or profitability performance of Portugal Telecom over time does not give very informative results about the impact of special rights on company performance. As special rights only began to be abolished in 2003, insufficient time has lapsed to allow a before-and-after comparison of long-term performance. Moreover, the right to veto certain company decisions continued to be in place at the end of the period.

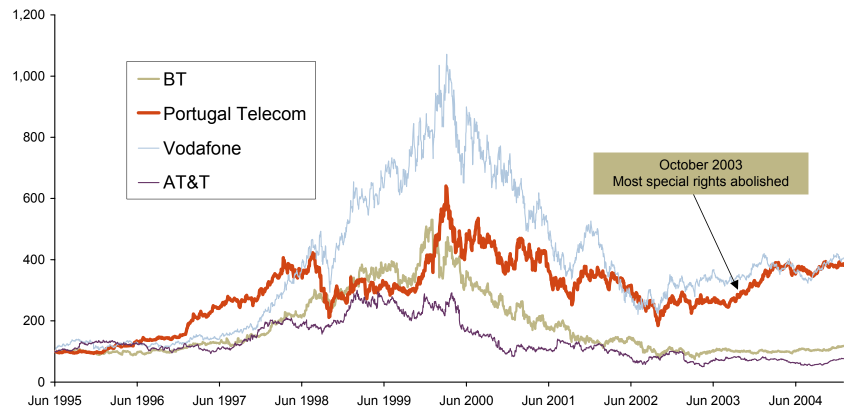
5.7.3 Benchmarking analysis

The comparators for Portugal Telecom are the same as for KPN: BT (UK), Vodafone (UK), O2 (UK), AT&T (USA), and Telstra (Australia).

Financial performance

The share price performance comparison, shown in Figure 5.23, shows that Portugal Telecom has not underperformed against all of the benchmarks over the period. Rather, share price performance has been better than that of UK operator, BT, and US company, AT&T.

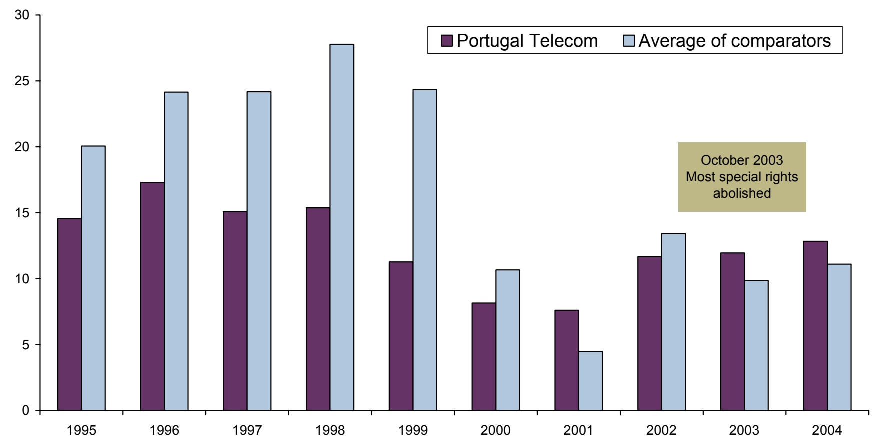
Figure 5.23 Comparison of share price performance, 1995–2004



Notes: The return index for O2 and Telstra was not available for the entire period.
Source: Datastream and Oxera calculations.

Figure 5.24 shows a comparison of the profitability of Portugal Telecom against its benchmarks. In terms of ROCE, Portugal Telecom was underperforming in the first half of the ten-year period examined; since then, the comparative performance has improved, with Portugal Telecom's ROCE somewhat exceeding that of its comparators in 2003 and 2004.

Figure 5.24 Comparison of ROCE (%), 1995–2004



Notes: See notes to Figure 5.3.
Source: Datastream and Oxera calculations.

Table 5.17 summarises the financial performance of Portugal Telecom and its benchmarks, by considering all chosen indicators averaged over the period 1995–2002. From the table, Portugal Telecom seems to be underperforming along many important dimensions of financial performance (eg, returns on capital and equity), but not for all indicators (eg, the price–earning ratio). This makes it difficult to ascertain a negative impact of special rights on the company's financial performance.

Table 5.17 Summary of comparative financial performance, 1995–2002 averages

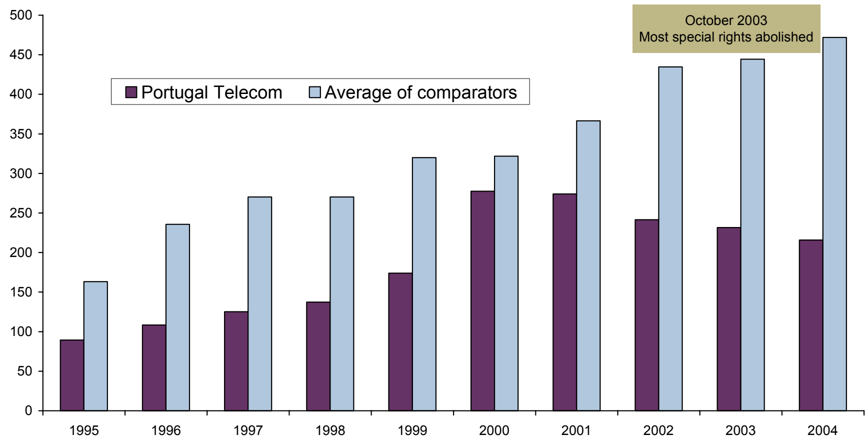
	Portugal Telecom	Average comparators
Financial performance—accounting-based		
Return on sales (%)	21.9	20.8
Return on capital employed (%)	12.6	18.6
Return on equity (post-tax) (%)	12.5	15.2
Dividend payout ratio (%)	32.7	43.4
Gearing (%)	50.3	38.2
Financial performance—market-based		
Market-to-book ratio	2.8	4.0
Dividend yield (%)	2.1	2.0
Price–earnings ratio	21.3	16.0

Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

Operating performance

In terms of labour productivity, as shown in Figure 5.25, the Portugal Telecom seems to have been consistently underperforming its comparators.

Figure 5.25 Comparison of labour productivity, 1995–2004



Notes: See notes to Figure 5.4.
Source: Datastream and Oxera calculations.

The underperformance is also evident from an analysis of the other indicators of operating performance, summarised in Table 5.18. Although output has grown more rapidly, Portugal Telecom's operating performance has been worse on average than that of the comparators. The conclusion does not change if the company's operating performance is benchmarked against the comparators excluding the two mobile operators.

Overall, these findings are consistent with a finding of a negative impact of special rights. However, it is difficult to arrive at a strong conclusion, particularly given that the company only began to be privatised in 1995 and continued to have state ownership during the earlier years of the time period considered.

Table 5.18 Summary of comparative operating performance, 1995-2002 averages

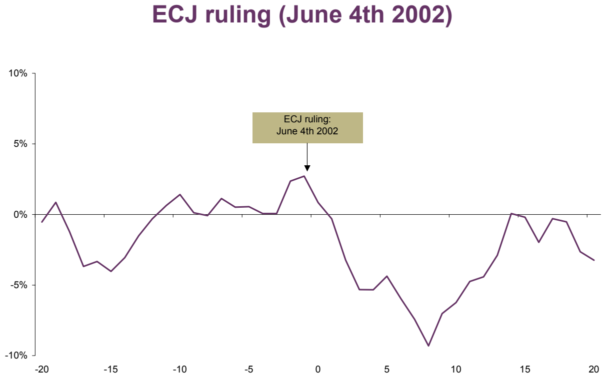
	Portugal Telecom	Average comparators
Labour productivity (output per employee) (€'000)	178.5	297.8
Output/total assets (%)	42.8	59.6
Output/fixed assets (%)	87.4	118.1
Investment relative to fixed assets (%)	19.7	24.2
Investment per employee (€'000)	39.9	55.0
Output growth rate (nominal) (%)	18.4	6.8

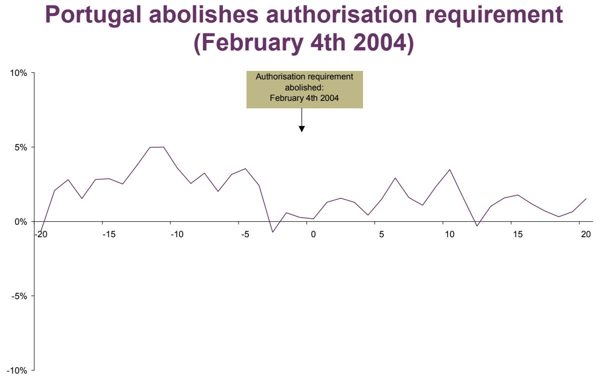
Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

5.7.4 Event-study analysis: Share price reactions

A number of dates were used to test for an impact of events that relaxed investment restrictions in Portugal Telecom, or could have triggered an expectation in the market that the restrictions would be relaxed. Figure 5.26 shows share price reactions around two of the event dates considered: the date of the landmark ruling by the ECJ against Portugal; and the date when Portugal abolished the requirement for prior approval of large acquisitions.

Figure 5.26 CARs (%) around ECJ ruling and abolition of investment restriction





Source: Datastream and Oxera calculations.

Share price reactions are not consistent with the hypothesis that the events changed the market's valuation of Portugal Telecom. For example, on the day the ECJ made its judgment, ARs were negative, with a further fall in share prices in the trading days immediately following the event. According to press reports, shares in Portugal Telecom slipped at that time amid uncertainties about elections in Brazil, where the company had a stake in the country's largest mobile-phone company.[94] This might explain the absence of a return pattern consistent with a golden share effect. As argued above for the other Portuguese case study company, it may not be surprising that there was no positive share price response to the court ruling. Commission investigations started as early as 1994, with a referral to the ECJ in 1997. As the court's decision had been expected in the market, any effect would already have been capitalised in share prices.

Further infringement proceedings were initiated by the Commission against Portugal for non-compliance with the court ruling (ie, letter of formal notice and reasoned opinion in May 2003 and January 2004, respectively). No positive share price responses were observed, and the results are omitted.

In February 2004, Portugal abolished the authorisation requirement for stakeholdings of more than 10%, after having repealed most other investment restrictions in October 2003. Figure 5.26 shows that there was no share price response on the day the authorisation requirement was abolished, and no clear pattern of positive returns following that date. There was also no share price response on the October abolition date; the results are omitted. As before, if the market expected the abolition of special rights, the lack of share price response is not surprising. It was not possible to identify the date when the market first learned about the change in special rights arrangements in Portuguese companies and test for share price responses around that date.

5.8 Case study 6: BAA

5.8.1 Background information

BAA owns and operates seven airports in the UK, including London's Heathrow, Gatwick and Stansted Airports. It manages both the terminals and the airfields, overseeing operations such as security, mass transit, engineering, and customer services, including airport shops, restaurants, car rental offices, and car parking. In addition, BAA operates the Heathrow

[94] Reuters News (2002), 'Portugal Telecom hits 9-month low on Brazil worries', June 7th.

express rail service and, through BAA Lynton, develops real estate around its airports. Outside the UK, the company has management or retail contracts and stakes in airports in Australia, Italy and the USA.

BAA was privatised in 1987, with the government retaining special rights that effectively restricted shareholdings above 15% and gave control over major management decisions. In 2003, the ECJ passed a ruling against the UK government for retaining special rights in the company.

Table 5.19 Summary of special rights

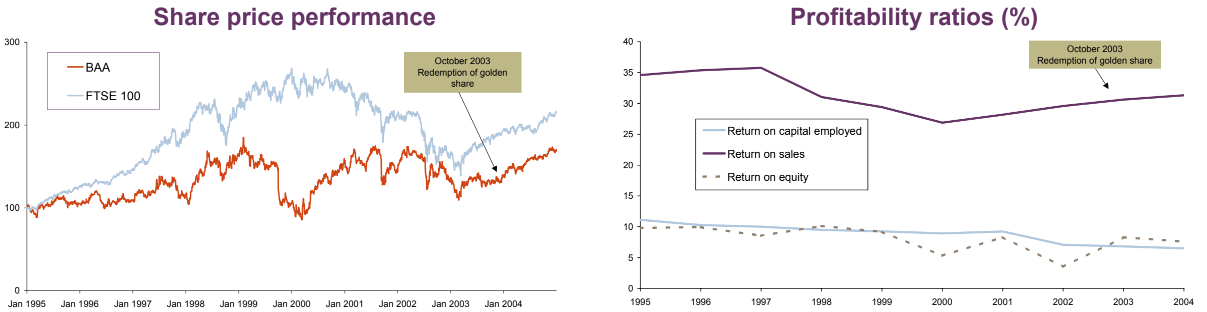
	Description
Direct investment restriction	Restriction on shareholdings above 15%
Indirect investment restriction	State approval required for major management decisions
Stated objective	National interest in future operation of BAA
Redemption date	October 2003: Redemption of golden share
	July 2004: Articles of Association modified to abolish 15% ownership ceiling

Source: Oxera based on various sources.

5.8.2 Overview of company performance over time

Figure 5.27 summarises the share price movements of BAA compared with the UK market. Over the period, the company has underperformed the UK market, as measured by the FTSE 100. The figure also shows three measures of company profitability during 1995–2004, with the complete set of performance indicators reported in Appendix 2. Profitability levels have remained stable over the years, and it is not possible to infer what historical performance would have been in the absence of the special rights. As these were abolished in 2003 and 2004, it is too early to measure whether the abolition will generate performance improvements in the longer term. Also, BAA is subject to regulation, which limits significant improvements in profitability.

Figure 5.27 Share price and financial performance, 1995–2004



Notes: See notes to Figure 5.1.
Source: Datastream and Oxera calculations.

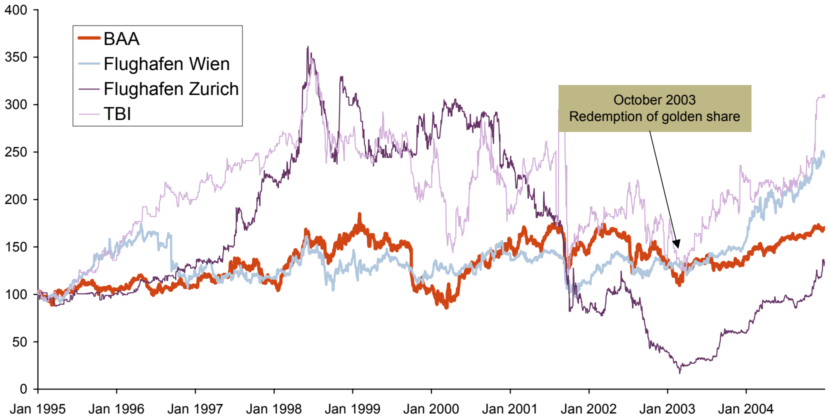
5.8.3 Benchmarking analysis

BAA is benchmarked against other airport operators: Flughafen Wien (Austria), Flughafen Zurich (Switzerland), TBI (International), Fraport (Germany), and Aeroporti di Roma (Italy). If the presence of special rights had any detrimental impact on BAA's performance, BAA might be expected to underperform relative to these comparators.

Financial performance

Figure 5.28 charts the share price movements of BAA and its comparators. It shows that BAA's returns fluctuated less than those of the benchmarks for which share price data was available for the period 1995–2004. Over the ten-year period, the company generated total returns higher than Zurich but lower than Vienna Airport, although the latter only started outperforming in mid-2003.

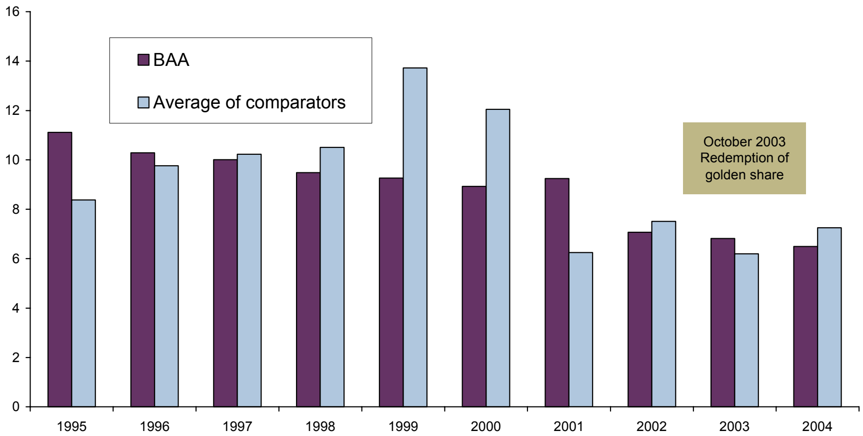
Figure 5.28 Comparison of share price performance, 1995–2004



Notes: The return index for Fraport and Aeroporti di Roma was not available for the entire period.
Source: Datastream and Oxera calculations.

Figure 5.29 compares BAA's profitability levels. In terms of ROCE, there is no evidence of consistent underperformance, with the ratio being in line with the comparator average in most years.

Figure 5.29 Comparison of ROCE (%), 1995–2004



Notes: See notes to Figure 5.3.
Source: Datastream and Oxera calculations.

A summary of all financial indicators is reported in Table 5.15, showing averages for the period from 1995 to 2002 (the year before the golden share was redeemed). For most indicators, BAA's performance was in line with, or better than, that of comparators (eg, returns on equity, price–earnings ratio). Thus, the empirical evidence does not support the view of a negative impact on the company's financial performance.

Table 5.20 Summary of comparative financial performance, 1995–2002 averages

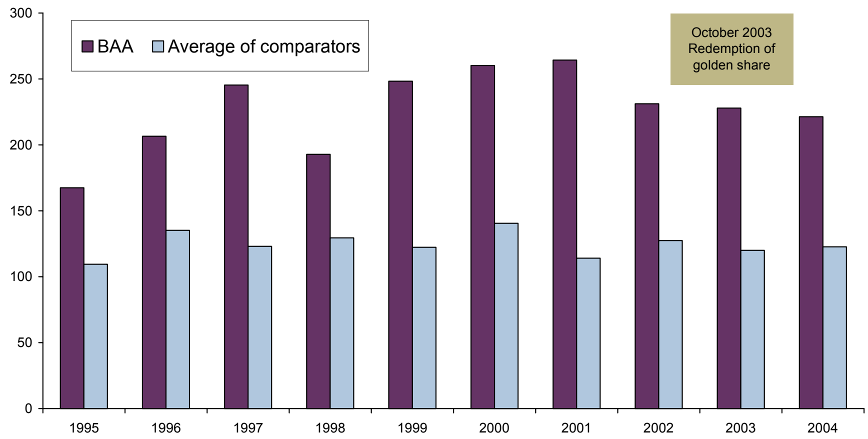
	BAA	Average comparators
Financial performance—accounting-based		
Return on sales (%)	31.3	16.3
Return on capital employed (%)	9.4	9.8
Return on equity (post-tax) (%)	8.1	8.2
Dividend payout ratio (%)	54.1	38.7
Gearing (%)	30.4	39.6
Financial performance—market-based		
Market-to-book ratio	1.5	1.9
Dividend yield (%)	2.7	2.1
Price–earnings ratio	20.8	19.8

Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

Operating performance

In terms of labour productivity, as shown in Figure 5.30, BAA has been consistently outperforming the comparators in all years, even before the special rights began to be abolished in 2003.

Figure 5.30 Comparison of labour productivity (€'000), 1995–2004



Notes: See notes to Figure 5.4.
Source: Datastream and Oxera calculations.

Table 5.21 presents the summary results for the other indicators of operating performance, averaged over the period 1995 to 2002. BAA is more capital-intensive than the airport operators that have been chosen as comparators. This is consistent with the observed higher labour productivity (and the higher return on sales reported in Table 5.20). Overall, it is not possible to conclude that special rights had a negative impact on BAA's performance, either in relation to operating performance or, as shown above, in relation to financial performance.

The lack of evidence may be due to the choice of comparators. BAA is fully privatised, but the comparators still tend to have significant state shareholdings. To the extent that state ownership may have an adverse effect on the performance of the comparator airport operators, this would bias the results of the benchmarking analysis against finding a negative effect of special rights on BAA's performance. Given the absence of more suitable comparators, it is not possible to draw any strong conclusions about the impact of the special rights that were held by the UK government in BAA.

Table 5.21 Summary of comparative operating performance, 1995–2002 averages

	BAA	Average comparators
Labour productivity (output per employee) (€'000)	227.0	125.2
Output/total assets (%)	26.5	41.1
Output/fixed assets (%)	30.1	61.1
Investment relative to fixed assets (%)	8.8	10.9
Investment per employee (€'000)	66.3	16.1
Output growth rate (nominal) (%)	7.4	6.0

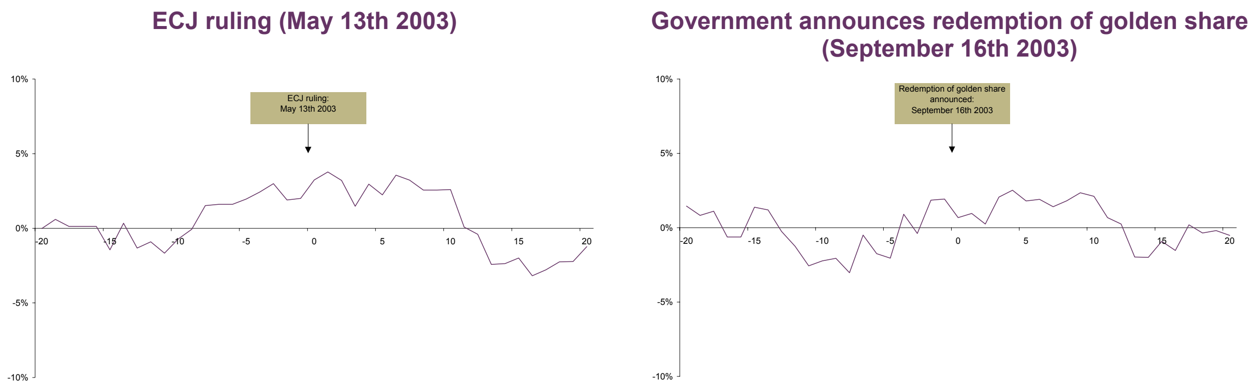
Notes: See notes to Table 5.5.
Source: Datastream and Oxera calculations.

5.8.4 Event-study analysis: Share price reactions

Several events were considered to assess BAA's share price reactions, including all announcements of infringement proceedings against the UK, the UK government's announcement of its redemption of the golden share in BAA, and the actual redemption date.

Figure 5.31 shows CARs around the date at which the ECJ ruled against the golden share arrangements in BAA and the date when the UK government announced that it would redeem the golden share. The events around early-stage infringement proceedings and the actual redemption date[95] did not show any ARs.

Figure 5.31 CARs (%) around ECJ judgment and redemption of golden share



Source: Datastream and Oxera calculations.

The pattern of returns is similar on both events, with cumulative returns being positive around the event dates, which would be consistent with the view that the market reacted positively in anticipation of the redemption of the golden share. However, share prices then fell such that 20 days after the events, CARs were close to zero. Overall, and considering the evidence obtained in the other case studies, it therefore seems difficult to attribute the share price pattern to expected changes in golden share arrangements.

[95] The golden share was redeemed in October 2003; the 15% ceiling for stakeholdings continued until July 2004.

Both events were commented on in the press, with suggestions that BAA may become a possible takeover target as a result of the golden share redemption:

> BAA, the former British Airports Authority …could be open to a hostile takeover bid this week if the European Court of Justice decides to scrap 'golden shares'.[96]

> According to several senior bankers specialising in transport and infrastructure deals, at least two banks are doing the rounds of private-equity firms, trying to rope together a consortium of investors to make a bid for BAA. BAA has been on banks' hit-lists in the past, but this time is different. ... The ownership rules have in the past provided BAA with a deterrent to a hostile bid, but their removal—which should take place at next year's annual general meeting—will put the company in play.[97]

Thus, although no share price responses could be identified, these statements confirm that the golden shares in BAA were perceived by the market and potential investors as binding barriers to direct investment.

5.9 Summary

The aim of the case study analysis was to examine the impact of special rights on the economic performance for a small sample of companies affected by recent infringement proceedings.

In order to draw inferences about the long-term impact of special rights, company performance was evaluated over a ten-year period starting in 1995 and using a set of different indicators of both financial and operating performance. In principle, the impact of special rights could be established if it were possible to observe company performance before and after the abolition of the special rights. However, in all cases considered, special rights were either still in place or only recently abolished. Hence, it was not yet possible to assess whether the abolition led to a notable and long-term improvement in company performance.

Instead of evaluating the impact using before-and-after comparisons, the case study analysis therefore focused on benchmarking the companies' performance against that of comparable companies not subject to special rights. Other things being equal, any observable difference between the case study firm and the comparators could be attributed to the existence of special rights.

The results of the benchmarking analysis were broadly consistent with a negative impact of special rights in four of the six case study companies considered. These companies tended to underperform relative to comparable companies not subject to special rights over the period since 1995, at least in terms of their operating performance (eg, labour productivity). The results of the financial performance comparison were more mixed—underperformance was observed for many but not all dimensions of financial performance (eg, market valuation).

Two of the six case study companies outperformed their comparators in terms of both financial and operating performance (Cimpor and BAA). This contradictory evidence is not consistent with theory (ie, the predicted impact of special rights is either negative, or at most negligible, but there is generally no basis for expecting a positive impact on company performance).

[96] Independent Newspapers (UK) Limited (2003), 'BAA under threat if court rules against golden share', May 12th.

[97] *The Sunday Times* (2003), 'Banks stir up private-equity bids for BAA', September 21st.

Overall, although there is some indication of a negative impact of special rights, the evidence obtained from the benchmarking analysis is disparate and does not allow any strong conclusions to be drawn. However, the results do not imply that special rights have no negative impact on companies' long-term performance. There are methodological shortcomings of the benchmarking analysis that may have confounded any measurable performance impact of special rights. In particular, given the nature of the industries in which the case study firms operate, the choice of comparators was restricted to companies operating in other countries, subject to a different regulatory regime or indeed still partly owned by the state. More generally, there are many company-specific factors that influence relative performance and make it difficult to isolate the impact of special rights.

Further research would be required to ascertain the negative impact of special rights on the long-term performance of companies, since the inferences that can be drawn from case study analysis are necessarily limited. Stronger results might be obtained if the impact of special rights were assessed using a larger sample of firms (and comparators) and econometric techniques that allow control for other factors affecting company performance. Notably, the study of Boardman and Laurin (2000) reviewed in section 3.1 adopts such techniques and, for a sample of 99 international companies, reports a statistically significant negative impact of golden shares on long-term share price performance.

Also, special rights in the case study companies as well as other EU privatised companies have only recently been abolished or indeed are still in place. It was therefore too early to assess whether the abolition had a notable impact on companies' performance, but research could be carried out to provide a full assessment of the long-term impact.

In addition to the historical performance assessment and benchmarking, the case study analysis examined whether there were positive share price reactions around the announcement dates of changes in special rights arrangements of the case companies. This approach critically relies on the identification of dates when the market learned, for the first time, that there may be a change in the arrangements. The event dates available, however, generally related to official announcements of infringement proceedings, ECJ rulings or actual abolition, which may have long been anticipated by the market. This may explain the general lack of share price responses. Overall, no evidence was available to conclude that the market reacted positively to the official measures taken to abolish special rights.

However, one event did produce informative results. There was a significant positive share price reaction to a takeover bid for Portuguese cement company, Cimpor. Takeover premiums are commonly observed, but what is important in this context is that the bid was made in expectation of (and conditional upon) the government abolishing its special rights in the company. At a minimum, this allows conclusions to be drawn that special rights of the type affecting Cimpor (ie, direct investment restriction) impose a binding constraint and hence negative impact on direct investment. Moreover, the negative impact extends to existing shareholders who, in the presence of special rights, cannot realise premium returns on their shareholdings. The positive share price reaction is also consistent with a negative impact of special rights on company performance, since it is likely to reflect the market's valuation of the financial and operating gains that could be realised in the event of takeover, or, conversely, the costs or forgone opportunities if the takeover were prevented.

It was not possible to identify similar events for the other case study companies considered in order to corroborate these conclusions. However, the event study analysis presented in section 6, which examines share price reactions around the golden share abolition in the UK water and electricity sectors in 1995, confirms these conclusions for a larger sample of firms.

6 Event study analysis: The impact of the redemption of golden shares in the UK electricity and water sector

In 1995, the UK government abolished the golden shares it held in the privatised regional electricity companies (RECs) and water and sewerage companies (WASCs) in England and Wales. This section presents evidence on the impact of the golden share abolition in these sectors. The main advantage of this event study is that it allows an impact assessment across entire sectors affected by golden shares, rather than select cases of companies (ie, the golden share redemption affected all 12 RECs and ten WASCs operating in England and Wales).

Section 6.1 provides the background information, section 6.2 explains the research questions and methodology, sections 6.3 and 6.4 present the empirical results, and section 6.5 concludes.

6.1 Background information

During the 1980s, the Conservative government, under Margaret Thatcher, embarked on an ambitious programme of privatisation. Following privatisations of British Telecom in 1984, British Gas in 1986, and BAA in 1987, this culminated in the privatisation of the electricity and water sectors of England and Wales.[98]

– **Electricity**—in March 1990 the existing electricity industry was split into generators, a transmission company and 12 RECs providing distribution and supply. In December that year, the RECs were floated. The UK government retained a golden share in each of the RECs,[99] with a five-year lifespan. This golden share gave the government a veto on changes to the companies' articles of association, which contained restrictions preventing anyone from having an interest in 15% or more of the voting share capital. The golden shares were redeemed on March 31st 1995.

– **Water**—the water industry in England and Wales is divided into regional monopolies, with a WASC operating within each region. The ten WASCs undertake two major activities: the supply of water and the treatment and disposal of sewage.[100] In February 1985, the government first announced that it was to examine the possibility of a 'measure of privatisation' in the water industry. However, progress was halting and the eventual sale of the industry took place in December 1989. At the time of privatisation, the government kept a single golden share in each of the WASCs. As with the RECs, the golden share had a five-year lifespan. The golden share effectively meant that no individual or single company could control more than 15% of voting shareholdings (unless 75% of shareholders voted otherwise) and so prevented hostile takeovers. On January 1st 1995, the government sold its golden shares in the WASCs, with the exception of that in Welsh Water, which had its special share powers removed in April 1996 following a shareholder vote.

[98] For further information, see, for example, Oxera (1998), *Guide to the Economic Regulation of the Water Industry*, Oxera (1999), *Guide to the Economic Regulation of the Electricity Industry*, and Public Services International Research Unit (2001), 'UK Water Privatisation—A Briefing'.

[99] The government also retained (and in some cases continues to retain) golden shares in other parts of the electricity industry.

[100] There are also water-only companies (WOCs) that were privatised at the same time as the WASCs. The WOCs are much smaller and provide water services, but not sewerage services. Unlike the WASCs, the government retained no golden share, and the WOCs were subject to immediate takeovers.

6.2 Empirical research questions and methodology

Using the UK government's redemption of the golden shares in the RECs and WASCs as the relevant event, the analysis addresses two main research questions.

– What was the impact of the golden share redemption on takeover activity in the electricity and water sectors?

  Given that takeovers were ruled out prior to the redemption, any immediate surges in takeover activity can be interpreted as evidence that golden shares of the type held by the UK government present a binding restriction on direct investment.

– How did the market react to the golden share redemption? Is there evidence of a positive share price reaction to the abolition of restrictions on takeovers in the sectors, and, if so, how large was the effect?

  A positive and significant share price reaction can be interpreted as evidence that special rights that restrict changes in corporate control have a negative impact on market performance. The size of the share price reaction provides an estimate of the market's assessment of the value (or cost) of special rights.

The first research question can be answered by inspecting the timing and volume of takeovers in the sectors following golden share redemption. Oxera consulted several published documents, including regulatory reports and press releases, to provide a description of takeover activity. This is summarised in section 6.3.

To address the second question, Oxera followed the event study approach described in section 5.1. Returns data for the 12 RECs and ten WASCs was downloaded from Financial Thomson's Datastream for the time period 1990–98. Data was also downloaded for the FTSE All-share index to adjust daily share price fluctuations of the companies for market-wide movements and calculate abnormal returns (ARs) earned by the companies. The ARs were also cumulated to calculate the total cumulative abnormal returns (CARs) earned by the companies over the relevant event period. The hypothesis to be tested is that the removal of takeover restrictions in the sectors triggered ARs around the event, with positive CARs earned over the relevant event period.

6.3 Impact on takeover activity

6.3.1 Electricity

Table 6.1 reports the company names of the 12 privatised RECs that were subject to the golden share preventing takeovers until March 31st 1995. Soon after the golden share redemption, the RECs became prime takeover targets. Foreign investors played an important role, with electricity companies from the USA being the most prominent bidders.

Four companies were acquired within seven months of the redemption, with the first takeover announced in July 1995 and completed in September 1995, when US company, Southern Company, took over SWEB. Within two years of redemption, all but one REC (Southern Electric) had been merged or acquired, in most cases by US companies. Southern Electric had been subject to a takeover bid in 1995, but the bid was blocked by the government due to competition concerns. The company merged with Scottish Hydro-Electric, a Scottish generator and supply business, at the end of 1998.

The surge in takeover activity was expected before March 31st 1995, and the first bid was made in December 1994, when Trafalgar House announced its plans to acquire Northern Electric in expectation of the expiry of the golden share a few months later.

Analyst reports and press releases provided comments such as:

> The expiration of a government-held 'golden share', which was designed to give the RECs time to establish themselves before being thrown to the wolves of market forces, is expected to be a catalyst for a major restructuring of the industry.[101]

> Having easily survived industry regulator's Offer's distribution price review, analysts expect to see stakebuilding in the RECs over the next months ahead of the expiry of the government's special 'golden shares' at the end of next March.[102]

Table 6.1 Takeovers and mergers of RECs following golden share redemption

Company name	Takeover announced	Takeover completed	Acquirer
SWEB	17/07/1995	18/09/1995	Southern Company (USA)
Manweb	24/07/1995	12/10/1995	ScottishPower
Eastern	31/07/1995	18/09/1995	Hanson
NORWEB	08/09/1995	08/11/1995	North West Water
SEEBOARD	06/11/1995	11/01/1996	CSW (USA)
SWALEC	04/12/1995	29/01/1996	Welsh Water Group
Midlands[1]	07/05/1996	07/06/1996	GPU/Cinergy (USA)
Northern[2]	28/10/1996	24/12/1996	CalEnergy/Kiewit (USA)
East Midlands	13/11/1996	13/01/1997	Dominion Resources (USA)
London	18/12/1996	07/02/1997	Entergy (USA)
Yorkshire	24/02/1997	01/04/1997	AEP/Colorado (USA)
Southern Electric[3]	01/09/1998	14/12/1998	Merger with Scottish Hydro-Electric

Notes: [1] Powergen made a bid for Midlands Electricity on September 18th 1995, but this was blocked by the government on April 24th 1996. [2] On December 14th 1994 Trafalgar House launched a bid for Northern Electric ahead of the expected date of golden share redemption on March 31st 1995; its bid lapsed on March 10th 1995. [3] National Power bid for Southern Electric on October 2nd 1995, but this was blocked by the government on April 24th 1996
Source: Oxera based on various sources.

6.3.2 Water and sewerage

Since the removal of the government's golden shares in the WASCs on January 1st 1995, the water sector has also seen a considerable amount of horizontal integration and intra-industry consolidation, with the first takeover bid occurring just two months after the golden share expiry—Suez-Lyonnaise announced a bid for Northumbrian Water in March 1995. Further takeovers of WASCs have taken place since. Again, foreign acquirers played an important role in the process.

Although considerable, the surge in takeover activity in the water sector following golden share expiry was not as pronounced as that in electricity. Despite the similarities in the sectors and the similar timing of the redemption of golden shares, the weaker takeover activity in the water sector was predicted by analysts at the time:

> This month's hostile bid by Trafalgar for Northern Electric, one of the regional electricity companies, has sent speculative ripples into the water sector. … Despite all the takeover talk, some observers are cautious. … Unlike the cash-rich RECs, virtually all of the water companies have negative cash flows. Even those, such as Wessex, which

[101] 'Mergers, takeovers to ignite Britain's electricity sector', *Wall Street Journal Europe*, September 8th 1994.
[102] 'Takeover talk sends Northern Elec to yr high', Reuters press release of December 9th 1994.

have more cash than borrowings, will have to take on debt to finance the investment needed to improve water and waste standards. … New legislation poses an additional risk. … Regulatory regimes also differ. Mr Ian Byatt, the water regulator, has kept the industry on a much tighter financial leash than Professor Stephen Littlechild, his opposite number in electricity.

Some analysts see water companies as less attractive than regional electricity companies to bidders. RECs are seen as having stronger cash generation and lighter, more quantifiable capital expenditure whereas water companies are overshadowed by risks such as the chance they may attract more stringent EU regulation on water quality, analysts said. The size of most regional electricity companies is more attractive also, analysts said. 'The RECs are good sizes for bidders but there are three very large water companies in the sector which would demand a particular sort of bidder', said one analysis.[103]

Table 6.2 Takeovers and mergers of WASCs following golden share redemption

Company name	Takeover announced	Takeover completed	Acquirer
Northumbrian Water	06/03/1995	08/03/1996	Lyonnaise-des-Eaux (France)
Southern Water	26/05/1996	07/08/1996	Scottish Power
Wessex Water	24/07/1998	02/10/1998	Enron Water (USA)
Thames Water	25/09/2000	09/11/2000	RWE (Germany)
Welsh Water[1]			n/a (see notes)
North West Water[2]			n/a
South West Water[3]			n/a
Anglian Water[4]			n/a
Severn Trent Water			n/a
Yorkshire Water[5]			n/a

Note: [1] Renamed Hyder after takeover of SWALEC. Hyder was taken over by Western Power Distribution in 2001. [2] Now called United Utilities. Took over NORWEB. [3] Now called Pennon. [4] Now called AWG plc. [5] Now called Kelda.
Source: Oxera based on various sources.

6.4 Impact on share prices

Having established the significant impact of the golden share redemption on takeover activity—in particular in the electricity sector but also in water—this section focuses on the impact on share prices and value. How did the market react to the removal of takeover restrictions in the electricity sector (section 6.4.1), and what happened in water (section 6.4.2)?

6.4.1 Electricity

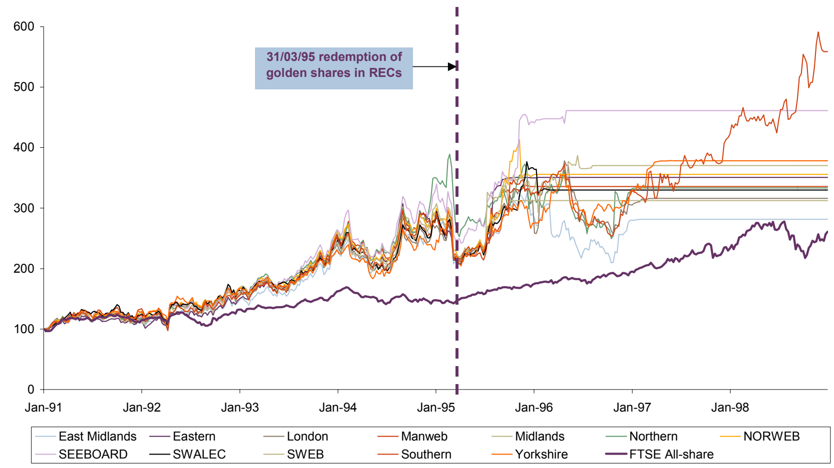
Figure 6.1 shows the total return performance of the 12 RECs since privatisation. All companies significantly outperformed the FTSE All-share index during the period. Indeed, the outperformance prompted many to consider that the RECs had been floated too cheaply and were given too easy a ride by the regulator.[104]

[103] 'UK water sector plays catch-up with electrics', Reuters, February 15th 1995.

[104] See 'Dividend rises expected to shock politicians', *Financial Times,* November 9th 1994.

Figure 6.1 also shows the surge in takeover activity discussed above, reflected in the discontinuation of all companies' return series soon after the golden share redemption (except for Southern Electric).

Figure 6.1 Post-privatisation share price performance of RECs, 1991–98 (total return index)

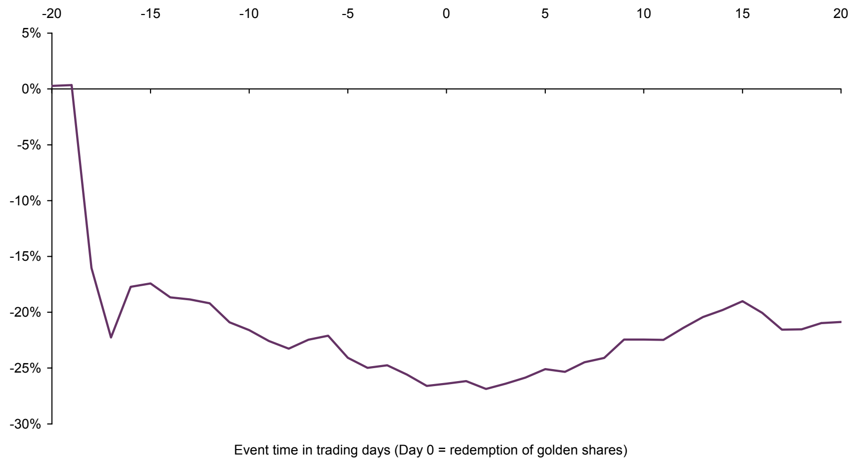


Source: Datastream.

The focus of the event study analysis is not on the long-term trend in REC performance, but on price movements around the period in which the UK government's golden share in the RECs expired.

Figure 6.2 reports the average CARs of the 12 RECs 20 days before and after the golden share expiry (day 0 in the chart represents March 31st 1995). There is no evidence of an abnormal share price reaction on the event date, which suggests that the actual redemption had no effect on the market. The only abnormal share price reaction occurred 18 trading days before the event. On March 7th 1995, share prices fell sharply when Stephen Littlechild, Director General of Electricity Supply, announced that he was considering tighter price controls for the sector, triggering an average AR of –16% in the sector.[105]

Figure 6.2 Average CARs (%) of UK RECs around golden share redemption (March 31st 1995)



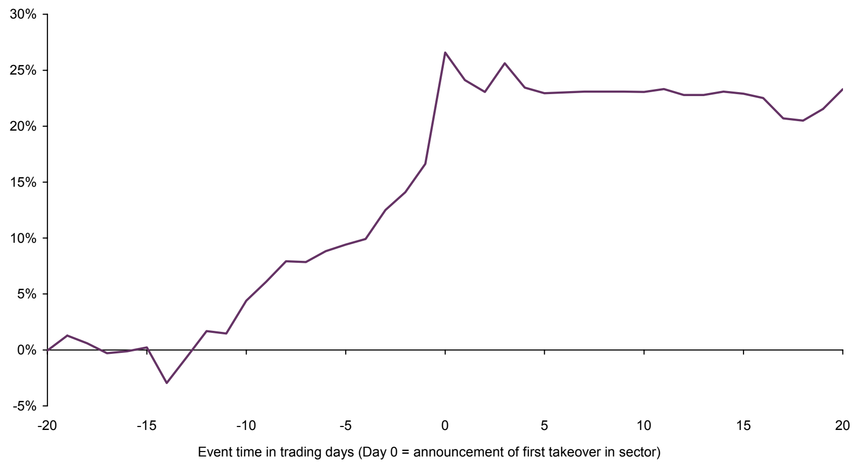
Source: Datastream and Oxera calculations.

[105] Subsequently, on March 24th 1995, Professor Littlechild announced that he had decided to proceed with the advertised modifications of the distribution price controls with effect from April 1st 1995.

Given that the golden share redemption had been fully expected since privatisation, the lack of response in share prices around the redemption date is not surprising. Instead, as noted above, rumours of takeovers started to emerge in the industry in 1994, and the first takeover bid was announced in December 1994 in expectation of the golden share redemption a few months later.

Figures 6.3 and 6.4 therefore consider CARs around the more relevant event date of December 14th 1994, when Trafalgar House announced that it was considering a takeover offer for Northern Electric. Figure 6.3 shows CARs for the target company only; Figure 6.4 shows average CARs for the 11 other RECs in the industry.

Figure 6.3 CARs (%) of Northern Electric around announcement of takeover bid, December 14th 1994



Source: Datastream and Oxera calculations.

As can be seen from Figure 6.3, there was a marked share price reaction around the announcement of the takeover bid. On the day of the announcement (December 14th), Northern Electric's AR was 10%.

Share prices had already been rising before that date. In particular, there had been continued speculation that the company was a likely takeover target, with Trafalgar already being considered a likely bidder.

Moreover, the interim reporting season for the RECs began in early December, and there was a widely held feeling that the RECs were likely to deliver substantial dividend rises, over and above the already high returns from previous years. Indeed, on December 12th 1994, or two days before the announcement by Trafalgar, Northern Electric unveiled a 30% jump in its interim dividend.[106]

The positive ARs prior to the Trafalgar announcement can partly be attributed to other factors—in particular, the sharp dividend increase. Nevertheless, the jump in share prices on the announcement date (ie, ARs of 10%) can be attributed to the expectation of the company being taken over.

Figure 6.3 also shows that on the day after the announcement (December 15th), Northern's share price experienced a dip when the UK Department of Trade and Industry announced

[106] The jump in the dividend followed a previous £100m buy-back of 10% of Northern Electric's shares, which enabled the company to pay out more in dividends to fewer shareholders. 'Northern Lights the Payout Path', *Evening Standard*, December 12th 1994.

that it intended to retain its golden shares in each of the 12 RECs in England and Wales until their redemption on March 31st 1995, and that no early expiry was planned.[107] It then rose again when, on December 19th 1994, Trafalgar House confirmed its bid intentions and made the formal takeover offer.

Comments in the press included:

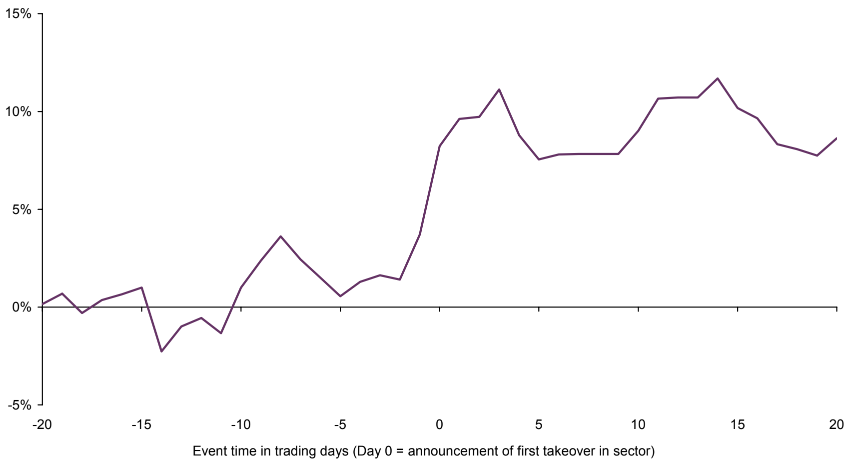
> Northern Electric has become the stock market's favourite bid victim. The shares have powered ahead as a variety of stories have surged through the rumour circuit over the past two weeks. … The government's 'golden share', due to expire in March, has tended to restrict the range of stories. Would the government be prepared to give up its controlling shares in the event of a bid before the deadline; or would a predator be willing to wait until then? Both seemed unlikely … . But the ever inventive market has produced a theory to overcome the influence of the 'golden share'. There is now talk of a dawn raid at 1,100p a share to mop up a 14.9% shareholding. This would put the predator in pole position, allowing it to wait until the government was due to relinquish control.[108]

> Trafalgar House Plc said it is considering a takeover offer for Northern Electric Plc. … The shares rocketed on the news. … They have been rising over the last week on market rumour of a takeover or merger, with Trafalgar already tipped as a potential bidder.[109]

Overall, during the 40-day window, CARs for Northern Electric were between 20% and 25%. About 10% or possibly more can be attributed to the takeover announcement made in expectation of the redemption of the government's golden share in the company.

Importantly, the other 11 RECs also saw a positive share price response to the announcement of the first takeover in the sector, as shown in Figure 6.4.

Figure 6.4 Average CARs (%) of other UK RECs around announcement of first takeover in sector, December 14th 1994



Source: Datastream and Oxera calculations.

On December 14th 1994, when Trafalgar announced its intention to make a takeover bid, ARs averaged 6.6%. Share prices already rose on the previous day, generating average ARs of 2.6% on the day. By December 19th 1994, when Trafalgar had formalised its offer,

[107] 'Northern electric loses spark on golden news', Reuters, December 15th 1994.

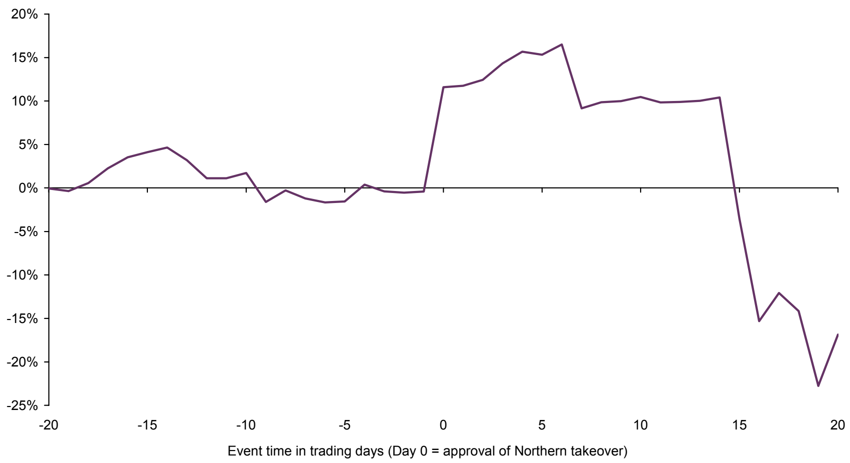
[108] 'Market report—Northern bid rumour favourite', *The Independent*, December 14th 1994.

[109] 'Trafalgar may bid for Northern Elec.', Reuters, December 14th 1994.

average CARs had risen to nearly 10%. The response in the other RECs' share prices is consistent with the view that the market expected more widespread takeovers in the sector in light of the golden share expiry, allowing more restructuring and the realisation of further synergies in the sector, as well as premium rewards for shareholders in potential future REC takeovers.

The Trafalgar bid for Northern Electric was subject to a potential competition probe by the UK authorities. However, on February 14th 1995, it was announced that the bid would not be referred to the UK Monopolies and Mergers Commission (MMC). This led to a further surge in the share price of Northern Electric, as shown in Figure 6.5, which reports CARs 20 days before and after the announced clearance of the bid. On February 14th, Northern's AR was 11.6%.[110]

Figure 6.5 CARs (%) of Northern Electric around approval of takeover by authorities (February 14th 1995)



Source: Datastream and Oxera calculations.

Figure 6.5 also shows a sharp downward adjustment in market value 15 trading days after the event day. This coincides with the regulator's announcement on March 7th 1995 of a tightening of price controls for the RECs. Throughout the sector, there was a sharp decline in share prices in response to this announcement (see also Figure 6.2), with average ARs on the day of –16%. The planned tightening of price controls resulted from concerns about the profits earned by RECs and their surplus cash. As one press article commented:

> the way that Trafalgar's takeover bid drew attention to Northern's excessive profits does credit to the operation of a free capital market. If hostile takeover bids for utilities had been forbidden, then Professor Littlechild would have remained in the dark about Northern's true profit potential and consumers would be paying higher prices for five years.[111]

Summary

The event study evidence is consistent with a significant market reaction to events that were immediately triggered by, or related to, the expiry of golden shares held by the UK government in the 12 RECs.

The timeline of relevant events referred to above can be summarised as follows.

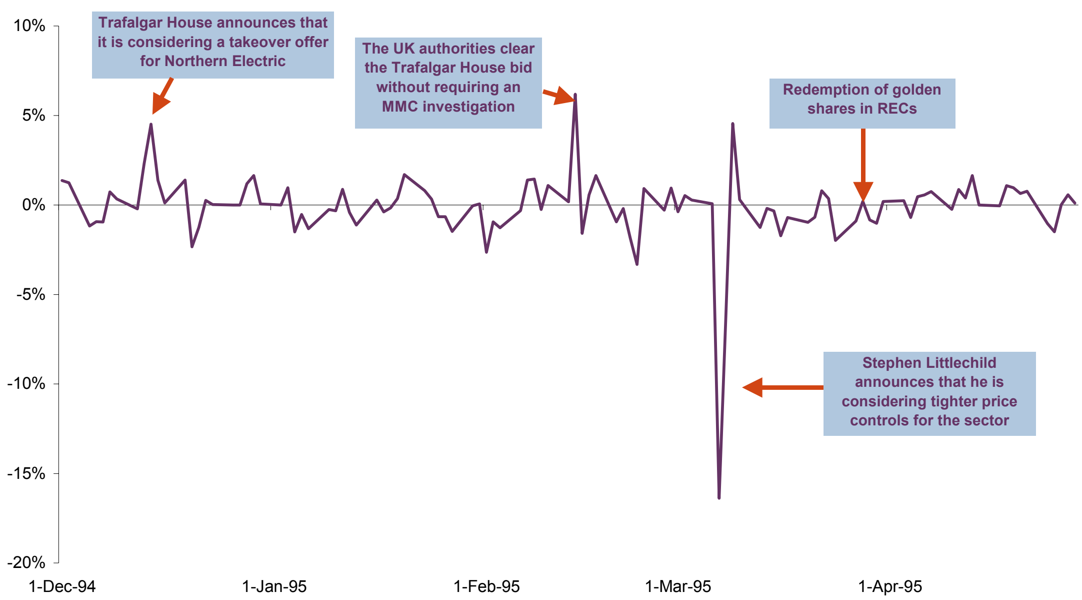
[110] Share prices in the other RECs also reacted positively upon competition approval of the takeover, with average ARs of 4% on the day of approval.

[111] 'The power of privatisation', *The Times*, March 27th 1995.

December 1994	The interim reporting season for the RECs begins in early December following a gradual rise in share price on the widely held feeling that the RECs will be likely to deliver substantial dividend rises, topping already high returns from previous years. In addition, analysts' expectations are to see stakebuilding in the RECs in light of the expiry of the government's golden shares at the end of March 1995
December 12th 1994	Northern Electric unveils a 30% jump in its interim dividend. This follows a previous £100m buy-back of 10% of its shares, which enabled the company to pay out more in dividends to fewer shareholders
December 14th 1994	Following rumours over the previous couple of weeks that the company is a likely takeover target, Trafalgar House announces that it is considering a takeover offer for Northern Electric, causing an immediate and large share price rise
December 15th 1994	The UK Department of Trade and Industry announces its intention to retain its special shares in each of the 12 RECs in England and Wales until their redemption on March 31st 1995 and that no early expiry is planned. Northern's share price dips
December 19th 1994	Trafalgar House makes a formal offer for Northern Electric. Northern's share price rises
February 14th 1995	The UK authorities' decision to clear Trafalgar House plc's bid for Northern Electric plc without an MMC investigation prompts a rapid share price rise for all the RECs on the basis that the decision clears the way for further electricity company offers
March 7th 1995	Share prices of RECs fall sharply following statements by Professor Littlechild that he is considering tighter price controls for the sector
March 24th 1995	Professor Littlechild decides to go ahead with the price re-review
March 31st 1995	Golden shares in the RECs are removed. There is no observable price response to the (already expected) redemption

Figure 6.6 summarises, in a single chart, the share price reaction to four main events, showing average ARs (rather than the CARs) in the sector.

Figure 6.6 Average ARs of RECs around key events

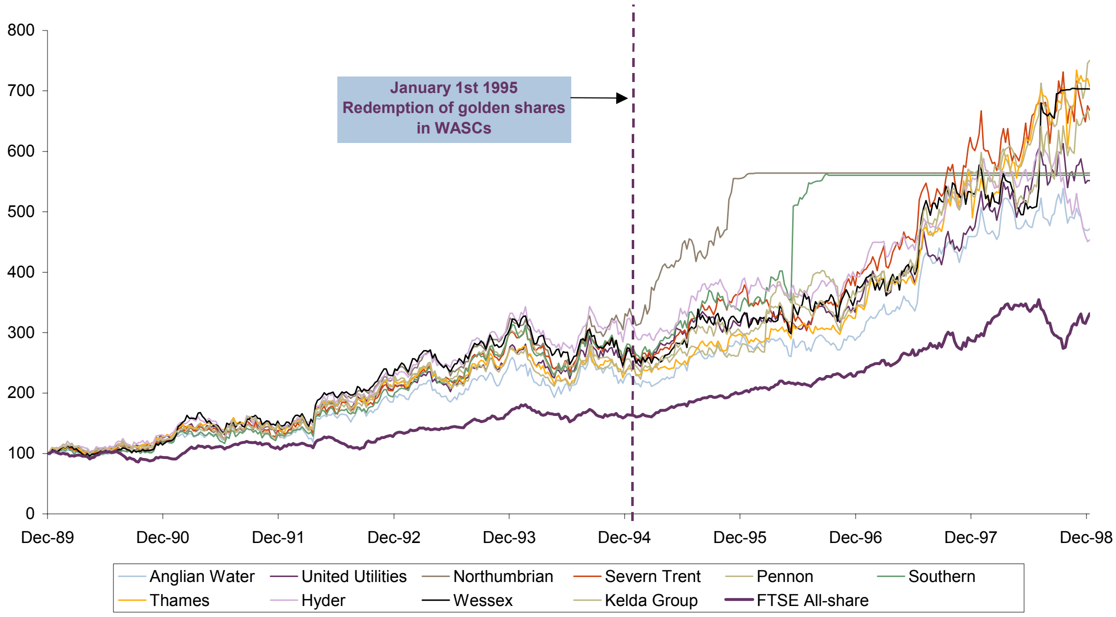


Note: In this figure, the average is calculated across all 12 RECs. This explains the differences in estimated returns compared with Figures 6.3 to 6.5, which distinguish between the first takeover target (Northern Electric) and the RECs that were acquired or merged at a later stage.
Source: Datastream and Oxera calculations.

6.4.2 Water

Figure 6.7 presents an overview of the WASCs' share price performance from privatisation to 1998. Like the RECs, the privatised water sector generated significantly higher returns for shareholders over the period than the UK stock market as a whole, as measured by the FTSE All-share index. Figure 6.7 also shows the discontinuation in the return data series for the two first takeover targets in the sector after the golden share redemption on January 1st 1995—Northumbrian Water was taken over by French utility, Lyonnaise des Eaux, and Southern Water was acquired by energy company, Scottish Power.

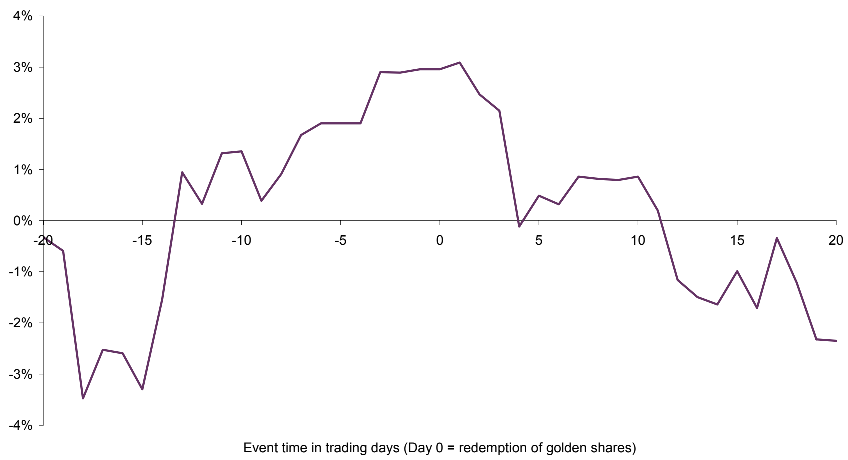
Figure 6.7 Post-privatisation share price performance of WASCs, 1989–98 (total return index)



Source: Datastream and Oxera calculations.

Figure 6.8 illustrates WASCs' share price performance around the date when the UK government redeemed its golden shares. Although share price movements generated average CARs that peaked at just under 3% on the actual redemption day, the return pattern is not consistent with a positive share price effect due to the golden share expiry.

Figure 6.8 Average CARs (%) of WASCs around golden share redemption, January 1st 1995



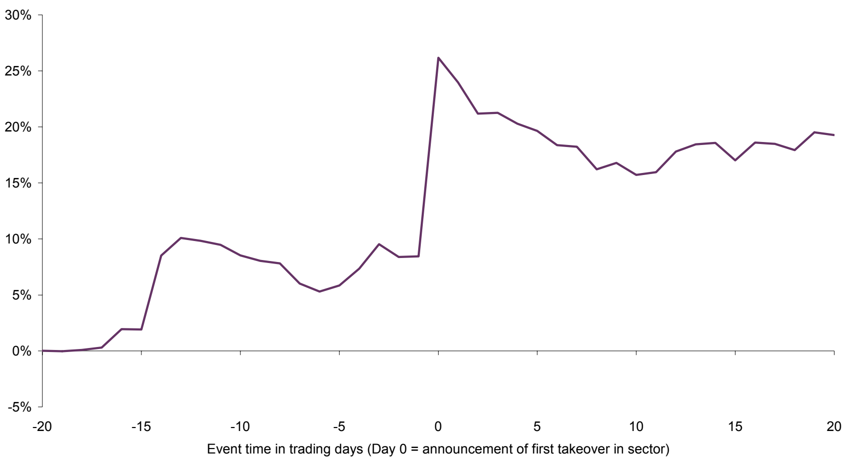
Note: The government retained its golden share in Welsh Water until 1996. Hence, returns on Welsh Water are not considered in the figure.
Source: Datastream and Oxera calculations.

As in the case of electricity, the redemption date was fully expected in the market (ie, golden shares were time-limited to five years following privatisation), so any lack of price response should not be surprising.

The share price movements observed 20 days before and after January 1st 1995 are more likely to be explained by other factors. For example, the negative returns on trading day –18 from the event day coincide with political developments that made a change in the UK government more likely and concerns that a future Labour government would impose a windfall tax on profits and tighten regulation.[112]

Importantly, however, the expiry of golden shares opened the sector to takeovers. Although there had been some speculation before, the first WASC takeover was announced two months following the expiry, when, on March 6th 1995, Lyonnaise des Eaux made a bid for Northumbrian Water. Figure 6.9 shows CARs of Northumbrian Water around the takeover announcement.

Figure 6.9 CARs (%) of Northumbrian Water around announcement of takeover (March 6th 1995)



Source: Datastream and Oxera calculations.

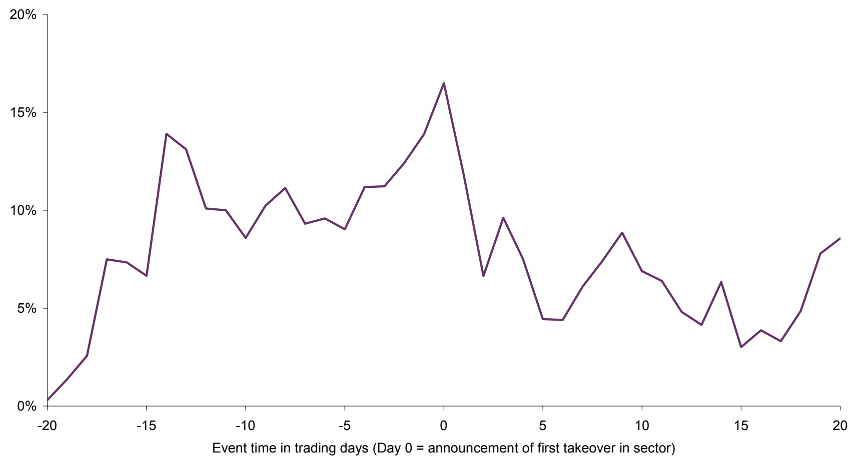
On the announcement day, the AR was 18%, reflecting a significant takeover premium for shareholders in the target company. Share prices had already started to increase before that day, in particular 14 days before the announcement—on February 14th 1995, Northumbrian's AR was about 7%, pushing cumulative returns over the period up to peak at more than 25% on the event day.

February 14th 1995 was the day on which it was announced that the first takeover bid in the electricity sector would not be subject to a competition investigation by the MMC (see Figure 6.5 above).

The other WASCs in the sector also responded to the announcement of the Northumbrian Water takeover, as shown in Figure 6.10 below. On the actual event day, average ARs were about 3%. As for Northumbrian, share prices of the other WASCs also reacted to the clearance of the first REC takeover—average CARs on February 14th 1995 (day –14) rose from 7% to 14%, implying ARs on the day of 7%.

112 'UK stock market turnaround leaves utilities behind', Reuters, December 7th 1994.

Figure 6.10 Average CARs (%) of other WASCs around announcement of first takeover in sector (March 6th 1995)



Source: Datastream and Oxera calculations.

Share prices of the WASCs were in general influenced by developments in the electricity sector. The early takeover bid by Trafalgar House for Northern Electric generated wider expectations of further restructuring not only among the RECs but also in the water sector, although, as noted above, the WASCs were seen as less attractive takeover targets than the RECs:

> Monday's 1.2 billion pound hostile bid for north-eastern based Northern Electric from Trafalgar House may kick off a flood of copy-cat takeovers.[113]
>
> January 1, 1995 heralds the expiry of the government's 'golden share' in nine of the 10 regional water and sewerage companies in England and Wales. … Takeover talk started bubbling ahead of the deadline. This month's bid by Trafalgar House for Northern Electric, one of the regional electricity companies, has sent speculative ripples into the water sector. … Share prices in the water and sewerage groups have risen, after a period of underperformance, in sympathy with the RECs. Northumbrian, Southern, South West and Wessex, the four smallest water groups—seen as the most vulnerable—have outperformed the sector by about 3% this month.[114]
>
> Shares in water companies stayed buoyant, bucking the lower trend, as market players took the view that prices were due to catch up with shares in fellow utilities—the regional electricity companies (RECs). RECs raced ahead yesterday after news that the UK cleared the Trafalgar House Plc's bid for Northern Electric Plc. Water stocks yesterday rose also, but less strongly.[115]

Figure 6.11 shows average cumulative returns of all WASCs around the day on which the Northern Electric takeover was cleared by the UK authorities from an MMC investigation (February 14th 1995—ie, trading day –14 in Figures 6.9 and 6.10 above).

On the day, the sector experienced ARs that averaged about 4% across all WASCs. The reaction was particularly strong for the first WASC takeover target, Northumbrian Water, which saw ARs on the day of nearly 7%. The CAR for Northumbrian around the event is

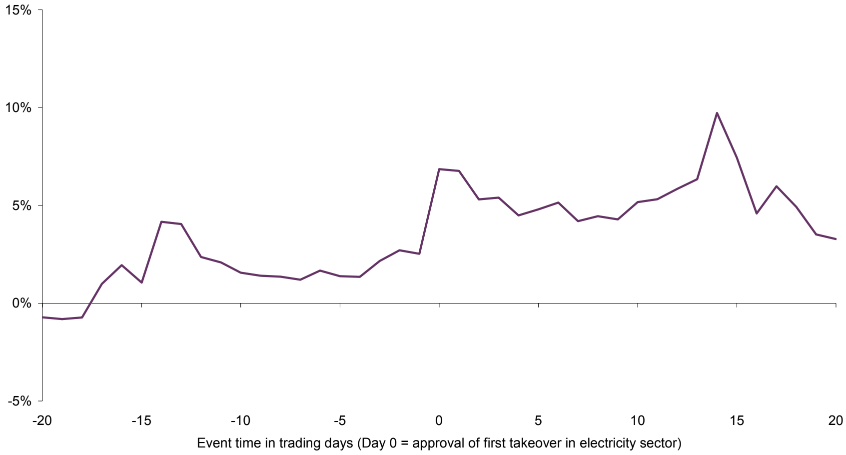
[113] 'Investors uninspired by Wessex Water's dividend rise', Reuters, December 20th 1994.

[114] 'Tide of interest faces many locks', UK Company News, *Financial Times*, December 30th 1994.

[115] 'UK water sector plays catch-up with electrics', Reuters, February 15th 1995.

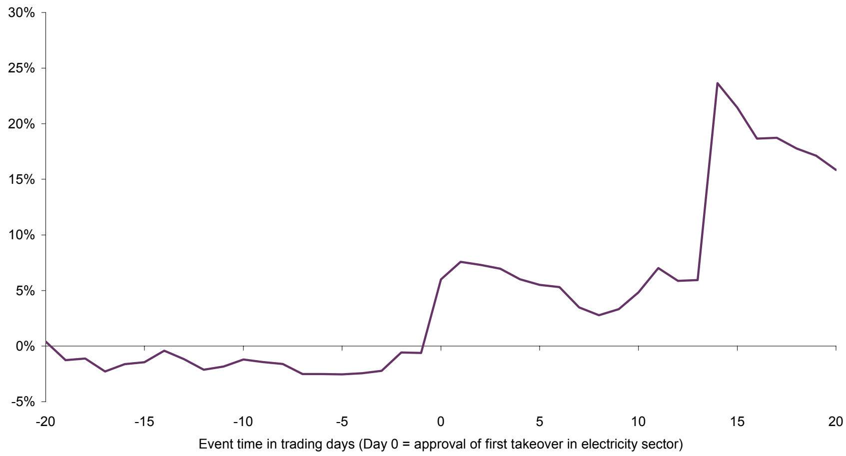
separately shown in Figure 6.12. (The second return peak occurs on the day on which Northumbrian itself was subject to a bid, as examined in Figures 6.9 and 6.10 above.)

Figure 6.11 Average CARs (%) of WASCs around approval of first takeover in electricity sector



Source: Datastream and Oxera calculations.

Figure 6.12 CARs (%) of Northumbrian Water around approval of first takeover in electricity sector (February 14th 1995)



Source: Datastream and Oxera calculations.

Summary

The relevant events in the water sector, examined above, can be summarised as follows.

January 1st 1995	Golden shares in WASCs removed, with the exception of Welsh Water
March 6th 1995	Lyonnaise des Eaux reveals that it is poised to make an offer for Northumbrian Water

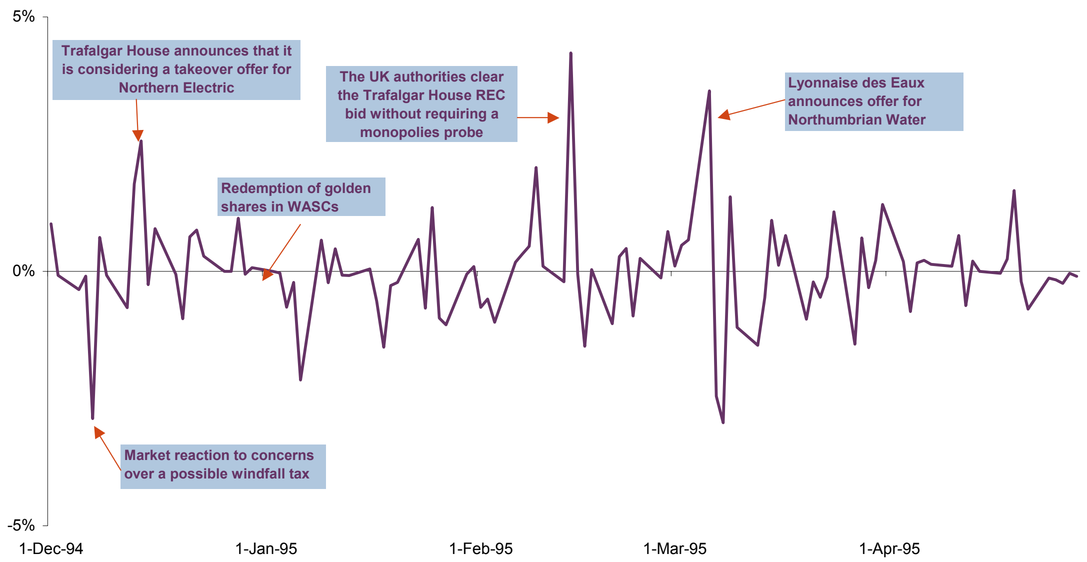
Not surprisingly, there was no share price reaction to the actual expiry of the golden shares since the market fully expected this event. However, once abolished, this removed takeover restrictions in the sector. The first takeover bid generated a significant takeover premium for shareholders in the target company, and triggered share price reactions for the other WASCs.

Prior to the first WASC takeover bid, share prices in the water sector had already been influenced by takeover-related events in the electricity sector, such as the following.

December 14th 1994	Trafalgar House announces that it is considering a takeover offer for Northern Electric
February 14th 1995	The decision by the UK authorities to clear Trafalgar House plc's bid for Northern Electric plc without an MMC investigation prompts a share price rise not only for all the RECs but also for the WASCs on the basis that the decision clears the way for further electricity and water company offers

Figure 6.13 presents summary evidence on share price reactions in the water sector, showing average ARs earned by the ten WASCs on certain critical event dates. In general, the share price reactions were less pronounced than in the electricity sector—this may not be surprising given that water was influenced, and lagged behind, electricity in terms of takeover activity and that the WASCs were largely seen as less attractive takeover targets than the RECs.

Figure 6.13 Average ARs of WASCs around key events



Source: Datastream.

6.5 Summary

The results of the event study in the UK electricity and water sector allow a number of conclusions to be drawn.

– The golden share redemption triggered a surge in takeover activity in both sectors. It therefore appears that special rights in the form of direct investment restrictions (in this case, caps on shareholdings above 15%) restrict the market for corporate control and have a binding, negative impact on takeover activity in the market.

– The takeovers announced as a result of the golden share redemption were associated with significant takeover premia (consistent with findings in the literature). It therefore appears that special rights of this type prevent shareholders in target companies from realising large premium returns.

– The event study analysis does not allow conclusions to be drawn about the impact of the golden share redemption on the longer-term performance of UK water and electricity companies. Nonetheless, the positive share price reactions—not just of the target companies but also of the other companies in the sector—are consistent with the view that the market expected significant synergies or other benefits from takeovers in the sectors. To the extent that these benefits would have been prevented if the golden shares had not expired, special rights of the UK type are likely to have adverse consequences on the longer-term performance of companies.

7 Summary and conclusions

Special rights affect the governance structure of privatised EU companies. They allow public authorities to retain considerable control despite having surrendered a majority of shares following privatisation. Special rights take many different forms. They either preserve the influence of a public authority on the shareholder structure of a company or they grant control over management decisions beyond the extent to which such influence would normally be afforded under general company law.

This report has assessed the extent to which special rights have negative implications, for the performance of individual companies affected by special rights, for investors and investment decisions, and for EU capital market integration more generally.

The impact assessment comprised four elements: a review of the relevant academic literature; a typology of special rights; a case study analysis based on a sample of EU companies affected by recent infringement proceedings; and an event study analysis around the abolition of golden shares in the UK electricity and water sectors. The overall results of the impact assessment allow the following conclusions.

– *Impact on investment and shareholders*—special rights present public restrictions on investment in privatised companies. They may be restricting investment directly (eg, through caps on substantial blockholdings) or indirectly through the government's influence on the management and operation of the company, which may deter strategic investors seeking an active role in the decision-making process. In other words, the markets in which transactions are being restricted are, in the first instance, the European markets for corporate control.

  Where golden shares deter a bidder from gaining control of a company, they almost invariably have an additional impact on the market for portfolio investment—the potential target's shareholders are deprived of an opportunity to dispose of their investments in the company. Usually, a takeover bid provides an exceptionally attractive opportunity for selling shares, with takeover premiums often exceeding 20%.

  The new empirical evidence presented in this report as well as the academic literature are consistent with these predicted impacts. Special rights that take the form of direct investment restrictions present effective barriers to takeover and have an adverse impact on the existing shareholders of the companies.

  Until 1995, the UK government held golden shares in the privatised water and electricity sectors, which effectively prevented anyone from controlling more than 15% of voting shareholdings. The redemption of the golden shares triggered a surge in takeover activity in both sectors. Within two years of redemption all but one of the 12 RECs had been merged or acquired, in most cases by foreign companies. In water, the first takeover bid for a WASC occurred just two months after the golden share redemption. The events were associated with significant share price rises.

  Similarly, the expected abolition of direct investment restrictions in at least two case study companies (Cimpor and BAA) triggered expectations of takeovers. In the case of Cimpor, the expectations materialised in a takeover bid that was made conditional upon the Portuguese government relinquishing its special rights and that triggered a significant appreciation in the company's share price.

– *Impact on company performance*—there is strong evidence in the literature of a relationship between the performance of companies and the likelihood of takeover. Any reduced fear of hostile takeovers means that the disciplining device that the market for corporate control would otherwise create has become less effective, and that overall corporate governance has been reduced. Poorer corporate governance in turn can result in managerial slack and a deterioration in economic performance. Correspondingly, special rights that provide a shield from takeovers can be expected to have an adverse effect on the performance of the protected companies if they thwart cross-border restructuring of industries and shelter management from market pressures.

In addition to reducing market discipline, any direct interference of governments in the management of the privatised companies may have a negative impact on the performance of the firms. This hypothesis is supported by academic research establishing performance improvements of companies following privatisation.

The positive share price reactions around the abolition of special rights and subsequent takeovers, as established empirically in this report, are consistent with a negative impact of special rights on companies' longer-term performance, to the extent that they reflect the market's valuation of synergies and other benefits that takeovers could deliver.

The empirical analysis conducted for this report also aimed to assess the impact on company performance directly (rather than through market valuations), using case study analysis. Although there was some indication that special rights may have had a negative impact on the long-term performance of the case study firms, the evidence obtained was disparate and does not allow any strong conclusions to be drawn. One possible, and plausible, explanation is data and methodological constraints. For example, in all cases considered, special rights were either still in place or only recently abolished. Hence, it was too early to assess whether the abolition of special rights led to a notable and long-term improvement in company performance.

Instead of evaluating the impact of special rights using before-and-after comparisons, the case study analysis therefore focused on benchmarking companies' performance against that of companies not subject to special rights but otherwise comparable. The results of the benchmarking analysis did show some underperformance of case study firms relative to their chosen comparators, in particular in operating performance.

However, the results were not conclusive overall. While some of the case study firms tended to underperform consistently, others outperformed the benchmarks at least along specific dimensions of performance. The lack of conclusive evidence may again be due to data and methodological problems. In particular, given the nature of the industries in which the case study firms operate, the choice of comparators was restricted to companies operating in other countries, subject to a different regulatory regime, or indeed still partly state-owned. Any differences in these or other company-specific factors are likely to influence comparative performance, thereby clouding the measured performance impact of special rights. Case study analysis is necessarily limited, and more conclusive results might have been obtained if the impact assessment had been based on a larger sample of firms, and if techniques had been applied that control for other factors influencing company performance, and allow the impact of special rights to be isolated from these factors.

Research findings in the existing literature suggest that such an impact is likely to be significant and that special rights reduce the competitiveness of affected companies in the longer term. In particular, the one study that explicitly tested for the impact of golden shares, using a large sample of international companies and econometric techniques to control for other factors, establishes a significantly negative impact of golden shares on the long-term share price performance of privatised companies. Boardman and Laurin (2000) conclude that the evidence:

supports the hypothesis that failure to transfer complete control to the private sector, combined with uncertainty surrounding the exercise of the golden share, has a detrimental effect on long-run share price performance.

– *Impact on market integration*—special rights that present effective restrictions on investment are an impediment to further integration of the EU capital markets. In particular, such rights distort market-driven direct investment activity, preventing firms from realising economies of scale and synergies that may result from cross-border mergers and acquisitions, and, more generally, hindering the efficient allocation of savings and capital. Special rights also raise concerns about the level playing field in the EU market for corporate control, since the companies they protect are no longer potential takeover targets but may still act as bidders.

Even if special rights have a negative impact on company performance, restrict direct and portfolio investment in the privatised companies, and hinder market integration, some may argue that the measures are justified in certain circumstances. In particular, governments may deem it necessary to impose golden shares following privatisation, given concerns about a divergence between public policy objectives and the private goals of unconstrained private companies. This applies in particular to enterprises providing public services, where there may be concerns about security of supply, universal access to a service, and distributional implications of pricing policy.

This would suggest that any of the negative implications would have to be set against the social benefits that may result from the retention of special rights. However, while the public policy argument may apply to enterprises providing public services, it is of little relevance for companies in other industries where special rights have been observed. Moreover, while potentially relevant for justifying the need to maintain some control over company decisions that would put the public policy objectives at risk, the argument provides little justification for special rights that constitute a direct investment restriction and outright blocking of a takeover of utilities.

From a policy perspective, it is important to appreciate the existence of alternative mechanisms to control privatised companies. In particular, regulation is now an essential part of most governments' approach to privatised companies in the public utility sectors. Regulation may be seen as a potentially less restrictive and more transparent means of achieving public policy objectives, especially if carried out by an arm's-length regulatory authority.

Special rights provide governments with a mechanism to privatise companies without relinquishing control. An alternative would be not to relinquish ownership in the first place. Indeed, it may be that governments would be less likely to sell their ownership stakes and fully privatise a company if they did not have the possibility of retaining special control rights. This is clearly important since, despite the significant privatisation wave in the last two decades, many EU governments still retain large stakes in companies and, as major shareholders, can use that ownership power to block acquisitions or influence management decisions.

Finally, special rights held by public authorities present only one type of barrier to cross-border investment in EU companies. There are many others, and these do not only apply to privatised companies. This report did not address the relative importance of special rights compared with other impediments to further EU capital market integration.

Appendix 1 Description of special rights in a sample of EU companies

Company	BAA	Copenhagen Airport	Volkswagen
Industry	Airports	Airports	Manufacturing
Country	UK	Denmark	Germany
Date of privatisation	1987	1994	1961
Value of first issue ($m)	2,028	112	315
Current % government shares	0	33.8	0 for central government, but the Land of Lower Saxony holds 20.94% of shares with voting rights
Description of restriction	State approval required for major management decisions Restriction on shareholdings above 15%	Restriction of ownership to 10% of shares Minister of Transport approval required for certain business decisions	No shareholder can acquire more than 20% of voting rights 20% blocking minority. 80% of votes required for major company decisions Mandatory representation of public authorities on the board
Justification of restriction	National interest in the future operation of BAA's airports	Protection of only national airport	Protection of minority shareholders and national and regional interests
Legal basis	Airports Act 1986, Articles of Association	Government Act 428 of 1990, Articles of Association	1960 law privatising Volkswagen 1959 agreement between the government (Bund) and the Land of Lower Saxony
Golden/special share?	✓	×	×
Actions taken against restriction	13/05/2003: Case C-98/01European Court of Justice (ECJ) Ruling 07/01/2004: Art. 228 letter of formal notice on residual restriction (IP/04/17)	05/02/03: Letter of formal notice (IP/03/178)	30/03/2004: Formal request to Germany to amend certain provisions of 1960 law (IP/04/400) 13/10/2004: Decision to take Germany to court (IP/04/1209)
Date of abolishment	October 2003: Redemption of special share 27/7/04: Articles of Association modified abolishing 15% ceiling 15/10/04: Closure of case (IP/04/1234)	May 2004: 10% ownership restriction abolished. Approval rights replaced by opposition rights in 2005	Case pending (as at December 2004)

Company	Banco Totta & Acores	Cimentos de Portugal (Cimpor)	Portugal Telecom
Industry	Finance	Cement	Telecommunications
Country	Portugal	Portugal	Portugal
Date of privatisation	1989	1994	1995
Value of first issue ($m)	195	241	988
Current % government shares	20	0	>0
Description of restriction	10% limit of foreign participation Acquisitions of more than 10% require state authorisation	State can block board decisions Shareholder voting limited to 10% No shareholder can hold more than 10% (in second and third stage of privatisation). Cap was 5% in first stage Acquisitions of more than 10% require state authorisation	No shareholder can hold more than 5% (in third stage of privatisation). Cap was 10% in first and second stages Acquisitions of more than 10% require state authorisation State can veto certain company decisions through privileged A shares (by Articles of Association)
Justification of restriction	The need to safeguard the financial interests of Portugal	The need to safeguard the financial interests of Portugal	The need to safeguard the financial interests of Portugal
Legal basis	Law 11/90. Also Decree laws 65/94, 380/93	Law 11/90. Also Decree laws 65/94, 380/93, 120/94, 64/96, 94-A/98	Law 11/90. Also Decree laws 65/94, 380/93, 44/95, 34-A/96, 226-A/97
Golden/special share?	×	×	✓
Actions taken against restriction	04/06/02: ECJ Case C-367/98 15/05/03: EC decides to initiate new infringement proceedings (IP/03/692) 21/01/04: Commission sends letter of formal notice (Art. 228)	04/06/02: ECJ Case C-367/98 15/05/03: EC decides to initiate new infringement proceedings (IP/03/692) 21/01/04: Commission sends letter of formal notice (Art. 228)	04/06/02: ECJ Case C-367/98 15/05/03: EC decides to initiate new infringement proceedings (IP/03/692) 21/01/04: Commission sends letter of formal notice (Art. 228)
Date of abolishment	October 2003: Portugal repeals restrictions of Law 11/90 and Decree Law 65/94 04/02/04: 10% authorisation requirement abolished	October 2003: Portugal repeals restrictions of Law 11/90 and Decree Law 65/94 04/02/04: 10% authorisation requirement abolished Shareholder voting limit of 10% is still maintained in Articles of Association.	October 2003: Portugal repeals restrictions of Law 11/90 and Decree Law 65/94 04/02/04: 10% authorisation requirement abolished Right to veto certain company decisions through privileged A shares is still maintained in Articles of Association

Company	Petrogal	Electricade de Portugal	ELF Aquitaine
Industry	Energy	Energy	Energy
Country	Portugal	Portugal	France
Date of privatisation	1992	1997	1986
Value of first issue ($m)	279	2,100	493
Current % government shares	75	33	0.75
Description of restriction	40% limit of foreign participation Government can appoint a board member Government can block board decisions Acquisitions of more than 10% require state authorisation	Shareholder voting limited to 5% No shareholder can hold more than 10% Acquisitions of more than 10% require state authorisation	Minister for Economic Affairs approval for acquisition of shares exceeding 10%, 20% or 33% of the company's stock Government can oppose decisions to dispose of, or transfer, certain assets or use them as security
Justification of restriction	The need to safeguard the financial interests of Portugal	The need to safeguard the financial interests of Portugal.	To guarantee supplies of petroleum products in the event of a crisis
Legal basis	Law 11/90. Also Decree laws 65/94, 380/93, 353/91, 145-A/95	Law 11/90. Also Decree laws 65/94, 380/93	13/12/93: Decree n.93-1298
Golden/special share?	×	×	✓
Actions taken against restriction	04/06/02: ECJ Case C-367/98 15/05/03: EC decides to initiate new infringement proceedings (IP/03/692) 21/01/04: Commission sends letter of formal notice (Art. 228)	04/06/02: ECJ Case C-367/98 15/05/03: EC decides to initiate new infringement proceedings (IP/03/692) 21/01/04: Commission sends letter of formal notice (Art. 228)	04/06/02: Court ruling C-483/99
Date of abolishment	October 2003: Portugal repeals restrictions of Law 11/90 and Decree Law 65/94 04/02/04: 10% authorisation requirement abolished The reference to Decree laws 353/91, 145-A/95 is maintained in Articles of Association, which implies the right for the state to: appoint a board member; veto decisions; and place restrictions on acquisitions of shares	October 2003: Portugal repeals restrictions of Law 11/90 and Decree Law 65/94 04/02/04: 10% authorisation requirement abolished	03/10/02: Decree n.2002-1231 repealed golden share law

Company	TNT Post Groep	KPN	Telecom Italia
Industry	Communications	Communications	Communications
Country	Netherlands	Netherlands	Italy
Date of privatisation	1994	1989	1997
Value of first issue ($m)	3,868	3,868	15,500
Current % government shares	0	14	0
Description of restriction	The state has the right to appoint three members of the supervisory board. The state has special rights to block certain strategic decisions taken by the firm's board (eg, dividend policy, issue of shares, veto concerning the merger or dissolution of the company)	The state has the right to appoint three members of the supervisory board The state has special rights with respect to certain strategic decisions taken by the firm's competent bodies (eg, dividend policy, issue of shares, veto concerning the merger or dissolution of the company)	The government can oppose the acquisition of >5% holdings The government can block certain management decisions
Justification of restriction	To guarantee provision of a minimum universal service in postal sector	To guarantee provision of a universal service in the telecoms sector	National economic and political policy; security of supply
Legal basis	Articles of Association	Articles of Association	Framework Law 474/1994 23/12/99: Financial Law No. 488 & Decree of 11/02/00
Golden/special share?	✓	✓	×
Actions taken against restriction	17/12/03: Commission decides to take the Netherlands to the ECJ (IP/03/1753)	17/12/03: Commission decides to take the Netherlands to the ECJ (IP/03/1753)	May 2000: ECJ ruling (Case C-58/99) 05/02/03: Following changes in legislation (Financial Law No 488 & Decree of 11/02/00) the Commission switched to Art 226 procedures and issued a letter of formal notice (IP/03/177).
Date of abolishment	Proceedings are pending as case C-283/04 (as at December 2004)	Proceedings are pending as case C-282/04 (as at December 2004)	Amendments: Law 350/2003 & Decree 10/06/04. The Commission is examining the new amendments to the law (as at December 2004)

Note: Koninklijke KPN N.V. (KPN) and TNT Post Groep N.V. (TPG) are the two firms that emerged from the privatisation of Koninklijke PTT Nederland N.V., the public telecoms and postal services operator in the Netherlands. On June 29th 1998, TNT Post Group separated from KPN.

Company	ENEL	ENI	Distrigas
Industry	Energy	Energy	Energy
Country	Italy	Italy	Belgium
Date of privatisation	1999	1995	1996
Value of first issue ($m)	17,402	3,907	103
Current % government shares	50.63	20.32	0
Description of restriction	The government can oppose the acquisition of >5% holdings The government can block certain management decisions Suspension of voting rights of public companies' holdings above 2% in Italian energy companies	The government can oppose the acquisition of >5% holdings The government can block certain management decisions Suspension of voting rights of public companies' holdings above 2% in Italian energy companies	The Minister for Energy may oppose any transfer of technical installations and any specific management decisions taken concerning the companies' shares, which may jeopardise national supplies of natural gas The government can appoint two government representatives to the board
Justification of restriction	National policy. Provision to be removed once a fully competitive gas and electricity market is achieved	National policy. Provision to be removed once a fully competitive gas and electricity market is achieved	To maintain minimum supplies of gas in the event of a serious crisis
Legal basis	Framework Law 474/1994 25/05/01: Decree-Law No. 192, converted into Law No.301 (20/07/01)	Framework Law 474/1994 25/05/01: Decree-Law No. 192, converted into Law No.301 (20/07/01)	Belgian Royal Decree of 16 June 1994
Golden/special share?	×	×	✓
Actions taken against restriction	May 2000: ECJ ruling (Case C-58/99) 05/02/03: Following changes in legislation (Financial Law No 488 & Decree of 11/02/00), the Commission switched to Art 226 procedures and issued a letter of formal notice (IP/03/177) 16/12/03: Italy taken to court over investment in energy restriction (IP/03/1734) June 2005: ECJ ruling against Italy (Case C-174/04)	May 2000: ECJ ruling (Case C-58/99) 05/02/03: Following changes in legislation (Financial Law No 488 & Decree of 11/02/00) the Commission switched to Art 226 procedures and issued a letter of formal notice (IP/03/177) 16/12/03: Italy taken to Court over investment in energy restriction. (IP/03/1734). June 2005: ECJ ruling against Italy (Case C-174/04)	04/06/02: Case C-503/99 decision by ECJ ruled restrictions as legitimate (CJE/02/49)
Date of abolishment	Amendments: Law 350/2003 and Decree 10/06/04. The Commission is currently examining the amendments to the law Amendments: Decree-law no. 81 of May 14th 2005	Amendments: Law 350/2003 & Decree 10/06/04. The Commission is currently examining the new amendments to the law Amendments: Decree-law no. 81 of May 14th 2005	

Company	SNTC	Argentaria	Endesa
Industry	Energy	Finance	Energy
Country	Belgium	Spain	Spain
Date of privatisation	n/a	1993	1988
Value of first issue ($m)	n/a	1,027	750
Current % government shares	0	0	2.95
Description of restriction	Advance notice of any change in the use of the company's strategic assets must be given to the Minister of Energy, who is entitled to oppose operations if deemed necessary The Minister for Energy may appoint two representatives of the government to the board of directors	Government can oppose the acquisition of more than 10% of the company's capital Government can block certain management decisions (sale of assets, dissolution, mergers, change of business aims)	Government can oppose the acquisition of more than 10% of the company's capital Government can block certain management decisions (eg, sale of assets, dissolution, mergers, change of business aims) Government can oppose the exercise of voting rights in excess of 3% where such holdings are acquired by public companies
Justification of restriction	To maintain minimum supplies of gas in the event of a serious crisis	Protection of strategically important public services	Public services of strategic importance require protection to ensure continuity in the services
Legal basis	Belgian Royal Decree of June 16th 1994	Framework Law 5/1995, Royal Decree	Framework Law 5/1995, Royal Decree Law 55/1999
Golden/special share?	✓	×	×
Actions taken against restriction	04/06/02: Case C-503/99 decision by ECJ ruled restrictions as legitimate (CJE/02/49)	13/05/03: Case C-463/00 ECJ ruled against Spain	13/05/03: Case C-463/00 ECJ ruled against Spain 15/07/04: Letter of formal notice (Art 228) (IP/04/923) 30/12/03: Spain introduced Article 94 of Law 62/2003 amending Law 55/1999. The Commission is currently examining this law
Date of abolishment		Special rights were phased out in 1999 following the merger of Argentaria with BBV	30/12/03: Spain introduced the 25th Provision of Law No. 62/2003 amending Law 5/1995, but this does not fully implement the court ruling Special powers are due to expire in 2008

Company	Repsol	Telefónica	Tabacalera
Industry	Energy	Communications	Tobacco
Country	Spain	Spain	Spain
Date of privatisation	1989	1987	1998
Value of first issue ($m)	1,140	375	2,230
Current % government shares	0	0	0
Description of restriction	Government can oppose the acquisition of more than 10% of the company's capital Government can block certain management decisions (eg, sale of assets, dissolution, mergers, change of business aims) Government can oppose the exercise of voting rights in excess of 3% where such holdings are acquired by public companies	Government can oppose the acquisition of more than 10% of the company's capital Government can block certain management decisions (sale of assets, dissolution, mergers, change of business aims)	Government can oppose the acquisition of more than 10% of the company's capital Government can block certain management decisions (sale of assets, dissolution, mergers, change of business aims)
Justification of restriction	Public services of strategic importance require protection to ensure continuity in the services	Protection of strategically important public services	Protection of strategically important public services
Legal basis	Framework Law 5/1995, Royal Decree Law 55/1999	Framework Law 5/1995, Royal Decree	Framework Law 5/1995, Royal Decree
Golden/special share?	×	×	×
Actions taken against restriction	13/05/03: Case C-463/00 ECJ ruled against Spain 15/07/04: Letter of formal notice (Art 228) (IP/04/923) 30/12/03: Spain introduced Article 94 of Law 62/2003 amending Law 55/1999. The Commission is currently examining this law	13/05/03: Case C-463/00 ECJ ruled against Spain 15/07/04: Letter of formal notice (Art 228) (IP/04/923)	13/05/03: Case C-463/00 ECJ ruled against Spain
Date of abolishment	30/12/03: Spain introduced the 25th Provision of Law No. 62/2003 amending Law 5/1995, but this does not fully implement the court ruling Special powers are due to expire in 2006	30/12/03: Spain introduced the 25th Provision of Law No. 62/2003 Remaining special powers due to expire in 2007	Special rights phased out in 2000 following the merger of Tabacalera and Seita to create Altadis

Appendix 2 Case study companies: Overview of historical performance

Cimpor

	1995	1996	1997	1998	1999	2000	2001	2002	*2003*	*2004*	1995–2002 average
Company size											
No. of employees	4,503	4,655	4,782	4,918	5,806	6,995	5,974	6,061	*5,785*	*5,706*	
Turnover (€m)	592	640	835	930	981	1,316	1,386	1,317	*1,361*	*1,366*	
Market capitalisation (€m)	1,033	1,399	2,021	2,283	2,218	3,575	2,624	2,131	*2,733*	*2,769*	
Financial performance (accounts)											
Return on sales (%)	22.2	12.9	13.5	18.2	22.1	22.1	18.5	20.3	*20.4*	*17.2*	18.7
Return on capital employed (%)	18.8	7.9	9.7	14.4	20.0	15.8	13.0	12.5	*11.7*	*9.5*	14.0
Post-tax return on equity (%)	15.0	10.5	9.1	10.9	13.0	14.0	13.3	19.1	*20.1*	*19.6*	13.1
Dividend payout ratio (%)						52.7	65.0	63.2	*59.2*	*63.5*	60.3
Gearing (%)	3.9	2.6	9.8	20.0	44.4	52.1	53.0	61.6	*61.5*	*60.2*	30.9
Financial performance (market)											
Market-to-book ratio	1.7	1.4	2.0	2.0	2.1	3.2	2.4	2.2	*2.8*	*2.9*	2.1
Dividend yield (%)	4.6	3.7	2.5	2.9	3.5	2.6	3.6	4.4	*3.8*	*3.1*	3.5
Price–earnings ratio	11.3	14.2	22.4	19.2	14.2	23.3	19.1	12.1	*14.6*	*14.8*	17.0
Operating performance											
Output per employee (€'000)	131.4	137.5	174.7	189.0	169.0	188.1	232.0	217.3	*235.2*	*239.3*	179.9
Output/total assets (%)	70.5	51.6	59.1	55.5	45.4	48.4	49.0	41.2	*45.6*	*44.7*	52.6
Output/fixed assets (%)	175.4	103.5	127.4	111.8	110.9	124.8	108.3	101.3	*114.0*	*112.2*	120.4
CAPEX/fixed assets (%)	21.6	11.4	10.7	8.4	11.2	14.9	15.5	14.0	*13.0*	*13.7*	13.5
CAPEX/employee (€'000)	16.2	15.2	14.7	14.1	17.1	22.4	33.3	30.1	*26.8*	*29.3*	20.4
Output growth rate (nominal) (%)	24.0	8.1	30.6	11.3	5.5	34.1	5.3	–4.9	*3.3*	*0.3*	14.2

Note: Indicators for the years 2003 and 2004 have been highlighted in italics to indicate that special rights ceased to exist in those years.

Volkswagen

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995–2004 average
Company size											
No. of employees	242,420	242,543	279,892	279,916	306,275	324,402	322,070	324,892	334,873	342,502	
Turnover (€m)	45,055	51,192	57,901	68,637	75,167	85,555	91,740	90,005	89,956	88,963	
Market capitalisation (€m)	8,413	11,917	20,986	28,315	23,299	21,240	20,030	13,241	17,022	12,800	
Financial performance (accounts)											
Return on sales (%)	–7.5	–2.2	–0.1	1.7	–0.1	1.0	3.5	3.1	–0.1	0.1	–0.1
Return on capital employed (%)	–11.6	–3.7	–0.2	3.1	–0.2	2.1	5.9	4.5	–0.1	0.1	0.0
Post-tax return on equity (%)	3.2	5.9	10.6	12.6	8.8	23.0	12.2	10.5	4.6	3.0	9.4
Dividend payout ratio (%)	61.7	46.5	35.5	27.6	38.8	16.0	18.8	19.4	36.6	57.1	35.8
Gearing (%)	69.0	67.9	66.6	61.8	62.0	64.7	64.1	64.9	69.2	71.9	66.2
Financial performance (market)											
Market-to-book ratio	1.6	2.0	3.2	3.1	2.4	2.4	0.8	0.5	0.7	0.5	1.7
Dividend yield (%)	1.3	1.4	1.2	1.1	1.4	2.1	2.5	3.8	2.4	3.2	2.0
Price–earnings ratio	46.5	35.4	30.7	25.0	28.4	10.3	6.8	5.1	15.6	18.9	22.3
Operating performance											
Output per employee (€'000)	185.9	211.1	206.9	245.2	245.4	263.7	284.8	277.0	268.6	259.7	244.8
Output/total assets (%)	104.8	105.9	111.4	114.4	112.0	107.9	89.1	83.7	76.5	71.2	97.7
Output/fixed assets (%)	308.5	305.7	319.9	343.4	315.5	300.0	316.1	287.7	274.6	274.1	304.5
CAPEX/fixed assets (%)	45.8	46.7	45.1	51.7	54.3	58.3	22.1	21.8	20.5	23.1	38.9
CAPEX/employee (€'000)	27.6	32.2	29.1	36.9	42.2	51.3	19.9	21.0	20.1	21.9	30.2
Output growth rate (nominal) (%)	10.1	13.6	13.1	18.5	9.5	13.8	7.2	–1.9	–0.1	–1.1	8.3

Repsol

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995–2004 average
Company size											
No. of employees	18,878	19,701	21,440	22,625	29,262	37,387	37,510	32,602	30,644	33,337	
Turnover (€m)	10,931	12,155	14,538	13,597	25,633	44,043	42,851	35,555	36,069	40,585	
Market capitalisation (€m)	7,167	8,979	11,720	13,649	27,348	20,779	19,998	15,383	18,875	23,392	
Financial performance (accounts)											
Return on sales (%)	8.7	6.7	6.6	8.8	7.8	11.2	8.6	6.4	7.4	9.0	**8.1**
Return on capital employed (%)	14.2	9.1	8.4	10.5	7.3	13.2	9.8	7.9	9.9	12.8	**10.3**
Post-tax return on equity (%)	19.5	15.7	16.2	16.8	9.5	19.3	10.4	16.8	16.4	15.0	**15.5**
Dividend payout ratio (%)	40.0	40.8	40.1	34.2							**38.8**
Gearing (%)	31.9	36.0	43.5	43.4	60.0	59.1	58.9	46.9	43.8	39.0	**46.2**
Financial performance (market)											
Market-to-book ratio	1.8	1.8	2.1	2.3	2.2	1.4	1.4	1.1	1.4	1.6	**1.7**
Dividend yield (%)	4.3	3.6	3.1	2.9	1.8	2.9	1.3	2.4	2.6	2.6	**2.8**
Price–earnings ratio	10.1	12.5	15.5	15.6	23.7	8.4	19.5	7.9	9.4	12.0	**13.5**
Operating performance											
Output per employee (€'000)	579.0	617.0	678.1	601.0	876.0	1,178.0	1,142.4	1,090.6	1,177.0	1,217.4	**915.6**
Output/total assets (%)	109.0	93.7	90.6	79.1	61.6	85.2	84.4	94.9	97.2	107.1	**90.3**
Output/fixed assets (%)	191.5	156.2	152.3	131.9	98.9	141.2	140.8	172.9	185.2	206.3	**157.7**
CAPEX/fixed assets (%)	17.4	16.7	18.1	16.7	10.1	12.8	12.8	10.8	11.5	12.2	**13.9**
CAPEX/employee (€'000)	52.6	65.9	80.5	76.2	89.9	107.0	103.8	68.3	73.1	71.8	**78.9**
Output growth rate (nominal) (%)	8.5	11.2	19.6	–6.5	88.5	71.8	–2.7	–17.0	1.4	12.5	**18.7**

KPN

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995–04 average
Company size											
No. of employees	90,251	139,969	34,257	36,073	38,550	45,151	49,121	38,118	32,736	31,116	
Turnover (€m)	8,692	9,305	6,920	7,478	8,100	10,554	11,734	11,788	11,870	11,731	
Market capitalisation (€m)	12,156	13,903	18,071	20,262	46,349	14,736	12,862	15,437	15,107	16,116	
Financial performance (accounts)											
Return on sales (%)	18.4	19.1	19.9	18.2	4.6	2.0	–8.6	11.8	20.2	19.9	**12.6**
Return on capital employed (%)	15.4	15.1	12.8	13.3	3.0	0.5	–3.3	7.3	13.3	13.9	**9.1**
Post-tax return on equity (%)	16.0	15.6	10.8	14.9	9.0	10.2	–74.9	–171.7	34.9	23.0	**12.8**
Dividend payout ratio (%)	51.6	52.8	77.4	57.1	88.6	42.7	0.0	0.0	24.9	51.8	**44.7**
Gearing (%)	27.0	34.7	25.0	41.6	47.4	63.0	65.2	76.9	58.6	58.1	**49.7**
Financial performance (market)											
Market-to-book ratio	1.8	1.9	2.3	3.4	7.3	1.0	1.1	3.4	2.1	2.4	**2.7**
Dividend yield (%)	4.5	4.3	3.7	2.5	1.1	4.3	0.0	0.0	4.1	5.0	**2.9**
Price–earnings ratio	11.9	12.5	14.8	29.4	55.9	6.5	–1.0	–1.6	5.5	11.1	**14.5**
Operating performance											
Output per employee (€'000)	96.3	66.5	202.0	207.3	210.1	233.7	238.9	309.3	362.6	377.0	**230.4**
Output/total assets (%)	66.3	57.2	50.8	54.9	45.0	19.9	29.0	47.0	53.3	54.5	**47.8**
Output/fixed assets (%)	97.5	101.5	88.7	88.3	91.1	88.9	105.4	119.5	130.2	133.2	**104.4**
CAPEX/fixed assets (%)	19.7	19.1	18.5	23.0	28.4	32.0	26.5	11.5	15.6	19.3	**21.3**
CAPEX/employee (€'000)	19.4	12.5	42.0	54.0	65.5	84.1	60.0	29.8	43.4	54.6	**46.5**
Output growth rate (nominal) (%)	7.3	7.1	–25.6	8.1	8.3	30.3	11.2	0.5	0.7	–1.2	**4.7**

Note: The average value for Post-tax ROCE is the median value owing to outliers in 2001 and 2002.

Portugal Telecom

	1995	1996	1997	1998	1999	2000	2001	2002	*2003*	*2004*	1995–2002 average
Company size											
No. of employees	22,600	21,961	21,524	21,339	18,490	18,539	20,887	23,109	*24,872*	*27,925*	
Turnover (€m)	2,024	2,383	2,696	2,932	3,218	5,145	5,726	5,583	*5,764*	*6,023*	
Market capitalisation (€m)	2,668	4,189	8,093	7,419	11,368	11,696	10,975	8,216	*9,781*	*10,615*	
Financial performance (accounts)											
Return on sales (%)	24.0	24.7	23.0	23.1	24.7	16.1	18.6	21.0	*20.4*	*19.0*	**21.9**
Return on capital employed (%)	14.6	17.3	15.1	15.4	11.3	8.2	7.6	11.7	*12.0*	*12.8*	**12.6**
Post-tax return on equity (%)	10.1	13.3	17.6	20.5	17.9	11.4	–0.8	10.2	*10.9*	*22.2*	**12.5**
Dividend payout ratio (%)	33.5	32.0								*44.5*	**32.7**
Gearing (%)	38.6	32.5	34.0	69.4	52.4	49.1	59.1	67.0	*66.1*	*65.2*	**50.3**
Financial performance (market)											
Market-to-book ratio	1.4	2.1	4.0	3.4	4.1	2.7	2.4	2.6	*3.3*	*3.9*	**2.8**
Dividend yield (%)	3.2	3.1	2.1	2.6	1.8	0.0	1.1	2.4	*2.8*	*3.9*	**2.1**
Price–earnings ratio	14.7	15.3	23.1	16.8	23.0	21.7	35.0	21.1	*42.0*	*21.2*	**21.3**
Operating performance											
Output per employee (€'000)	89.6	108.5	125.3	137.4	174.1	277.5	274.1	241.6	*231.8*	*215.7*	**178.5**
Output/total assets (%)	48.3	54.7	54.0	31.6	37.8	38.9	33.4	43.5	*44.4*	*48.3*	**42.8**
Output/fixed assets (%)	61.7	72.5	81.3	79.7	83.5	94.5	104.3	122.0	*135.1*	*148.3*	**87.4**
CAPEX/fixed assets (%)	12.5	16.7	19.6	23.9	22.8	21.1	22.1	18.7	*13.1*	*15.4*	**19.7**
CAPEX/employee (€'000)	18.1	25.1	30.1	41.2	47.6	61.9	58.0	37.0	*22.5*	*22.4*	**39.9**
Output growth rate (nominal) (%)	29.0	17.8	13.1	8.8	9.8	59.8	11.3	–2.5	*3.2*	*4.5*	**18.4**

Note: Indicators for the years 2003 and 2004 have been highlighted in italics to indicate that special rights ceased to exist in those years.

BAA

	1995	1996	1997	1998	1999	2000	2001	2002	*2003*	*2004*	1995–2002 average
Company size											
No. of employees	8,171	8,227	8,393	12,335	12,724	13,076	13,559	12,431	*11,861*	*12,533*	
Turnover (£m)	1,159	1,253	1,373	1,679	1,959	2,121	2,182	1,870	*1,902*	*1,967*	
Market capitalisation (£m)	4,838	5,537	5,367	6,154	7,350	4,074	6,594	6,756	*5,044*	*5,532*	
Financial performance (accounts)											
Return on sales (%)	34.6	35.4	35.8	31.0	29.4	26.9	28.2	29.6	*30.6*	*31.3*	**31.3**
Return on capital employed (%)	11.1	10.3	10.0	9.5	9.3	8.9	9.2	7.1	*6.8*	*6.5*	**9.4**
Post-tax return on equity (%)	9.8	9.9	8.6	10.1	9.2	5.3	8.3	3.5	*8.3*	*7.6*	**8.1**
Dividend payout ratio (%)	37.2	36.8	43.9	38.0	41.0	72.9	46.6	116.2	*53.7*	*56.1*	**54.1**
Gearing (%)	25.0	27.5	29.6	33.9	32.8	30.6	28.9	35.2	*40.4*	*42.4*	**30.4**
Financial performance (market)											
Market-to-book ratio	1.7	1.7	1.6	1.6	1.7	0.9	1.4	1.4	*1.1*	*1.1*	**1.5**
Dividend yield (%)	2.2	2.1	2.4	2.3	2.2	4.3	2.9	2.9	*4.0*	*3.9*	**2.7**
Price–earnings ratio	17.2	17.5	18.1	22.1	18.4	15.7	16.5	40.6	*13.4*	*14.6*	**20.8**
Operating performance											
Output per employee (€'000)	167.4	206.6	245.3	192.9	248.3	260.2	264.3	231.2	*227.9*	*221.4*	**227.0**
Output/total assets (%)	27.1	25.6	25.0	26.1	28.0	29.2	28.9	21.9	*20.3*	*18.9*	**26.5**
Output/fixed assets (%)	28.6	27.8	28.0	30.3	32.3	34.0	32.9	26.8	*24.4*	*21.7*	**30.1**
CAPEX/fixed assets (%)	10.0	9.4	9.1	10.2	8.0	7.0	8.1	9.0	*8.7*	*14.0*	**8.8**
CAPEX/employee (€'000)	58.5	69.7	79.5	65.0	61.1	53.4	64.9	78.0	*81.5*	*142.5*	**66.3**
Output growth rate (nominal) (%)	5.6	8.1	9.6	22.3	16.7	8.3	2.9	–14.3	*1.7*	*3.4*	**7.4**

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