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TAKEOVER REGULATION IN THE UNITED STATES AND EUROPE: AN INSTITUTIONAL APPROACH

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I. Introduction

The United States and Europe, whatever their differences, have for some time represented the world's two great powers. Their collective history, social ties, and economic dependence make them partners on the global stage. While the threats of terrorism, new superpowers, and economic degradation confront the two with perhaps insoluble problems, they still stand out as beacons of progress in many areas: technological advancement, democratic government, and justice. They are also the centers of the world's leading financial institutions and multinational corporations. In many ways, U.S. and European corporate governance systems are similar and converging, and long-standing differences are disappearing as transatlantic cooperation and governance codes expand. Convergence has only grown with the fall of the Soviet Union and the liberalization of much of Eastern Europe.

But one intractable area of corporate governance has remained untouched by the larger trend of convergence. Laws in the United States and the European Union regulating hostile takeovers, one of the more remarkable and headline-grabbing events in a corporation's life, have remained strikingly dissimilar. The behavior of acquiring companies and target companies are subject to entirely different requirements under U.S. and E.U. law. It has never adequately been explained why the divergence in this one area of law has resisted, and indeed increased in the face of, broader trends favoring assimilation.

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To begin with, takeovers occur when an acquiring individual (or, more often, an acquiring corporation) acquires through a tender offer a majority of shares of a target corporation. Most commentators who have studied the question have concluded that the possibility of takeovers is generally beneficial for the market. Takeovers, or at least a mechanism for facilitating takeovers, provide at least four benefits for shareholders and the market in general: better allocation of resources, synergy gains, better management discipline, and more accurate market valuation.

Hostile tender offers do not come without their risks, though. First, the target corporation's board of directors, which is responsible for the business and management of the company, has an incentive to fight off even value-maximizing takeovers because the directors will likely lose their jobs if the offer is successful. Second, the majority shareholder of the target company has an incentive to sell his shares at a premium over the market price and allow the minority shareholders to be bought out at lower prices. Third, the acquirer can construct coercive tender offers, with a front-end offer higher than the back-end, thereby putting pressure on shareholders to tender.

Takeover regulations, then, are designed to maximize shareholder value by encouraging beneficial takeovers while minimizing the risks of misbehavior by the directors, the majority shareholders, and the acquirers. They can do this by imposing any number of requirements on acquiring corporations, target boards of directors, or the shareholders themselves. Fiduciary duties to act in the best interest of all shareholders, mandatory bids for all shares at the same price, and board neutrality are all potential rules that can approximately accomplish the purposes of takeover regulations.

The United States and Europe have adopted drastically different solutions to this problem. The United States has given a substantial amount of freedom to both acquiring and target corporations: the acquiring corporation can make an offer for any number of shares, and the target board of directors may take defensive measures against the offer. The European Union has instead put significant restrictions on both acquirer and target: the acquiring corporation must make a bid for all outstanding shares, and the target board of directors may not take any actions to frustrate the bid unless these actions are authorized by the shareholders.

These differing approaches stem from a number of sources. Unfortunately, they do not come from logical differences in ownership structure. Instead, to a great extent, they are caused by the institutions through which the laws were created and/or interpreted. In the United States, Delaware courts are the primary and most influential source of takeover law. In Europe, the European Union and its institutions developed the Takeover Directive through a process of consultation, political compromise, and lobbying. Another factor in the development of the regulations is the background laws already in place. In the U.S., state fiduciary duties formed the backbone of corporate law, while in Europe, the British Takeover Panel has been very influential. Finally, takeover regulations have been affected by empirical and theoretical research on the effects of takeovers on corporations.

The process by which Delaware courts developed their case law concerning takeover duties seems ideal. Judges reached their conclusions through reasoned analysis of the background law and the current state of empirical research, at least nominally free of political pressure. The process of adoption of the E.U. Takeover Directive, on the other hand, was riddled with venal compromises and pork-barrel politics. It is interesting, then, that the E.U. regulations seem much more consonant with the purposes inspiring the legislation than the U.S. ones do. They more effectively facilitate takeovers, while at the same time give greater protection to shareholders from the misaligned interests of directors.

In Part II, this paper will explain the theoretical background for takeovers. In Part III, it will describe the U.S. framework for takeover regulation. Part IV will describe the E.U. framework for takeover regulation. Part V will explain the reasons for the differences in the two jurisdictions. Finally, Part VI will give a more normative analysis of the effectiveness of the respective regulations.

II. Theory of Takeovers

Before analyzing how the United States and Europe have attempted to regulate takeovers in their respective legal systems, it is perhaps appropriate to set forth a general theory of takeover regulation. After all, without knowing the purpose of legal rules, it is difficult to assess their efficacy. I start with the relatively uncontroversial proposition that rules governing acquisitions should maximize economic value for shareholders.[1] This is an assumption that underlies much of corporate law in the United States and Europe,[2] and it will not be thrown out here. It does not, of course, mean that short-term spikes in share price are to be encouraged. Instead, efficient capital markets that reward productive corporations while punishing wasteful ones will in the end increase corporate value and, thereby, shareholder wealth.

In any legal regime, the availability of a mechanism allowing corporations to engage in takeovers is basically beneficial with respect to corporate value. Takeovers, or the potential for takeovers, offer four major economic benefits: first, they can put resources in the hands of those best able to use them; second, they can create synergies between two companies; third, they can discipline careless or misbehaving management; and fourth, they can correct market inefficiencies reflected in share price. Takeovers are engaged in for many other reasons, but these are the essential benefits for shareholders.[3] I will not focus on irrational economic reasons for takeovers, such as hubris or empire-building.

First, an acquiring corporation often takes over a target corporation because it believes that it can use the capabilities of the target corporation more efficiently. Innovative business strategies or unique talent amongst employees can increase cor-

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[1] Although this proposition is not entirely uncontroversial, as Hansmann and Kraakman have observed, "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value." Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law* 1 (John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 280, 2000).

[2] Various statutes in some member states of the European Union, and some states in the United States, contemplate the welfare of employees, stakeholders, and society in general. *See, e.g.*, CAL. CORP. CODE § 309 (West 1990 & Supp. 2002); IND. CODE ANN. §§ 23-1-35-1 (LexisNexis 1999 & Supp. 2002). These statutes address an important point: shareholders are only one group of many that have an interest in the company, and it seems reasonable that the law should protect them as well. This is an argument for another time, however.

[3] *See* Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21 (1988); *see also* Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. ON REG. 119 (1992).

porate profits and value, and if one corporation can develop and exploit these opportunities, then facilitating takeovers will create added wealth. The acquiring corporation will likely also pay a higher price for the shares of the target corporation, rewarding shareholders.[4]

Second, when a corporation acquires another corporation, it is often because the acquiring company believes that it can exploit synergy gains with the target company. The value of the two firms combined may be greater than the sum of the values of the firms individually because of economies of scale (when average costs decrease as production increases) and economies of scope (when a firm's resources are complementary, like production and advertising or transport).[5] Similarly, excess management capacity can be used to control corporations, cutting down on waste and reducing management costs.[6]

Third, the threat of takeover can discipline the management of a potential target corporation to improve its performance. If management knows that it will lose its job in the event of a takeover, it will work to make sure that such a takeover is unnecessary: it will reduce inefficiencies, thereby increasing share price and lowering the incentive for takeovers. When management is underperforming, the share price will decrease and make the possibility for takeovers rise. The potential for takeovers, then, will be a constant reminder to management that it must perform its duties with the utmost care.

Finally, takeovers ensure efficient capital markets by allowing underpriced companies to be bought out. If the market misprices a corporation's shares, then alert acquirers will buy the corporation and pocket the difference between the true value of the company and the market value of the company. Especially considering theories of market myopia—that is, that investors overvalue short-term gain while undervaluing long-term profit—there is a good argument that the availability of takeover measures increases market efficiency.[7] While such a

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[4] The High Level Group of Company Law Experts, *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, 19 (Jan. 10, 2002), *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf (last visited Feb. 24, 2009).

[5] Romano, *supra* note 3, at 126.

[6] *Id.*

[7] Romano, *supra* note 3, at 144-45.

takeover may not represent a true gain, because the target shareholders lose what the acquirer gets, it is a gain for shareholders generally, due to better market information.

In a perfect market, then, takeovers would occur whenever such takeovers would increase corporate and, therefore, shareholder wealth. But while takeovers offer the potential for delivering benefits to shareholders, they do not always work perfectly. These risks spring from basic "agency" problems first identified by Berle and Means in their seminal work, *The Modern Corporation and Private Property*.[8] According to Berle and Means, the separation of ownership from management in modern corporations creates a fundamental misalignment in the interests of shareholders and directors. Whereas owners desire to have profits dispersed to them through the issuance of dividends, directors and officers prefer to have the profits reinvested in the company and preferably trickle down into their salaries. This statement is overbroad, but it captures the essence of the dichotomy between shareholder and management perspectives.

The conflict of interests between shareholders and management takes on especial importance in situations like takeovers, in which the future of a firm is in question. Take, for example, the case of an acquiring corporation (Corporation A) that knows that it can increase the value of a target corporation (Corporation B) by replacing its management. Corporation A will be happy to pay a premium above the market price of the shares to current shareholders in order to take over control of Corporation B. The shareholders, or most of them, will be happy to tender their shares, unless they believe they can make more by keeping them. The directors of Corporation B, however, will oppose the takeover because they face the possibility of being fired. If the directors have the ability to thwart a takeover offer (by, for example, adopting defensive measures such as poison pills or selling the crown jewels) in the face of shareholder ap-

[8] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6 (Harcourt, Brace & World rev. ed. 1968) ("The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear.").

proval, then a value-maximizing takeover will be passed over.[9] Shareholders will lose out.

In addition to management-shareholder misalignment, there is another agency problem involved in takeovers, one that involves the conflict between majority shareholders and minority shareholders. In general, it seems logical to trust the judgment of controlling shareholders: because their money is invested just like minority shareholders, they have financial incentives to maximize shareholder returns. But there may be cases in which this reasonable assumption does not hold true. If the acquiring corporation believes that it can achieve synergy gains by taking control of the target corporation, it will probably want to do this in the cheapest way possible. It may only need 51% of the shares to control the company, and an even lower percentage in widely dispersed firms. It can acquire these shares on the open market, or it can negotiate directly with a majority shareholder. If it negotiates with the majority shareholder, it can offer that shareholder some of the gains expected from the takeover, and the minority shareholders will be left out. Through "squeeze-outs" or "freeze-outs," those minority shareholders might have to take a lower price for their shares after the takeover has occurred.

A second element of the conflict between majority and minority shareholders is the potential for private benefits of control.[10] In a takeover attempt, minority shareholders face the very real possibility of having to deal with a new controlling shareholder. This new blockholder controls the governance of the corporation and, thus, may be able to extract benefits that are not provided to other shareholders. Corporate raiders, then, have an incentive to pay a premium to the majority shareholder of the target corporation if they think they can receive private

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[9] This analysis assumes that the market or shareholders are the best judges of corporate value, which Delaware courts may not believe. Black and Kraakman argue that the core Delaware takeover cases embrace a "hidden value" model of the stock market, in which a firm's true value is visible only to well-informed directors and hidden to shareholders and the market at large. Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521 (2002).

[10] For a comprehensive analysis of the concept of private benefits of control, *see generally* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006).

benefits of control that come at the expense of the minority. The minority will then be forced to deal with a majority shareholder who is intent on looting the company.

Finally, there is the problem of structurally coercive tender offers.[11] In order to convince wary shareholders to tender their shares, acquiring companies have developed the so-called two-tier, front loaded cash tender offer. In this maneuver, the acquirer announces a two-step takeover. In the first step, they offer a certain price for a majority of shares. Once they have acquired control of the company, the acquirer will merge the target firm into another and cash out the minority at a price lower than in the tender offer. This strategy is coercive because it forces shareholders to make the choice of tendering their shares at a price perhaps below what they value it, or holding out and facing the possibility of receiving an even lower price when the acquired corporation is merged.

So, there are some agency problems that could prevent takeovers from delivering all their potential benefits. This is where takeover regulation enters the picture. The goal of takeover regulation should be to facilitate the types of takeovers that increase shareholder value while preventing management and controlling shareholders from acting against the interests of shareholders as a whole. The European Union and the United States have adopted radically different approaches to this problem,[12] and an analysis of their takeover laws will follow.

III. The U.S. Framework

The regulation of takeover law in the United States has received a massive amount of attention in scholarly literature and in judicial discourse. A survey of this literature is not within the scope of this paper. It is appropriate, however, to discuss the broad outlines of the framework for assessing the legality of takeovers. At the same time, such a discussion must address a

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[11] For an explanation of the coercive aspects of two-tier offers, *see generally* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247 (1989).

[12] At the most fundamental level, shareholder value is not explicitly the goal of the European Directive on Takeover Bids.

variety of sources of law: federal statutes, state statutes, and judicial decisions interpreting common law duties. This section will focus on these three sources, and more specifically, the Williams Act, the *Unocal/Revlon* line of case decisions, and state anti-takeover statutes.

a.) *The Williams Act*

The modern era of federal regulation of tender offers began in 1968, when Congress passed the Williams Act as an amendment to the Securities Exchange Act of 1934.[13] The Act's purpose, according to its sponsor Sen. Harrison Williams, was to "make the relevant facts known so that shareholders have a fair opportunity to make their decision."[14] To this end, the Act provides rules governing takeover offers in two basic areas: first, it requires offerors to disclose information about the offer, and, second, it establishes procedural requirements governing tender offers.[15]

Section 13(d) of the Act addresses the offeror's disclosure duties. If an acquirer obtains more than a specified percentage of shares, such acquisition triggers a duty to disclose certain information, including: the offeror's background and identity; the source of the offeror's acquisition funds; the purpose of the acquisition, including any plans to liquidate the target company or make any other major change to its business; and the extent of the offeror's holdings in the company.

In Section 14(d), the Williams Act imposes certain basic rules of the game. For example, shareholders who tender their shares may withdraw them during the first 7 days of the tender offer. The offer must remain open for at least 20 days. If more shares are tendered than the offeror sought, then purchases must be made on a pro rata basis. Importantly, the offeror

[13] 15 U.S.C. § 78(a), 48 Stat. 881 (1995); Guhan Subramanian, *A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill*, 23 DEL. J. CORP. L. 375 (1998). For a more thorough discussion of the Williams Act, *see generally* John G. Finley & Andrew J. Colau, *Doing Deals: Understanding the Nuts and Bolts of Transactional Practice: Overview of the Williams Act*, 711 PLI/Comm 109 (1995), available in Westlaw.

[14] S. REP. No. 90-550, at 3 (1967).

[15] *See CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987), for a similar analysis.

must pay the same per share price to all the tendering stockholders.

So, the Williams Act imposes some minimal requirements on acquiring corporations in the process of a tender offer. The acquiring corporation must disclose the purpose of the acquisition, offer plans for future major changes in the target, and pay the same price for all tendered shares. SEC regulations also make a corporation liable for false or misleading statements in relation to a tender offer.[16] The substance of a board's duties during a tender offer are mainly regulated by fiduciary duties as interpreted by courts.

b.) *Unocal/Revlon Duties*

Federal regulation makes up only a small part of the rules that apply to takeovers. In fact, the main line of cases addressing directors' duties to a corporation during takeovers interprets *state* law fiduciary duties. Unfortunately, this means that there are 50 different jurisdictions, in each of which the source of law is different. Fortunately, corporate law in the United States is heavily influenced by Delaware case law. The expertise and flexibility of the Delaware Court of Chancery has attracted a majority of large publicly trade corporations to incorporate in Delaware,[17] and that court's rulings carry influence beyond the state's borders.[18]

Through a line of cases beginning in the 1980's, Delaware courts have developed an "intermediate standard" of review for director actions during hostile takeovers.[19] In *Unocal Corp. v.*

[16] Security Exchange Act of 1934 § 14(e), 15 U.S.C § 78n (1995); 17 C.F.R § 240.14e1-3 (2008).

[17] *See* Delaware Department of State: Division of Corporations, About Agency, http://www.corp.delaware.gov/aboutagency.shtml (last visited Feb. 24, 2009) (stating that "[m]ore than 50% of all publicly-traded companies in the United States including 60% of the Fortune 500 have chosen Delaware as their legal home").

[18] For example, the famous case of *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), has been cited favorably by 12 of the 13 circuit courts and 15 state courts. *See* Dana M. Muir & Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?*, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 279, 354 (2005) (describing how Delaware courts have scrutinized director decisions to resist hostile takeovers).

[19] For a more extensive examination of this "intermediate standard," *see generally* Gilson & Kraakman, *supra* note 11. Gilson and Kraakman analyze the Del-

Mesa Petroleum Co., the Delaware Supreme Court recognized that in takeover situations, "directors are of necessity confronted with a conflict of interest," because an acquiring corporation is likely to replace the board.[20] Because of this conflict, the court concluded, the typical deference given to business judges was not appropriate. Instead, the court established a two-part test to determine whether directors could implement defensive measures against a takeover: first, the directors must have reasonable grounds to believe that the takeover presents a danger to corporate policy and effectiveness; and second, such measures must be reasonable in relation to the threat posed. The directors prove reasonable grounds "by showing good faith and reasonable investigation."[21] The court did not require shareholder approval before directors could take defensive measures. Under the *Unocal* test, the court accepted the validity of a poison pill defense in *Moran v. Household Int'l, Inc.*[22]

Less than a year later, the Delaware Supreme Court further circumscribed directors' freedom of action by holding in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* that, once a sale is in progress, the director's duty switches from protection or maintenance of the corporate enterprise to obtaining "the highest price for the benefit of the stockholders."[23] In other words, the directors become "auctioneers" attempting to sell to the highest bidder, and may not attempt to frustrate such sale. But in *Paramount Commc'ns, Inc. v. Time, Inc.*, the court gave more leeway to directors in deciding on defensive measures, even after it was inevitable that the target would be sold.[24] The court held that directors of a target corporation could consider factors other than the money values of the offers, including the amount of information available to shareholders, the conditions attached to the offers, and the timing of the offers.[25] These factors might justify defensive measures.

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aware case law as a middle ground between the two usual standards of review in corporate law, that is, the business judgment rule and the intrinsic fairness test.

[20] 493 A.2d at 955 (citations omitted).

[21] *Id.* (citations omitted).

[22] 500 A.2d 1346, 1357 (Del. 1985).

[23] 506 A.2d 173, 182 (Del. 1985).

[24] 571 A.2d 1140 (Del. 1989).

[25] *Id.* at 1153.

Two decisions in the 1990's clarified the duties of directors during takeover fights and broadened the availability of defensive measures. First, in *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, the court affirmed that enhanced scrutiny applied to directorial defensive actions in takeovers, but only once *Revlon* duties were triggered, or, that is, once a sale of the corporation was inevitable.[26] *QVC* suggested that pre-bid defenses were presumptively more reasonable, given that they occur before a solid takeover threat has emerged. Furthermore, in *Unitrin, Inc. v. American General Corp.*,[27] the Supreme Court of Delaware expanded the discretion of directors to resist hostile takeovers. According to the court, defensive measures approved by an independent board were permissible as long as they were not "draconian" and were within a "range of reasonableness."[28]

The thrust of this series of cases in Delaware is that directors in the United States have wide powers to resist a potential hostile takeover as long as they act in good faith after reasonable investigation, and as long as the measures adopted are not draconian. The doctrine applies an intermediate standard between the business judgment rule and the intrinsic fairness test, but is more akin to judicial deference than close judicial scrutiny.

c.) *State Anti-Takeover Statutes*

In addition to federal regulations and state law fiduciary duties, takeover law is also regulated by state anti-takeover statutes. These statutes tend to be less even-handed in their application, giving protection to in-state corporations from potential out-of-state acquirers.[29] They have gone through three generations of development, and differences between states abound, leading one commentator to observe that "[s]tate takeover acts are similar to snowflakes—if you think you have

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[26] 637 A.2d 34 (Del. 1994). For a good discussion of *QVC* and its implications, *see generally* Melissa K. Kurp, *Corporate Takeover Defenses After QVC: Can Target Boards Prevent Hostile Tender Offers Without Breaching Their Fiduciary Duties?*, 26 LOY. U. CHI. L.J. 29 (1994).

[27] 651 A.2d 1361 (Del. 1995).

[28] *Id.* at 1387-88.

[29] *See, e.g.*, ALASKA STAT. §§ 45.57.010-45.57.120 (2000); MASS. ANN. LAWS ch. 110C, §§ 1-13 (1995 & Supp. 2002); TENN. CODE ANN. §§ 48-103-101—48-103-505 (2002).

found identical ones, you are probably not looking closely enough."[30] However, some discussion of their key characteristics is necessary to complete the picture of U.S. takeover regulation.

The first generation of takeover statutes attempted to regulate tender offers by giving a state administrator the power to review an offer's merits or the adequacy of its disclosures.[31] The administrator could often hold hearings on the bid and could impose waiting periods between when an offer was filed and when it became effective. Many elements of the takeover statutes were invalidated under federal law, culminating in the *Edgar v. MITE Corp.*[32] decision, in which the Supreme Court declared the Illinois anti-takeover statute unconstitutional. According to the Court, "[w]hile protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders,"[33] and therefore a statute that placed burdens on inter-state commerce violated the Commerce Clause.[34] In that case, the Illinois statute provided for a hearing on the tender offer's terms and a waiting period.[35]

The second generation of anti-takeover statutes focused on disclosure-oriented protection for target corporations. One of the most effective of these laws was the "control share acquisition" statute, under which a majority of disinterested shares had to approve a bid to acquire the corporation. In *CTS Corp. v. Dynamics Corp. of America*,[36] the Supreme Court upheld Indi-

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30 Symposium, *State Regulation of Tender Offers*, 7 J. CORP. L. 603 (1982) (footnote omitted) *quoted in* James D. Cox & Thomas Lee Hazen, 3 COX & HAZEN ON CORPORATIONS 1491 (2d ed. 2003).

31 *See, e.g.*, LA. REV. STAT. ANN. § 51:1501(E) (repealed 1987); 70 PA. CONS. STAT. § 74(d) (Supp. repealed 1993). Many of these statutes were enacted to protect specific local industries. In a particular egregious example, Indiana enacted its first anti-takeover statute to protect one company, Arvin Industries. The company was a prominent member of the community in Columbus, Indiana, employing about 2000 workers and supporting local schools. When the Belzberg family, a group noted for greenmail, threatened a takeover, Arvin persuaded a state legislator to draft the takeover bill. *See* Michael W. Miller, *How Indiana Shielded a Firm and Changed the Takeover Business*, WALL ST. J., Jul. 1, 1987, at 1.

32 457 U.S. 624 (1982).

33 *Id.* at 644.

34 *Id.* at 645.

35 *Id.* at 627.

36 481 U.S. 69 (1987).

ana's control share statute.[37] That law stated that voting rights would be denied to shares held by anyone owning more than twenty percent of outstanding shares unless the independent shareholders authorized such voting rights in a shareholder meeting.[38] Other examples of second generation statutes include the "fair price" statutes (requiring takeovers to be approved by a supermajority of shareholders unless they all receive the best price paid by the offeror)[39] and "stakeholder" statutes (permitting management to consider the interests of groups other than stockholders).[40]

Finally, the third generation of takeover statutes go even further in expanding protection of in-state target corporations. Two varieties of the statute include the "freeze" statute and the disgorgement statute. The "freeze" statute, as enacted in New York, prohibits a merger within five years of an acquisition that gives control to an offeror unless that transaction was approved by the target company's directors before the acquisition itself.[41] The Pennsylvania disgorgement statute, on the other hand, requires any person owning more than twenty percent of a corporation's shares to disgorge any profit realized within an eighteen month period.[42] So far, third generation statutes have withstood constitutional challenges in federal court.[43]

In sum, then, anti-takeover statutes have given further protection to target corporations against hostile takeovers. States have done this by empowering boards of directors to take into account a broader range of factors in decision-making, and also by giving shareholders a larger role to play in the process.

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37 *Id.* at 94.

38 *Id.* at 73-74.

39 *See, e.g.*, CONN. GEN. STAT. ANN. §§ 33-840—33-842 (West 1997 & Supp. 2002); MD. CODE ANN., CORPS. & ASSNS. §§ 3-602, 3-603 (West 1999 & Supp. 2001).

40 *See, e.g.*, CAL. CORP. CODE § 309 (West 1990 & Supp. 2002); IND. CODE ANN. § 23-1-35-1 (1999 & Supp. 2002).

41 N.Y. BUS. CORP. LAW § 912 (McKinney Supp. 2002).

42 15 PA. CONS. STAT. ANN. §§ 2571—2576 (West 1999).

43 *See, e.g.*, BNS, Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988); Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989), cert. denied, 493 U.S. 955 (1989); West Point-Pepperell, Inc. v. Farley, Inc., 711 F. Supp. 1096 (N.D. Ga. 1989).

IV. The E.U. Framework

Just like in the United States, the European Union has a number of jurisdictions in each of which laws related to takeovers can differ in significant ways. Unlike the United States, however, the E.U. has adopted a comprehensive takeover directive that governs most of the important elements of a tender offer. Passed in 2004 after several previous failed versions, the E.U. Directive on Takeover Bids attempts to "harmonize" takeover regulation in the 27 member states.[44] While many of its provisions are relatively standard (ensuring that a bid is made public[45] and that offerors publish information about themselves),[46] it also institutes some reforms that are radically different from the American regime and that are considered quite controversial. This paper will focus on the three principle innovations of the E.U. takeover directive: the mandatory bid rule, the board neutrality rule, and the breakthrough rule. Together, these rules put critical restrictions on what both a raider and a target corporation's board can do during takeover battles.[47]

a.) *Mandatory Bid Rule*

The first pillar of the E.U. directive is the mandatory bid rule, which requires that an acquiring corporation must make a bid for all the outstanding shares of a corporation. This requirement stands in stark contrast to the law in the United States,

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[44] Council Directive 2004/25, On Takeover Bids, 2004 O.J. (L 142/12) (EC), *available at* http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:HTML (last visited Feb. 24, 2009)

[45] Council Directive 2004/25, art. 8, 2004 O.J. (L 142) 8 (EC).

[46] Council Directive 2004/25, art. 10, 2004 O.J. (L 142) 10 (EC).

[47] Before beginning this discussion, it is important to note some features of E.U. law. Under the Treaty of Rome, directives are "binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods." Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 189 [hereinafter EC Treaty]. Directives, unlike regulations, thus do not immediately become law within the member states, but must be transposed into national legislation. In the case of the E.U. takeover directive, the deadline for transposition was the end of 2006, although there is still some discussion about whether all member states have complied with the directive's proposals. *See Commission Report on the Implementation of the Directive on Takeover Bids*, at 4, (Feb. 2001), *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf (last visited Feb. 24, 2009) [hereinafter "Commission Report"].

which has no requirement to buy unwanted shares.[48] At the same time, the directive gives some flexibility to member states to work around the rule.[49]

Under Art. 5, an individual who acquires a threshold percentage of shares of a company that gives him control of the company must make a bid for all the securities of the company at an equitable price. The threshold percentage is defined by the member states.[50] An equitable price is defined as the "highest price paid for the same securities by the offeror" over a period of time to be determined by the member states.[51] The supervisory authorities of the member states are authorized to adjust the equitable price in accordance with declared criteria.[52]

The takeover directive, then, gives a certain amount of leeway to member states in defining the base rules for mandatory bids, but the bid is mandatory once the threshold is met. A look at the number of derogations that countries have provided at the level of law, though, shows just how flexible a directive can be.[53]

b.) *Board Neutrality*

The E.U. Directive on Takeover Bids also addresses the question of whether directors are permitted to adopt defensive measures in response to a hostile tender offer. In the United

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48 It is unclear whether a Delaware board's failure to use a poison pill or § 203 of the Delaware General Corporation Law to extract a back-end price equal to the tender offer price of a two-tier front-loaded cash tender offer would amount to a breach of fiduciary duties. In practice, there are no hostile offers in the U.S. that do not promise an equal price.

49 Commission Report, supra note 47, at 10.

50 Council Directive 2004/25, art. 5(3), 2004 O.J. (L 142) 5(3) (EC).

51 *Id.* at art. 5(4).

52 *Id.*

53 In Germany, for example, the supervisory authority can grant exemptions from the mandatory bid requirement if this seems justified:

> having regard to the interests of the offeror and the shareholders of the target company, the way in which control was obtained, the shareholder structure of the company, the actual possibility of exercising control or the fact that the shares in the target company is reduced below the control threshold subsequent to the acquisition of control." Ireland goes even further, giving the supervisory body the power to exempt corporations from the rules in exceptional circumstances and "in other circumstances.

Commission Report, *supra* note 47, at Annex 3.

States, the answer is that they may do so if they have reasonable grounds to believe the takeover is a threat and the measures are themselves reasonable. In sharp contrast, the E.U. takeover directive provides that directors are held to a strict rule of neutrality.

According to Art. 9 of the Directive, once a board has learned of a tender offer, it may not take "any action, other than seeking alternative bids, which may result in the frustration of the bid." Defensive measures are by their nature aimed at frustrating a bid, so almost all of them are presumptively a violation of Article 9. The Directive does, however, state that directors no longer have an obligation of neutrality if the general meeting of shareholders grants authorization for such measures.

It is interesting to note that the directive specifically mentions two kinds of defensive measures, approving of one and disapproving of another. First, it expressly allows the "white knight" defense: boards are free to search for alternative bids even without shareholder approval. Second, the directive prohibits another action, that of "issuing shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company."[54] This clause apparently refers to a tactic known as the poison pill, by which a board may dilute a raider's shares by giving a right to other shareholders to acquire additional shares at low prices. The directive makes it illegal for a corporation to adopt a poison pill, a strategy that is both widespread and generally accepted in the United States.[55]

c.) *Breakthrough Rule*

In addition to board neutrality, the takeover directive gives another strong tool to raiders: the breakthrough rule. The breakthrough rule ensures that, in the event of a takeover, the corporation operates strictly according to a one-share-one-vote system, voiding all inconsistent arrangements, whether in the

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[54] Council Directive 2004/25, art. 9(3), 2004 O.J. (L 142) 9(3) (EC).

[55] *See, e.g.*, *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985). For a description of the functioning of poison pills and the SEC reaction, *see generally* WILLIAM A. KLEIN, J. MARK RAMSAYER, & STEPHEN M. BAINBRIDGE, BUSINESS ASSOCIATIONS: CASES AND MATERIALS ON AGENCY, PARTNERSHIPS, AND CORPORATIONS 779-80 (Foundation Press 6th ed. 2006).

articles of association or in contractual agreements. One of the more controversial[56] and complicated[57] provisions of the directive, this rule serves to greatly facilitate hostile takeovers.

Art. 11 of the directive states that, once a bid has been made public, any restrictions on the transfer of securities are not to apply vis-à-vis the offeror during the validity of the tender offer.[58] In addition, restrictions on voting rights will not apply in the general meeting of shareholders that decides on defensive measures.[59] Finally, if the offeror has acquired at least 75% of the voting capital, then (i) any restrictions on transfer or voting and any extraordinary rights of shareholders to appoint or remove directors are not to apply, and (ii) multiple vote securities will carry only one vote at the first general meeting of shareholders called by the offeror.[60]

Taken together, these provisions make it more difficult for a controlling blockholder, as well as incumbent directors, to exercise disproportionate control of a company. They can no longer use multiple voting rights and transfer restrictions to block a hostile tender offer, and must instead compete for control. Once again, no similar rule exists in the United States.

d.) *Opt-Outs and Exemptions*

As a final note on the mechanics of the E.U. Takeover Directive, it should be mentioned that the provisions regarding board neutrality and the breakthrough rule are optional. Art. 12 of the directive states that member states may opt out of these requirements.[61] If they do so, however, they must give corporations the option to apply the two rules, a decision that must be made by the general meeting of the shareholders.[62] Further, member states may exempt companies that decide to

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[56] *See* Vanessa Edwards, *The Directive on Takeover Bids – Not Worth the Paper It's Written On?*, 1 EUR. CO. & FIN. L. REV. 416, 437 (2004).

[57] The article calls for "equitable compensation" for any loss suffered by the holders of any loss connected to the inapplicability of voting rights or share transfer rights. It does not, however, specify how the compensation should be calculated. Such responsibility falls on the member states. It is far from clear how they are to do so, and member states have struggled with this problem. *Id.*

[58] Council Directive 2004/25, art.11(2), 2004 O.J. (L 142) 8 (EC).

[59] *Id*. at art. 11(3).

[60] *Id*. at art. 11(4).

[61] *Id*. at art. 12(1).

[62] *Id*. at art. 12(2).

implement the board neutrality and breakthrough rules from these requirements in the event that an acquiring company that does not apply the rules launches an offer for them.[63] These provisions are designed to give flexibility to member countries with different traditions in corporate governance, and also to reassure companies that they will not be disadvantaged by their decision to take part in the directive's rules.

V. Causes and Explanations

The two principle elements of any takeover regulation are acquirer duties and board duties. Any regulation must decide the amount of freedom that acquirers should have to structure their bid, and also the amount of freedom that boards should have to resist that bid. It is hard to imagine two systems for takeover regulation being more divergent with respect to these two elements: in Europe, raiders must make a bid for all outstanding shares, and boards must be neutral; in America, raiders may make a bid for as many or as few shares as they desire, and boards can take strong defensive actions. The difficult question that arises from this analysis of American and European approaches to takeover law is how they came to be so different. Do the differences stem from assumptions about ownership structures in the United States and Europe? Are they a result of the process by which they were formulated? Could they be purely arbitrary decisions adopted as solutions to coordination problems? Or perhaps one system represents a clear failure on the part of decisionmakers? This section will attempt to explain why and how Delaware courts,[64] on the one hand, and the European Union, on the other, developed their respective takeover laws. I will argue that three factors have been decisive in determining how U.S. and European takeover law has developed: first, the background laws governing corporate duties; second, the process by which laws are created and/or interpreted; and third, research on the effects of takeovers.

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[63] *Id.* at art. 12(3).

[64] The focus will be on Delaware case law, rather than the Williams Act and state anti-takeover statutes. The Williams Act is devoted mainly to disclosure and, thus, is less relevant to a comparison of the E.U. and the U.S. systems. State anti-takeover rules are relevant, but they are necessarily numerous and varied. Therefore, some mention will be made of them, but Delaware case law will represent the bulk of the section.

The sixth section will address how effective the systems have been in accomplishing their primary goals of promoting wealth-creating takeovers while protecting shareholder interests.

a.) *U.S. Takeover Law Explained*

Delaware courts have played a dominant role in developing American takeover law in the past twenty years. Beginning with the seminal *Unocal* case, the Delaware Supreme Court has articulated and explained the role that target boards may play in hostile takeover situations, and it has interpreted that role to be a large one. At the same time, courts hesitate to announce sweeping changes in legal rules and rely to a great extent on precedent.[65] They also may only address legal issues that are presented to them, and any statements not necessary to the opinion are considered non-binding dicta. To understand how the Delaware courts have reached their decisions, then, one must read their opinions with the knowledge that background laws are guiding the judge's reasoning.[66]

In *Unocal*, the court was faced with the question of whether a corporation's buy-back of its own shares was valid under state law. The court couched its decision in the language of past precedent, but it went beyond precedent to create a new standard

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[65] *See* Robert Barnhart, *Principled Pragmatic Stare Decisis in Constitutional Cases*, 80 NOTRE DAME L. REV. 1911 (2005); Wallace Jefferson, *Stare Decisis*, 8 TEX. REV. L. & POL. 271 (2004). *But see* William S. Consovoy, *The Rehnquist Court and the End of Constitutional Stare Decisis: Casey, Dickerson and the Consequences of Pragmatic Adjudication*, 2002 UTAH L. REV. 53 (2002).

[66] There is an important line of thought that, in constructing corporate law, Delaware courts take into account political issues. Bill Cary argued in 1981 that Delaware's reliance on revenue from corporate charters led its courts to craft laws to be management-friendly. *See* Bill Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). More recently, scholarly articles have taken up the issue of takeover law and its political ramifications. Lucian Bebchuk and Allenn Ferrell, in particular, have focused on the ways in which Delaware courts have developed takeover laws to give excessive protection to incumbent management. *See, e.g.,* Lucian A. Bebchuk, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999); Lucian Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition,* 87 VA. L. REV. 111 (2001); Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1 (2002); Lucian Bebchuk & Allen Ferrell, *On Takeover Law and Regulatory Competition,* 57 BUS. LAW. 1048 (2002). This position is important to note, but it is the argument of this paper that overtly political institutions function in different ways than overtly non-political courts.

of review for board actions in takeover situations. The court cited past cases for the rule that the lenient business judgment rule applied in the context of a takeover.[67] At the same time, the court recognized that takeovers presented management with a conflict of interest: their duty is to act in the interest of the corporation, but their job is threatened by a successful tender offer. In addition, the court acknowledged that there was fierce academic and professional debate about the proper role of target management. Justice Moore cited the debate between, particularly, Martin Lipton, an advocate of board freedom,[68] and Frank Easterbrook and Daniel Fischer, supporters of board passivity.[69] The court gave great weight to Mr. Lipton's arguments. In a long footnote, for example, the court observed that "[o]ne rather impressive study indicates that the stock of over 50 percent of target companies, who resisted hostile takeovers, later traded at higher market prices than the rejected offer price, or were acquired after the tender offer was defeated by another company at a price higher than the offer price."[70] The study cited was a 1979 article published by Lipton.

The court's logic, then, was simple. First, state statutes and precedential case law established that the business judgment rule, which gives a presumption of good faith and informed judgment to directors, applied during takeovers. Second, academic articles and common sense showed that some conflicts of interests existed during takeovers. Third, due to the conflict of interest, an enhanced, intermediate standard of review should apply to directors actions during such periods.

But the court was not acting entirely freely. Footnote 10 makes it obvious that the court felt constrained to come to its decision despite convincing arguments that directors should be

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[67] *Unocal*, 493 A.2d at 954.

[68] *See* Martin Lipton, *Takeover Bids in the Target's Boardroom: An Update After One Year*, 35 BUS. LAW. 101 (1979); Martin Lipton & Andrew Brownstein, *Takeover Responses and Directors' Responsibilities: An Update*, ABA National Institute on the Dynamics of Corporate Control (Dec. 8, 1983).

[69] *See* Frank Easterbrook & Daniel Fischer, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733 (1981) (hereinafter "*Takeover Bids*"); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) (hereinafter "*Proper Role*").

[70] *Unocal*, 423 A.2d at 956 n.11.

obligated to refrain from frustrating the bid. According to the court:

> It has been suggested that a board's response to a takeover threat should be a passive one. However, that clearly is not the law of Delaware, and as the proponents of this rule of passivity readily concede, it has not been adopted either by courts or state legislatures.[71]

Easterbrook and Fischel, in the articles cited by the court, argue that cash tender offers "increase everyone's welfare"[72] and refute Lipton's economic rationale for allowing directors to resist hostile takeovers. But Justice Moore felt compelled to reject their proposals because "that clearly is not the law of Delaware." Moore may have been a bit disingenuous in making this statement, in that he then proceeded to fashion a new standard of review for board decisions in takeover situations. After all, Delaware courts create national policy in many areas of corporate law, and they came close to creating some of these rules from scratch, using the soft clay of fiduciary duties. But Moore nevertheless reasoned that his conclusion was mandated by the law of Delaware. The court was guided in its decision by the web of background laws governing corporate decisions and the research of academics in the field.

The Delaware Supreme Court took a similar approach in 1995 when it decided *Unitrin, Inc. v. American General Corp.*[73] The court was presented with the issue of whether a corporation's share repurchase program, designed to prevent an acquisition by American General Corp., was a violation of the board's *Unocal* duties. Justice Holland hewed closely to the *Unocal* framework, asking whether Unitrin's board had reasonable grounds to believe that a threat to corporate policy existed and whether the board's response was reasonable in relation to that threat.[74] But the court slightly refashioned that rule to expand the discretion of directors. Accordingly, a defensive measure was permissible under *Unocal* as long as it was not "draconian," by which the court meant that it was not "coercive or preclu-

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[71] *Id.* at 955 n.10 (citing *Takeover Bids*, *supra* note 69, at 1750). *See Proper Role*, *supra* note 69 at 1194.

[72] *Takeover Bids, supra* note 69, at 1733.

[73] 651 A.2d 1361 (Del. 1995).

[74] *Id.* at 1373.

sive."[75] If the measure is not draconian then, the directors' actions will meet the *Unocal* proportionality standard as long as the measures are within a "range of reasonableness" as a response to the threat to corporate effectiveness.[76] The terminology used by the court in *Unitrin* consequently widened the deference given to director actions in tender offer situations.

In support of its decision, the court relied on past judicial rulings, but also cited heavily from scholarly literature. Justice Holland propped up his arguments with no fewer than thirty citations to scholarly publications, ranging from Bebchuk and Kahan's *A Framework for Analyzing Legal Policy Towards Proxy Contests*[77] to Gilson and Kraakman's *Delaware's Intermediate Standard for Defensive Tactics*.[78] The court's decision to expand the "reasonableness" test of *Unocal* to a "range of reasonableness" seems to have been largely based on an article by Gregg Kanter in the University of Pennsylvania Law Review.[79] In a footnote, the court observed that "[e]fforts to relate *Unocal*'s inherently qualitative proportionality test to a quantitative formula have demonstrated the fallacy of such an exercise."[80] The court went on to show that any equation used to calculate the proper response to a hostile tender offer would be hopelessly arbitrary and approximate.

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[75] *Id.* at 1387.

[76] *Id.*

[77] Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071 (1990), *cited in Unitrin*, 651 A.2d at 1379. The court uses the article in support of its argument that the shareholder franchise deserves special protection under *Unocal*. Bebchuk's and Kahan's work argues that the widespread use by corporations of sophisticated defensive measures have made proxy contests indispensable for corporate raiders.

[78] Gilson & Kraakman, *supra* note 19, *cited in Unitrin*, 651 A.2d at 1384. The court uses the authors' categorization of the threats posed by hostile tender offers. This categorization serves to identify the nature of the threat posed by American General's proposed acquisition. Justice Holland's analysis, however, is based on a mistaken understanding of the article. Gilson and Kraakman argue that substantive coercion is a slippery concept that must be tied to effective proportionality review to work well, given that shareholders may make equally good decisions as directors. Holland, instead, uses substantive coercion as a rationale for deferring to the decisions of directors.

[79] *See* Gregg H. Kanter, Comment, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the Unocal Test*, 138 U. PA. L. REV. 225 (1989). The article is in fact a student note, and the court mistakenly gives the name of the author as George.

[80] *Unitrin*, 651 A.2d at 1374 n.13.

The preceding analysis serves to show how the United States has arrived at its current laws governing takeover law. First, Delaware courts have played the predominant role in explaining the role of corporate boards in tender offer situations.[81] Second, these courts have been influenced heavily by the web of background laws already existing: that the business of the company is to be managed by the board of directors, that the decisions of directors are subject to the deferential business judgment rule, and other laws. Third, while the court has been constrained by the surrounding legal environment, it has also taken into consideration the state of current legal scholarship in writing its decisions. By their nature, courts work in fits and starts. They may only address issues that are presented to them in the form of a lawsuit. They are bound by precedent. They also are made up of judges, a group of individuals with largely similar (and conservative) viewpoints. These elements have worked together to make American takeover law what it is today. It is striking, then, to see how Europe has arrived at its current law.

b.) *European Takeover Law Explained*

While courts have played a dominant role in defining takeover law in the United States, the European Union arrived at its takeover law in a very different way. The Directive on Takeover Bids is the product of years of studies, commissions, and negotiations. The final version is very different from what was originally expected, largely because of the process by which it was fleshed out. That process involved compromises that made the document much different from what was originally envisioned.[82]

[81] Courts have unique characteristics in the scheme of government. Alexander Bickel stated:

> [Courts] have certain capacities for dealing with matters of principle that legislatures and executives do not possess. Judges have, or should have, the leisure, the training, and the insulation to follow the ways of the scholar in pursuing the ends of government.

Alexander Bickel, THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS 25 (1962).

[82] For a good history of the Takeover Directive, *see generally* Edwards, *supra* note 56. Edwards argues that the directive in its final version raises serious concerns about whether it can accomplish its intended goals. Edwards points specifically to the opt out rules for breakthrough and board neutrality, as well as the

The first step towards a European takeover law came from a Commission study on how to complete the internal market. The Commission's White Paper mentioned the need to improve procedures for the "offers of shares to the public" because of great variance between countries.[83] In 1989, the Commission proposed a Thirteenth Council Directive on Company Law concerning takeover and other general bids.[84] Based on the United Kingdom's City Code on Takeovers and Mergers, the proposal presented the general principle of equal treatment of shareholders and outlined obligations for the bidder and the board of the target company.[85] The bidder was required to provide certain information about the offer and was required to submit a bid for all outstanding shares once it had acquired a certain percentage of shares.[86] The target board was prohibited from engaging in certain kinds of frustrating actions.[87]

The proposal failed when it met fierce criticism, especially from the United Kingdom and Germany.[88] Although the proposed directive was based on the City Code, the U.K.'s Department of Trade and Industry worried that codifying the nonstatutory City Code would destroy the Takeover Panel's main strength: its speed and flexibility.[89] In addition, European in-

failure of the directive to mandate a uniform threshold for triggering the mandatory bid, as ineffective measures for harmonizing takeover law through the E.U. Edwards is cautiously optimistic that the general principles of the directive could improve the plight of minority shareholders, given their effectiveness in the United Kingdom.

83 *Completing the Internal Market: White Paper from the Commission to the European Council* (Jun. 1985), *available at* http://aei.pitt.edu/1113/01/internal_market_wp_COM_85_310.pdf (last visited Feb. 24, 2009).

84 *Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover and Other General Bids,* COM (1989) 823 final (Jan. 19, 1989).

85 *See* Edwards, *supra* note 56, at 437; *see also* J.W.A. Cann, *Consideration of the Proposed Takeover Directive in the light of the United Kingdom Experience of Takeover Regulation*, in CONFERENCE ON MERGERS & ACQUISITIONS (J.D. Kleyn ed., 1991), for a comparison of the Commission's proposal with the UK system.

86 *See* Edwards, *supra* note 56, at 419.

87 *Id*.

88 *See* Ingrid Depser, *Amended EC Proposal for a 13th Council Directive on Company Law concerning Takeover and other General Bids*, 19 INT. BUS. LAW. 482 (1991).

89 *See* Edwards, *supra* note 56, at 420.

dustry feared that the directive would cause frequent and frivolous litigation.[90]

After extensive consultation with member states, the Commission submitted a new proposal for a directive on takeover bids in 1996. Although based on the previous proposal, the new directive did not require a mandatory bid for all shares when an offeror acquired a certain threshold percentage.[91] The draft also attempted to allay the U.K. Takeover Panel's fears about losing its discretionary power. The proposal provided that "[t]his Directive does not affect the power which courts may have in a Member State to decline to hear legal proceedings . . . provided that an injured party enjoys adequate remedies."[92]

Unimpressed, the U.K. Takeover Panel launched a public campaign against the Commission's proposal.[93] Once again, it argued that the Directive would open the door to costly litigation that would delay the implementation of valuable transactions. The Netherlands also opposed the 1996 Directive, largely because the country's laws allowed target boards to use a wide range of defensive tactics against hostile takeovers.[94] This legal regime would be threatened by the Commission's proposal. France, for its part, lobbied successfully to include employee protection provisions in the proposed directive.

The Parliament approved the Council's common position in 2000 with some amendments.[95] In a demonstration of the power of politics, one amendment submitted by the Rapporteur of the Legal Affairs Committee proposed that supervisory authorities have the right to permit boards to take defensive ac-

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[90] The Union of Industrial and Employer's Confederation in Europe (UNICE) was particularly vocal about its criticisms. One amendment it wanted was to allow boards more leeway to use defensive measures. *See* Depser, *supra* note 88, at 488.

[91] Member states could refrain from adopting such a law, as long as "rules or other mechanisms or arrangements are in force which . . . offer other appropriate and at least equivalent means in order to protect the minority shareholders of that company." European Commission, *Proposal for a 13th European Parliament and Council Directive on Company Law Concerning Takeover Bids*, at art. 3(1), COM 95, 0655 FINAL (1996), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:51995PC0655:EN:NOT (last visited Feb. 24, 2009).

[92] *Id.* at art. 4(5).

[93] *See* Edwards, *supra* note 56, at 421-22.

[94] *See* Wiek J. Slagter, *Takeovers and the Draft 13th EC-Directive*, *in* FURTHER PERSPECTIVES IN FINANCIAL INTEGRATION IN EUROPE 173 (Eddy Wymeersch ed., 1994).

[95] 2000 O.J. (C 232) 168.

tion without consulting shareholders. The Rapporteur was Klaus-Heiner Lehne, a German Christian Democrat who represented Düsseldorf. Lehne was undoubtedly influenced by the fact that Mannesman, a Dusseldorf company, had just previously been acquired by Vodafone, a U.K. company, in Germany's first hostile takeover.[96]

The draft directive ended up falling apart because of political pressure. Domestic industry in Germany (particularly Volkswagen and BASF) and unions lobbied against the proposal because they wanted greater freedom for boards to engage in defensive tactics against hostile tender offers.[97] Spanish members of the European Parliament also sided with the German MEP's, purportedly in return for German support for greater fishing subsidies.[98] The proposal was dropped for other, less venal reasons as well: until the creation of a level playing field for European takeover targets, it did not make sense to require prior shareholder approval of poison pills; some member states like France desired greater protection for the employees of target companies; and the directive failed to level the playing field with the United States.[99]

In a last ditch effort, the Commission set up a group of company law experts headed by Jaap Winter to advise it on another takeover directive draft. The Winter Group's task was to propose rules for takeover bids that would "consolidat[e] and integrat[e] Europe's industry in order for European business to make optimal use of the EU's single market."[100] Once again, the buzz words were a "level playing field." Winter came back with the breakthrough rule, along with other innovations, as a way of ensuring equal treatment of shareholders.

The new proposal adopted by the Commission in 2002 faced withering criticism yet again. Sweden had serious problems with the breakthrough rule, given that over half its listed com-

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[96] *See* Edwards, *supra* note 56, at 425 n.91.

[97] *Id.* at 426.

[98] *Id.* at 427.

[99] *Id.*

[100] Jaap Winter, *We All Want to Go to Heaven but Nobody Wants to Die*, 1 EUR. CO. L. 4 (2004), *quoted in* Michel Menjucq, *The European Regime on Takeovers*, 3 EUR. CO. & FIN. L. REV. 222, 222 (2006).

panies have a system of dual voting rights.[101] The rule would render the Swedish system nearly useless in takeover situations. The Wallenberg family, for example, used multiple voting rights to secure its control over companies such as Investor and Ericsson. In Ericsson, A shares are granted 1000 times the votes of B shares, allowing the Wallenbergs to control the company with only 7% of the capital.[102] The influential family made harsh public statements about the proposal, including that it violated human rights and constitutional law.[103] Other countries with similar legal arrangements supported Sweden's position. Germany had concerns as well, considering that Volkswagen, Europe's largest carmaker, was protected against hostile tender offers by the large number of shares owned by the Land of Lower Saxony and by a law prohibiting any shareholder from casting more than twenty percent of the votes.[104] The European Parliament, reflecting these concerns, commissioned a report by two law professors in which the authors criticized the breakthrough rule as "not persuasive" and "highly inconsistent."[105]

After months of negotiations, and many proposed compromises, the Italian presidency revived the idea of allowing companies a choice as to whether to apply the rules on board neutrality. The Italian compromise would allow member states to opt in or out of the board neutrality and breakthrough provisions of the Takeover Directive.[106] This new compromise solved many of the worries of the various countries, and the proposal garnered broad support, finally being adopted in 2003, despite the protest by many, both in academia and in government, that

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[101] *See* Rolf Skog, *The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*, 48 RIVISTA DELLE SOCIETA 1141 (2003).

[102] Paul Betts, *A Helping of Euro-Fudge: A Common European Code for Takeovers is Certain to Disappoint*, FIN. TIMES (London), May 6, 2002, at 6.

[103] Christopher Brown-Humes & Francesco Guerrera, *Wallenberg Attacks EU Over Takeover Proposals*, FIN. TIMES (London), Jan. 31, 2002, at 10.

[104] *See* Edwards, *supra* note 56, at 428.

[105] Barbara Dauner-Lieb & Marco Lamandini Reinier, The New Proposal of a Directive on Company Law Concerning Takeover Bids and the Achievement of a Level Playing Field, p. 57 (Eur. Parliament Working Paper, 2002), *available at* http://www.jura.uni-duesseldorf.de/dozenten/noack/texte/sonstige/study.pdf.

[106] *See* Edwards, *supra* note 56, at 430.

the Directive had "fallen victim to horse-trading and unholy alliances"[107] and was "not worth the paper it's written on."[108]

The final version of the Takeover Directive, then, was the result of a process extending more than ten years. The original goals, that of fostering a fair market for takeovers while protecting shareholder rights, guided the directive throughout, but limitations in the form of lobbying and pork-barrel politics often obstructed progress. The proposals themselves came from reasoned analysis by professors and bureaucrats, whether in the Commission or the Winter Group, but these proposals were distorted in unexpected ways by the forces of interest-group politics. The determination by many member states to maintain their current background laws of corporate governance meant that the directive would have to be flexible to get broad-based support.

A comparison with the British City Code on Takeovers and Mergers is apposite here, given that it was the starting point for European negotiations.[109] Enforced by the City Panel, the City Code governs the conduct of takeovers in relation to British corporations. The City Panel consists of members drawn from investment banks, law firms, and accounting firms. Unlike the Takeover Directive, the City Code contains a blanket rule prohibiting managers from taking any actions to frustrate a takeover bid without approval of the shareholders.[110] The Code includes a non-exhaustive list of prohibited defenses.[111] In order to deal with structural coercion, the Code allows non-tendering shareholders to have another opportunity to tender. The Panel, while a non-governmental body with informal mechanisms, lies at the far end of the spectrum from American take-

[107] Carl Mortished, *EU's Bids Directive Has Bite Removed*, TIMES (LONDON), Nov. 28, 2003, at Bus. 35 (Statement by Frits Bolkestein, Internal Market Commissioner, in reference to the weakened bids directive).

[108] Edwards, *supra* note 56, at 417.

[109] 1 PETER F.C. BEGG, CORPORATE ACQUISITIONS AND MERGERS (ed. 1998).

[110] *Id.* at A7.4.

[111] *Id.* at A7.22 (stating that pursuant to Rule 21 a board may not: "(a) issue any share authorized but unissued shares; (b) issue or grant options in respect of any unissued shares; (c) create or issue, or permit the creation or issue of, any securities carrying rights of conversion into or subscription for shares; (d) sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of a material amount; or (e) enter into contracts otherwise than in the ordinary course of business.").

over law. It goes beyond the European Directive in enforcing board neutrality, and it may be a good point of reference for assessing the American and European approaches.

c.) *Ownership Structure as a Flawed Explanation*

The important point here is that both American and European takeover law is not just a logical expression of the ownership structures in the respective jurisdictions, as some commentators have suggested. According to Marco Ventoruzzo, the divergence between the respective takeover laws can be explained by ownership structures; the difference in takeover law "mirrors the basic distinctions between the most common ownership structures in the United States and in Europe."[112] In addition, "entrusting the directors in the U.S. system and shareholders in European systems may simply reflect the reasonable view that, in the takeover context, the decision must necessarily reside with those most interested and competent."[113] Neither of these explanations rings true when questioned more closely. First, it is far from clear that ownership structures differ in recognizable ways between the United States and Europe. The common wisdom is that American companies are generally diffusely owned and therefore director-centric, whereas European ones are owned by controlling shareholders and therefore their rules are more favorable to shareholder power.[114] However, at least one study has concluded that ownership in the U.S. is equal to or more concentrated than in other countries.[115]

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112 Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171, 219 (2006).

113 *Id.*

114 *See* JEAN TIROLE, THE THEORY OF CORPORATE FINANCE 40 (2006); Diane K. Denis & John J. McConnell, *International Corporate Governance*, 38 J. FIN. & QUANTITATIVE ANALYSIS 1 (2003); Marco Becht & Bradford DeLong, *Why Has There Been So Little Blockholding in America, in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS (Randall K. Morck ed., 2005).

115 *See* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, REV. FIN. STUD. ADVANCE ACCESS, Dec. 10, 2007, *available at* http://rfs.oxfordjournals.org/ (search "Search This Journal" for "The Myth of Diffuse Ownership).

Second, ownership structures, while certainly the background for the decisions of courts and policymakers, were rarely cited as the reason for particular rules. In addition, shareholders and managers are equally interested in takeovers, the former because the value of their shares is at stake, and the latter because their jobs are on the line. The issue of competence is a murkier and more complicated question because of the differences between interested shareholders and directors, and it begs the question why managers can be trusted when their interests are misaligned with the interests of shareholders.

The flaws in the process by which the E.U. Takeover Directive was adopted are evident, but it is not so obvious that the directive is not worth the paper it is written on. The next section will address how well American and European law accomplishes the goals of takeover regulation.

VI. Takeover Law Effectiveness Compared

There is a tremendous amount of literature on the effectiveness of takeover regulation in the United States and Europe.[116] Most of this literature has focused on the pros and cons of various elements of the law: mandatory bids, board neutrality, and the breakthrough rule. This section will attempt to analyze the European and U.S. approach to tender offers in light of the basic goals of takeover regulation: encouraging value and maximizing takeovers while protecting the interests of shareholders.

As mentioned in the first section of this paper, takeovers have beneficial effects on companies, and therefore capital markets, for four main reasons: better allocation of resources, synergy gains, better management discipline, and more accurate

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[116] *See* Edwards, *supra* note 56; Blanaid Clarke, *Articles 9 and 11 of the Takeover Directive (2004/25) and the Market for Corporate Control*, 1 J. Bus. L. 355 (2006); Menjucq, *supra* note 100; Peter O. Mülbert & Max Birke, *In Defense of Passivity – On the Proper Role of a Target's Management in Response to a Hostile Tender Offer*, 1 Eur. Bus. Org. L. Rev. 567 (2000); *see* Ventoruzzo, *supra* note 112; *See generally* Gilson & Kraakman, *supra* note 19. There are also many articles analyzing empirical evidence concerning takeovers. *See, e.g.,* Martin J. Conyon & Annita Florou, *Top Executive Dismissal, Ownership and Corporate Governance* (2002), *available at* http://ssrn.com/abstract=304940; Jerold Warner, Ross Watts & Karen Wruck, *Stock Prices and Top Management Changes*, 20 J. Fin. Econ. 461 (1988); *see generally* Mark R. Huson, Robert Parrino & Laura T. Starks, *Internal Monitoring Mechanisms and CEO Turnover: A Long Term Perspective*, 56(6) J. Fin. 2265 (2001).

market valuation.[117] These are all good reasons to make a system for hostile takeovers available in any legal system.

At the same time, tender offers present some risks for shareholders. Of course, there are worries about irrational decisions by companies and managers, such as desires for empire-building or hubris. But even assuming that all the relevant actors will act entirely rationally, problems arise: management-shareholder misalignment, majority-minority misalignment, and structural coercion.

It is my premise, then, that a jurisdiction's laws should facilitate takeovers bids[118] while restricting the possibility for structural coercion, or conflicts of interest between managers and shareholders, on the one hand, and between majority shareholders and minority shareholders, on the other. The E.U. Takeover Directive and U.S. takeover regulation are successful to the extent that they satisfy these primary goals.

It is undoubtedly easier economically to launch a tender offer in the United States than in the European Union. The E.U. Takeover Directive, as implemented by the member states, requires corporations acquiring control of a company to make an offer for all outstanding shares of the target company. This requirement increases the cost of a takeover, and thereby might discourage some value-maximizing transactions. In the U.S., corporate raiders are free to make an offer for as many shares as they desire. At the same time, in actuality, corporations almost always do make full takeover bids for all voting securities. In effect, then, there is not much difference between the two laws.

On the other hand, boards in the U.S. are much freer to adopt defensive measures against takeovers. As long as such measures are not "draconian"[119] in relation to the threat posed to corporate policy, they will likely be upheld by a court, and shareholders need not authorize the use of them. In the E.U., any actions taken that would frustrate the bid are forbidden un-

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117 For the classic analysis of why takeovers occur, *see* Romano, *supra* note 3.
118 The High Level Group of Company Law Experts, *supra* note 4, at 19.
119 *Unitrin*, 651 A.2d at 1387-88.

less a general meeting of the shareholders approves them.[120] Pre-bid defensives may be overridden through the break-through rule. The E.U. regulation, therefore, facilitates takeovers to a greater extent than U.S. regulations.

But how effective are these rules with regard to protecting shareholder interests? In part, this depends on the effects of defensive measures. While the empirical evidence is mixed, the majority of studies show that defensive actions decrease shareholder value and are mainly used to entrench management.[121] Because management action during takeovers is given the lax business judgment rule in the U.S., and such action is broadly prohibited in the E.U., the E.U. passivity rule seems superior to the American approach in maximizing shareholder wealth.[122]

There is a real question, however, about the timing of shareholder meetings. In the case that shareholders want the board to adopt defensive measures, it may still be difficult for them to organize a general meeting to grant authorization to the directors in the short offer period.[123] In this case, the flexible American system, allowing directors to adopt defensive tactics without shareholder approval, might reflect the wishes of the shareholders better. But given empirical evidence that, in the majority of cases, defensive measures reduce shareholder wealth, this criticism is only marginally relevant.

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[120] While this provision of the directive is optional, a sizeable majority of member states impose the board neutrality rule. *See* Commission Report, *supra* note 47, at 6.

[121] *See, e.g.,* Lucian A. Bebchuk, John C. Coates & Guhan Subramanian, *The Powerful Anti-takeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887 (2002); James Cotter & Marc Zenner, *How Managerial Wealth Affects the Tender Offer Process*, 35 J. FIN. ECON. 63 (1994); Larry Dann & Harry DeAngelo, *Corporate Financial Policy and Corporate Control*, 20 J. FIN. ECON. 87 (1988); Frank Easterbrook & Gregg A. Jarrell, *Do Targets Gain From Defeating Tender Offers?*, 59 NYU L. REV. 277 (1984); Paul Asquith, Merger Bid, *Uncertainty and Stockholder Returns*, 11 J. FIN. ECON. 51 (1983); Peter Dodd, *Merger Proposals, Management Discretion and Stockholder Wealth*, 8 J. FIN. ECON. 105 (1980). *But see* Martin Lipton & Paul Rowe, *Pills, Polls and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1 (2002).

[122] *See* Mülbert & Birke, *supra* note 116. But for an opposing view, *see* Christian Kirchner & Richard W. Painter, *Towards a European Modified Business Judgment Rule for Takeover Law*, 1 EUR. B. ORG. L. REV. 353 (2000) (arguing that the business judgment rules *protects* shareholders by allowing management to prevent corporate raiders from launching coercive offers).

[123] *See* Kirchner & Painter, *supra* note 122.

Therefore, the E.U. Takeover Directive may well be superior to American takeover law in facilitating takeovers and protecting the interests of shareholders in general. But a special problem in corporate governance is how to take into account *minority* shareholders. In a democratic system, minorities are supposed to lose, because majorities win votes. Constitutional law, however, provides some minimal guarantees to all individuals, and corporate law does the same. Both the E.U. Directive and the U.S. Williams Act require offerors to pay the same price for all shares. This rule ensures that minority shareholders will be able to enjoy their fair share of the control premium paid by the acquirer.[124] But neither the Williams Act nor any other legislation requires an offeror to buy all outstanding shares, which may mean that some stockholders involuntarily get stuck with shares in the new corporation. The acquirer can negotiate privately with the majority shareholder for control and decide not to buy out the minority. Fortunately for minority shareholders, it is virtually unheard of in the United States that a corporate raider would not make an offer for all shares, so the legal position of minority shareholders in the U.S. and Europe is broadly similar.

As a caveat to this analysis, it should be remembered that the board neutrality and breakthrough rule (disabling many defensive measures) are optional provisions in the E.U. takeover directive. The breakthrough rule, especially, has not found support in the majority of member states.[125] In fact, this has been the main criticism of the directive, in that the purpose of the directive, to harmonize legal systems across Europe, was compromised. But a similar criticism can be leveled at American takeover regulation because the bulk of takeover law comes from state court decisions about fiduciary duties and state anti-takeover legislation.

In sum, then, the European regime on takeovers seems to fit quite closely with the purposes of the legislation: encourag-

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[124] For an argument that minority shareholders should not share in the control premium offered by the acquirer in some circumstances, *see* Karl Hofstetter, *One Size Does Not Fit All: Corporate Governance for Controlled Companies* (Harvard Law Sch. Working Paper, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=802705.

[125] Only the Baltic states are expected to impose this breakthrough rule. *See* Council Directive, *supra* note 44, at 7.

ing takeovers while protecting shareholders. The U.S. regime fares less well. It gives discretion to managers to institute defensive actions when such actions have been found to decrease shareholder value, and it does not require a mandatory bid for all outstanding shares, which allows for the possibility of abuse of minority shareholders. There are certainly arguments in favor of both of these rules, but the weight of scholarly literature and empirical research argue against them.

Given this paper's argument about the reasons underlying the differences in E.U. and U.S. law, this conclusion is surprising. The Takeover Directive was the product of political horse-trading, lobbying by powerful groups, and the clash of national interests. The important U.S. takeover laws were instead the result of reasoned analysis by politically uncompromised, well-educated judges. Perhaps it would be best to chalk one up to bureaucracies and modern politics.

VII. Conclusion

While convergence may be the word of the day in corporate governance, it is noticeably absent in takeover regulation. The United States and Europe have adopted strongly dissimilar laws governing the process and substance of hostile tender offers, and their respective paths seem to be diverging rather than converging. Much of this can be explained by process and institutional competency: courts have played the primary role in the development of American law, while political (whether government or non-government) actors dominated the E.U. adoption of the Takeover Directive. Additionally, scholarly research and empirical evidence plays an important part in decision-making on both sides of the Atlantic. A more flexible variable is the state of the background laws governing corporate actions. As these become more similar, perhaps one could expect other areas to converge as well. This theory, after all, formed the foundation of the original European Community, as expressed in the functionalist approach to integration, and the E.C. has developed into one of the world's great powers.

For now, it is unclear whether transatlantic takeover law will grow together or apart. Nationalism may play a part in this process, since most countries desire to protect their own companies from takeovers by foreign companies. Reciprocity may provide the solution. By allowing companies to adopt more restrictive rules governing board actions, but giving them the option to disapply these rules when facing threats from companies that do not have similar restrictions, reciprocity can be a painless way of escaping from the prisoner's dilemma. It is too early to know.