NYLS Law Review
Vols. 22-63 (1976-2019)

Volume 51
Issue 3 *Perspectives on Post-Conflict Constitutionalism*

Article 10

January 2006

The Takeover Directive and Inspire Art: Reevaluating the European Union's Market for Corporate Control in the New Millennium

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VOLUME 51 | 2006/07

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The Takeover Directive and *Inspire Art*: Reevaluating the European Union's Market for Corporate Control in the New Millennium

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When General Electric chairman Jack Welch came home with the news that the E.U. had squashed his ambitious plan for a merger with Honeywell, there were predictable reactions. U.S. senators raced angrily to the TV cameras to complain that Europe had no right to impose its antitrust rules on a merger born and bred in the U.S.A. The Secretary of the Treasury complained that the European Commission was "meddling outside its jurisdiction. . ." Some business colleagues urged Welch to say "To hell with Europe" and complete the merger anyway. Welch, the realist, rejected all these fantasies. The power that gave Europe the authority to say no, he explained, was plain enough: sheer market power. The unification of the continent has produced a single market bigger than the United States or Japan; no American business leader can say, "To hell with Europe" anymore. When a sympathetic TV interviewer began griping about E.U. regulation of American business, Welch cut him short: "We have to do business with Europe, so we have no choice but to respect their law," he said. Then he added, in the tones of a man who has learned a hard lesson, "That really is just the way the world works now."[1]

I. INTRODUCTION

The vision of a united Europe is nearly as old as Europe itself.[2] Today, under the auspices of the "European Union,"[3] Europe is increasing its influence worldwide by increasing economic integration and strengthening cooperation among its member states. The European policymakers seek to create an efficient regulatory environment that will foster free trade in goods, services, and capital.[4] In Brussels, policymakers advance such agendas by promoting uniformity of legal rules through "Directives."[5] Takeover law is one of the areas in which the Euro-

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1. T.R. REID, THE UNITED STATES OF EUROPE: THE NEW SUPERPOWER AND THE END OF AMERICAN SUPREMACY 88–111 (2004).

2. Derek W. Urwin, *European Union* (2004), MICROSOFT ENCARTA ONLINE ENCYCLOPEDIA, http://encarta.msn.com/text_761579567___0/European_Union.html (last visited July 20, 2004). Throughout history, European conquerors and tyrants repeatedly tried to unite the continental Europe. For example, Charlemagne's early ninth century empire covered a significant part of Western Europe, in the early nineteenth century, the French empire of Napoleon I covered most of the continent, and Nazi Germany, eagerly following Hitler, almost succeeded in transforming the European people into an Arian race. *Id*. (arguing that such efforts failed because they relied on "forcibly subjugating other nations rather than fostering cooperation among them").

3. The E.U., formally established on Nov. 1, 1993, by the Maastricht Treaty, is the most recent in a series of European cooperative organizations. In 1991, the European Community ("E.C.") became the E.U. when its then twelve members signed the Maastricht Treaty (also know as the Treaty on European Union). In 1995, Austria, Finland, and Sweden joined the E.U. In May 2004, the E.U. absorbed ten more countries, bringing the number of E.U. Member States to twenty-five. REID, *supra* note 1, at 88–111.

4. *See* Treaty Establishing the European Economic Community, Mar. 25, 1957, arts. 2 & 3, *available at* http://www.hri.org/docs/Rome57/Part1.html (obliging the E.U. to adopt a Common Commercial Policy and a Common Agriculture Policy); *see also* Overviews of the European Union Activities: Internal Market, http://europa.eu.int/pol/singl/overview_en.htm (last visited Mar. 12, 2006) ("The single market is the core of today's Union. To make it happen, the E.U. institutions and the member countries strove doggedly for seven years from 1985 to draft and adopt the hundreds of directives needed to sweep away the technical, regulatory, legal, bureaucratic, cultural, and protectionist barriers that stifled free trade and free movement within the Union.").

5. A directive is a type of legislation issued by the E.U. that is binding on member states in terms of the results to be achieved, but leaves the precise method for achieving those goals to member states. Europa – The European Union Online, http://europa.eu.int/ (last visited Apr. 12, 2006). This aspect of the E.U.'s legislative process is unlike that of the U.S. where policymakers promote uniform rules through federal

pean Union ("E.U.") is making substantial, and often contentious, efforts to achieve harmonization of the member states' laws.[6]

The attempts by the E.U. to create common rules which govern corporate takeovers are a long-standing part of its ambition to create a single integrated capital market.[7] To this end, European policymakers crafted the Thirteenth Directive on Company Law (the "Takeover Directive"). The Takeover Directive initiative occurred against the backdrop of a Europe where integration of a single market had gained pace, while widely divergent national rules impeded cross-border takeovers and increasingly stood out as an anomaly.

The rationale underlying the Takeover Directive was straightforward. It sought to harmonize fifteen (now twenty-five) sets of national takeover regulations with the goal of achieving uniformity and a level playing field among member states. Most notably, it set out to provide additional safeguards to minority shareholders and curb abusive practices by directors and managers.[8] The Takeover Directive was a means to provide equal treatment to all shareholders, including the United States and the United Kingdom pension funds often kept in the dark by managers during takeover bids in Continental Europe.[9] The Takeover Directive reflected the European Commission's (the "Commission") ambition to change Europe's regulatory scheme from a traditionally restrictive takeover regime to a more pro-investor, takeover-friendly system driven by natural market forces.[10] The ultimate goal was to achieve a single, well-functioning, and liquid securities market that would lead to higher firm valuations, lower costs of capital for firms, and a greater return for shareholders.[11] Another, though a less

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preemption. *See, e.g.*, Edgar v. MITE Corp., 457 U.S. 624 (1982) (striking down a state statute as unconstitutional under the Federal Preemption doctrine).

6. *See Commission Proposal for a Directive of the European Parliament and of the Council on Takeover Bids*, COM (2002) 534 final (Oct. 2, 2002) [hereinafter Explanatory Report]. Divergent regulatory regimes in the E.U., however, impede the advent of such a free market environment because they entail transaction costs as managers and investors expend resources in an attempt to determine how conflicting laws from other jurisdictions may affect their business. *Id.*; *see also* Christian Kirchner et al., *Regulatory Competition in E.U. Corporate Law After* Inspire Art*: Unbundling Edlaware's Product for Europe* 4 (University of Illinois College of Law and Economics Working Paper Series, Working Paper No. LE04-001, 2004), *available at* http://ssrn.com/abstract=617681.

7. *See* Joseph A. McCahery et al., *The Economics of the Proposed European Takeover Directive*, at 7–25, Centre for European Policy Studies (CEPS), CEPS Research Report in Finance and Banking, No. 32, Apr. 2003 (on file with the New York Law School Law Review).

8. McCahery et al., *supra* note 7, at 5–25.

9. Yves Tiberghien, *Competitive Supranationalism: Financial Globalization, EU Institutions, and the EU Takeover Directive*, J. EUR. PUB. POLICY (forthcoming).

10. *Id*. at 3–18.

11. *Id*. Vast scholarship and literature exist supporting the proposition that hostile takeovers can improve the operational efficiency of corporations. *See, e.g.*, Lucian Ayre Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Clas Bergstrom et al., *The Regulation of Corporate Acquisitions: A Law and Economics Analysis of European Proposals for Reform*, 1995 COLUMB. BUS. L. REV. 495, 500 (1995) ("The

obvious aspiration, was to empower the E.U. to challenge the United States in the international rulemaking realm by creating a robust capital market that could one day rival that of the United States.[12]

After an eighteen-year politically charged roller-coaster ride, the European Parliament at last passed a watered-down version of the Takeover Directive on December 16, 2003.[13] As a way to end the impasse, a controversial political compromise was struck. The two most contentious, and arguably most important, provisions of the Takeover Directive — Article 9 on takeover defenses and Article 11 on multiple voting rights — were reduced to mere options. "We all want to go to heaven — but nobody wants to die," remarked one insider in summing up the bargaining and back-tracking that surrounded the Takeover Directive's passage.[14]

Part II of this Note will examine the environment in the E.U. that prompted the Commission's intensive pursuit of the Takeover Directive. In Part III, this Note discusses the Takeover Directive's procedural history — the astonishing bureaucratic roller-coaster that reveals the many sensitive intricacies of the E.U.'s bureaucracy, including nationalistic sentiments and the clash of divergent views of capitalism within the E.U., along with other narrowly conceived national interests and politics. Part III also discusses the Takeover Directive's shortcomings and analyzes the Takeover Directive's actual effects against its stated goals of providing additional protections to minority shareholders, achieving uniformity, and creating a level playing field. Part IV posits that, on its own, the Takeover Directive may not be enough to reinvigorate the E.U.'s capital market or even to harmonize takeover regulations across Europe because of the compromise in the Parliament. Nonetheless, the European Court of Justice's

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hostile acquisition of Revlon by Ronald Perelman in 1985 is the most noted example of how the market for corporate control can improve the operational efficiency of conglomerates." In that transaction, "Revlon had acquired a large range of subsidiaries outside its cosmetics base, including several health care companies. Perelman soon brought in $2 billion by selling off most of the other businesses, thus enabling him to spend more money on strengthening the core cosmetics business that had been neglected."); William J. Carney, *Federalism and Corporate Law: A Non-Delaware View of Results of Competition, in* INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES 153 (Joseph McCahery et al. eds., 1996); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 YALE L.J. 663 (1974); Roberta Romano, *Explaining American Exceptionalism in Corporate Law, in* INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES, *supra* at 127; Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987).

12. Tiberghien, *supra* note 9.

13. The European Parliament, the European Commission, and the European Council are the three main institutions of the E.U. The European Parliament is the only institution that is elected by the citizens of the E.U.

14. Ben McLannahan, *Takeover Makeover*, CFO EUROPE.COM, Feb. 2004, http://cfoeurope.com/displayStory.cfm/2383116 (quoting Jaap Winter, the chairman of the High Level Group; Winter is also a partner at Dutch law firm De Brauw Blackstone Westbroek and the architect of the latest version of the directive).

seminal decision in *Inspire Art* suggests that harmonization of takeover regulation may yet occur across the E.U. because, in light of *Inspire Art*, the respective regulatory regimes of member states will be exposed to market forces. The market will harmonize the takeover rules and will be the ultimate force to pass a judgment on the vitality of corporate protectionism in the E.U. Part V then concludes that a takeover-friendly regime will eventually emerge in the E.U., as corporate markets respond to the Takeover Directive's initiatives.

II. ECONOMICS, POLITICS, AND PSYCHOLOGY OF CORPORATE TAKEOVERS

During the 1980s, mergers and acquisitions yielded colorful terms and phrases such as *Saturday night specials*, *shark repellants*, *bust-ups*, *bear hugs*, *good-bye kisses*, *lock-ups*, and *poison pills*; companies paid off *raiders* with *greenmail* and sought help from *white nights*.[15] As corporations realized extraordinary gains and losses, the takeover environment attracted the attention of journalists, movie producers, novelists, and politicians.[16] The result was that an enduring — and sometimes unfair — stigma attached to hostile takeovers.

Now, hostile takeovers are a routine option of blue-chip companies, rather than an underhanded tactic employed by infamous corporate raiders like Sir James Goldsmith, Carl Icahn, and T. Boone Pickens.[17] Nonetheless, the effects of "anti-takeover fervor" of the 1980s are evident even today, as is reflected by the anti-takeover rules,[18] court opinions, and statutes that affect modern mergers

15. *See generally* WILLIAM J. CARNEY, MERGERS AND ACQUISITIONS 2–9, 66–73, 230–42, 256–92 (2001) (discussing the history of corporate acquisitions, the concerns implicated in unsolicited takeovers and tender offers, and defenses to unsolicited takeover attempts, which are often undertaken by directors and managers).

16. A classic and lasting image is one of Michael Douglas with hair slicked back playing a corporate raider in WALL STREET.

17. A recent example is an unsolicited (hostile) attempt by BASF Aktiengesellschaft, a German corporation, to acquire Engelhard Corp., a Delaware corporation. *See* Engelhard Corp., Schedule 14D-9 (SEC Filing), *available at* http://www.sec.gov/Archives/edgar/data/352947/0000950162-98-001108.txt; *see also, e.g.*, Christopher Brown-Humes, *Fireworks Light Up an Otherwise Dark Month for Equities*, FIN. TIMES, Nov. 1, 2005, at 30; Mark Mulligan & Mark Odell, *£18bn Telefonica Deal with O2 Aims to Create a Giant*, FIN. TIMES, Nov. 1, 2005, at 19; Dave Strauss & Delphine Shellock, *Best Showing in Two Years for Blue-Chips*, FIN. TIMES, Nov. 1, 2005, at 30.

18. The Sarbanes-Oxley Act ("SOX") of today readily illustrates this political dynamic. The Enron scandal had a direct effect on the federal statutes and the SRO rules. Modern economists and commentators suggest that much of the statutory criticism was unwarranted in the 1980s, as the SOX initiative was a grave overreaction today. *See, e.g.,* DALE A. OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS 468 (2d ed. 2003) ("[P]ublic condemnation of the 1980s was, at minimum, too harsh, and perhaps simply wrong."). While many recognized the opportunity for profit, and there were crafty individuals in the 1980s with skills to use debt to acquire troubled firms, in an "active, competitive bidding market for target firms, a winning bidder could not expect to take a lion's share of the gains expected from an acquisition." *Id.* But envious onlookers expect winners to profit more than the data from the 1980s shows raiders received. *Id*. Here are some arguments supporting this view: With buyers competing intensely with each other for targets, the takeover market matured quickly. Hence, opportunities for profit did not exist for long. Moreover, the market price is determined by the average price all willing buyers would pay. Thus,

and acquisitions practice.[19] In any event, since the 1960s regulators, judges, and lawmakers have been on a steady march toward entrenching management by denying shareholders the ability to sell out to a corporate raider. This Note advances the premise that takeovers serve an important function and should be encouraged by the legal system.

A. Takeovers Generally

One often hears the term "takeover" in corporate acquisition parlance. The term usually describes a stock purchase offer where the acquiring company (the "bidder") buys a controlling block of stock in a target company, most often a majority of the outstanding voting stock.[20] If, on the announcement of the offer, the acquiring firm does not have the support of the target company's management, the offer is *hostile*.[21] If the purchaser has the support of the target's management, then the offer is *friendly*.

Takeovers are about increasing efficiency.[22] Takeover bids are often used as a means to an end for unifying groups, fostering strategic combinations that help achieve economies of scale and other synergies, and restructuring companies to become more efficient with the ultimate goal of maximizing shareholder equity.[23] But perhaps the most significant effect of a hostile takeover, or even the threat of

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the winning bidder acquired the target at a price above market — a victim of the winner's curse. *Id*. at 468–69.

19. *Id*. at 467–69; *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (holding that directors have the right to thwart takeovers). This case is a viable precedent of the modern doctrine on directors' duties in hostile takeover situations.

20. OESTERLE, *supra* note 18, at 3. The controlling block of stock enables the purchasing firm to: (1) elect the target's board of directors; and (2) to approve a statutory merger between the acquiring firm and the target. *Id.*

21. *Id.* at 3–4. For a recent example of a hostile offer, see Offer to Purchase Engelhard Corporation by BASF Aktiengesellschaft, http://www.sec.gov/Archives/edgar/data/352947/000104746906000275/a2166481zscto-t.htm (last visited Apr. 12, 2006) (illustrating an unsolicited offer to purchase outstanding stock for cash), and the response Schedule 14D-9, item 4, http://www.sec.gov/Archives/edgar/data/352947/000093041306000397/c40601_14d-9.htm (last visited Apr. 12, 2006) (stating that the "Board of Directors, after careful consideration, including a thorough review of the Offer with its financial and legal advisors, has unanimously determined at a meeting duly held on January 20, 2006 that the Offer is inadequate and not in the best interests of the Company's stockholders. . .").

22. *See* CARNEY, *supra* note 15, at 34–65. For an early debate on what role directors should have in the case of an unsolicited takeover attempt, see Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) (arguing shareholders should be left alone to make the decision and that directors should take an entirely passive role, not even making recommendations) and Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979) (arguing that directors should have an active role and should be able to thwart unsolicited takeover attempt by implementing measures that they deem appropriate).

23. CARNEY, *supra* note 15, at 62–65. Bidders ordinarily pay a significant premium over company's publicly traded stock price to acquire a target company, often referred to as control premium. For an excellent discussion of control premiums and the reasons buyers pay these premiums, see BRADFORD CORNELL, CORPORATE VALUATION: TOOLS FOR EFFECTIVE APPRAISAL AND DECISION-MAKING (1993).

one, is that it serves as a check on directors and managers.[24] The possibility of a hostile takeover "acts as an incentive to managers to increase allocative efficiency of investment funds" and the "distribution of funds to shareholders."[25] In his seminal article on corporate-control market, economist (and law professor) Henry G. Manne explained:

> Apart from the stock market, we have no objective standard of managerial efficiency. Courts, as indicated by the so called business-judgment rule, are loath to second-guess business decisions or remove directors from office. Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders. Compared to this mechanism, the efforts of the SEC and the courts to protect shareholders through the development of a fiduciary duty concept and the shareholder's derivative suit seem small indeed.[26]

Indeed, the phrase hostile takeover is somewhat of a misnomer; hostile takeovers are usually hostile only to management. For shareholders, hostile bids can be and often are rewarding.[27] Commentators, including Professor Manne, have pointed out that takeover defenses distort the corporate-control market. Largely due to anti-takeover legislation and court decisions, the premium for change of control has gone from shareholders to management, as top executives are bought off to approve mergers.[28] Notably, it has been argued that this entrenchment of management has played a significant role in the recent epidemic of corporate scandals.[29]

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24. *See* McCahery et al., *supra* note 7, at 5 (stating that the threat of corporate takeover acts as a check on management).

25. *Id.*

26. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965).

27. For example, in *Unocal Corp*, 493 A.2d 946 (where the target succeeded in thwarting an attempted takeover attempt with the Delaware Supreme Court's blessing), Michael Jensen concluded that "shareholders received $1.1 billion less than Unocal shareholders would have received" had the takeover been successful. CARNEY, *supra* note 15, at 82.

28. Manne, *supra* note 26, at 113.

29. But the legislators in the U.S. missed the mark. Rather than reopening the market for corporate control, in a highly charged political atmosphere, politicians responded by legislating SOX, a series of additional stringent conflict of interest laws — laws that are likely to further discourage deal-making because it might lead to accusations of management misrepresentation. The negative consequences of SOX are evident today, as investors increasingly take their capital out of the stock market and re-invest it into the private equity sector; and law firms increasingly advise clients to list overseas and even deregister from the New York Stock Exchange. As a result, most experts would agree that New York is already behind London as a financial capital of the world.

B. *The Pre-Directive Regulatory Landscape of Europe's Takeover Regime*

Attempts to create common takeover rules among the E.U.'s member states began at the start of the single market project.[30] The Commission acknowledged that the existing differences in the European takeover legislation governing change of control procedures were too great among member states, even in light of sensitive national distinctions and varying cultural norms among member states.[31] For example, in the case of a transfer of control, some member states did not require a bidder to launch a full-blown bid, while others imposed such a requirement.[32] Several member states permitted the target company's board to adopt defensive measures, without shareholders' consent, for the purpose of thwarting an unsolicited takeover attempt, while others prohibited this practice.[33] Ownership caps, voting caps, and special rights to appoint board members were some additional defense mechanisms whose legality varied from member state to member state.[34] Member states also differed as to whether shareholders could give *prior* authorization concerning defensive measures.[35]

In addition to imperfect and often conflicting takeover regulations in the E.U., extreme ownership concentration structures and internal corporate governance rules impeded the emergence of a well functioning market for corporate control.[36] Some commentators viewed these conditions as a by-product of the reemergence of European industry after the end of World War II.[37] With a concentrated ownership structure, the hostile acquisition became a negotiation with the owner of the controlling block.[38] Instead, it was like purchasing a private

30. The E.U.'s endeavor to promote significant economic integration and to strengthen cooperation among its members is often referred to as Single Market Project. *See generally* McCahery et al., *supra* note 7. "The single market is the core of today's Union. To make it happen, the E.U. institutions and the member countries strove doggedly for seven years from 1985 to draft and adopt the hundreds of directives needed to sweep away the technical, regulatory, legal, bureaucratic, cultural and protectionist barriers that stifled free trade and free movement within the Union." Overviews of the European Union Activities: Internal Market, http://europa.eu.int/pol/singl/overview_en.htm (last visited Apr. 13, 2006).

31. *See* Explanatory Report, *supra* note 6, at 33.

32. *Id.*

33. *Id*.

34. *Id*.

35. *Id*. The economic claim underlying the level playing field is that differences in regulatory arrangements distort the conditions of competition and decrease shareholder value. *See* McCahery et al., *supra* note 7, at 7–25.

36. *See* Bergstrom et al., *supra* note 11, at 505–09 (arguing that such restrictions on the market make takeovers de facto impossible).

37. *Id*. at 506–07 ("The pervasiveness of concentrated family ownership, especially with respect to successful first-generation companies founded following World War II, reflect a member state's pattern of economic growth and the life cycle of a particular company.").

38. OESTERLE, *supra* note 18, at 3–4.

company.[39] In substance, it could not be a hostile takeover because it could not succeed without the support of the *one* controlling shareholder.[40] Internal governance rules that enabled European firms to create dual classes of stock and caps on voting also discouraged takeover bids.[41] These devices operated to concentrate ownership in the hands of incumbent management, thwart hostile takeovers, and arguably, prevent the emergence of a well functioning market for corporate control.

C. Trends Toward Market Integration in the European Union

In the last twenty years, the E.U. has made great strides towards becoming an integrated market, with the potential to rival that of the United States.[42] The Single European Act of 1986, strongly endorsed by Margaret Thatcher, marked a shift toward what historian John Gillingham called "economic integration from the bottom up" — driven, not by bureaucratic direction from Brussels, but by the market.[43] Though the reduction in tariffs among member states occurred earlier, non-tariff barriers remained.[44] The purpose of the Single European Act, which was largely implemented by the early 1990s, was to eliminate obstacles that impeded the cross-border flow of goods and capital.[45]

Likewise, the old policy of promoting national or European champions against rivals from the United States and Japan began to fade.[46] In 1985, most takeovers were domestic, constituting over 86% of all corporate takeovers, but in

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39. Bergstrom et al., *supra* note 11, at 505.

40. By definition, if on the announcement of the offer, the acquiring firm has the support of the target management, the offer is "friendly." OSTERLE, *supra* note 18, at 3.

41. For example, in Germany, regardless of how many shares are owned, the voting power of individual shareholders is capped at a certain level. Additionally, multiple classes of stock with disparate voting rights are common in Sweden. Bergstrom et al., *supra* note 11, at 508. *But see* Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Governance Environment*, 61 FORDHAM L. REV. 161, 176 (1992) (arguing that dual class voting schemes are more benign than capped voting).

42. Geoffrey Owen, *Will the E.U. . . . Really be able to Compete with the US*, FIN. TIMES, Mar. 27, 2004, at 66.

43. KLAUS HOPT & EDDY WYMEERSCH, EUROPEAN TAKEOVERS 4–38 (1992).

44. Owen, *supra* note 42, at 67.

45. *See* Life in the European Union, History of European Integration, http://en.wikipedia.org/wiki/History_of_the_European_Union (last visited Mar. 30, 2006) (providing a detailed overview of the E.U.'s history, economy, politics, etc.).

46. *Id*. "The greatest success for this new approach was in mobile telecommunications. To avoid the fragmentation that had plagued first-generation analog systems, European governments decided to adopt a common standard — GSM — for the new digital networks, and thus to facilitate Europe-wide competition." *Id.* The old-style industrial policy did not entirely disappear. Such a policy is evident in the case of Airbus: Airbus pursued a strategy that was to make it the world's largest manufacturer of civil aircrafts, helped by government support and blunders by its U.S. rivals. *Id*.

1999, this percentage fell to only 40%.[47] During the same time period, the percentage of corporate takeovers involving at least one European party rose from 15% to 43%.[48] Similarly, looking instead to the market value of these transactions, takeovers involving a European party rose from 11% of the world total in 1985, to 47% in 1999.[49] And in 2000, the value of takeover deals in the United Kingdom alone reached an astounding $173.7 billion.[50] Some scholars describe this period as a "First International Merger Wave."[51]

In addition to the Single European Act, commentators point to two additional forces at work in the integration of the European market: an increasing emphasis on maximizing shareholder value, and the remarkable pace of technological change, especially in information technology.[52] Underscoring the former was the hostile takeover of Mannesmann, one of the biggest names in German industry in 2000, by Vodafone, the British mobile telecommunications company. The Mannesmann takeover was unique because the company's shares were widely held, with a high proportion of non-German investors; and no dominant German shareholder could have frustrated the bid. One commentator explains:

> What was striking about the Mannesmann affair was not simply that Vodafone won, but that the German company's defense was based almost entirely on arguments about *shareholder value*; the directors claimed that *shareholders* would be better off sticking with Mannesmann as the independent company than accepting Vodafone's highly valued shares.[53]

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47. John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 7 (2001).

48. *Id*. at 8.

49. *Id*.

50. For example, the European steel industry, far from the epitome of a global industry, was transformed by cross-border mergers. British Steel merged with Hoogovens of the Netherlands in 1999. *See* Corus Group, PLC, http://www.britannica.com/eb/article-9399650/Corus-Group-PLC (last visited Nov. 10, 2006). In 2001, a three-way merger occurred between Usinor of France, Luxembourg's Arbed, and Spain's Aceralia. *See* Steel Firms Eye $2.1 Bn Tie, French Steel Firm in Talks with Spain's Aceralia and Luxembourg's Arbed, http://money.cnn.com/2001/02/16/europe/usinor/ (last visited Nov. 10, 2006).

51. Coffee, *supra* note 47, at 20–21. The potential driving force behind the increase in the European merger activity is the integration of European currencies into the Euro. A single, unified currency has given growth to a unified European corporate bond market, which tripled in 2001 and thereby ended the dependence of European acquirers on bank financing. Acquirers can now directly access the capital markets via debt, equity, or both. To this extent, Professor Coffee notes that the growth of the takeover market has been concomitant with the declining role of the universal bank. *Id.*

52. The Internet and other groundbreaking technological advances have largely eliminated national borders. In the global economy of today, companies must compete on a global basis and cannot hide behind national borders. *See, e.g.*, Owen, *supra* note 42, at 68 (attributing changes within the European market for capital, i.e., increase in cross-border mergers, to integration and technological change); *see also* Christian Kirchner & Richard W. Painter, *Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for Reform,* 50 AM. J. COMP. L. 451 (2002).

53. Owen, *supra* note 42, at 68 (emphasis added).

The conduct of the battle, commentators argue, "showed how far the United States' concept of shareholder value had gained ground in a country where stock market pressure on managers had traditionally been very weak."[54] With the cross-border merger activity on a steady rise and the nationalistic sentiments fading, the time was ripe to address the divergent and often market-chilling takeover regulations in the E.U.

III. THE TAKEOVER DIRECTIVE INTIATIVE

Under E.U. legislative procedures, member states' national governments directly negotiate agreements regarding E.U. matters among all E.U. member states.[55] These agreements, or E.U. Treaties, constitute "primary legislation" and must be ratified by the national parliaments of member states.[56] These Treaties define the roles and responsibilities of the E.U.'s legislative bodies and decision-making processes. "Secondary legislation," such as E.U. Directives, is based on E.U. Treaties. With E.U. Directives, the E.U. can impose common objectives onto member states, to be achieved within a certain time period, but the national governments, generally, are free to choose the form and the means to implement each Directive.

A. Procedural History

The Takeover Directive saga began in 1985. The Commission recognized that cross-border takeover bids could contribute considerably to the development and reorganization of European companies — "a key condition for withstanding international competition and developing a single capital market."[57] Yet, companies in the E.U. lingered under very different national takeover rules. In takeover bids involving companies from different member states, conflicting takeover rules often resulted in needless obstacles and uncertainties.[58]

Then, in a 1985 White Paper on completing the internal market,[59] the Commission announced its intention to pursue a directive that would harmonize national rules that govern takeover bids across the E.U.[60] On January 19, 1989,

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54. *Id*.

55. E.U. Legislative Procedures, http://www.eubusiness.com/guides/legislation (last visited Apr. 13, 2006). Subsequent amendments must follow the same procedure. *Id.*

56. *Id*. For example, treaties establishing European Communities include: the Single European Act of 1987, revised by the Treaty on the European Union of 1992, also known as the "Maastricht Treaty," which was last revised by the Treaty of Amsterdam in 1997. *Id*.

57. Explanatory Report, *supra* note 6, at 3.

58. For example, "the law applicable and the competent authorities." *Id.*

59. White papers published by the European Commission are documents containing proposals for E.U. action in a specific area. They sometimes follow a Green Paper released to launch a public consultation process. White Paper, http://en.wikipedia.org/wiki/White_Paper (last visited Apr. 13, 2006).

60. Explanatory Report, *supra* note 6, at 2.

the Commission presented an initial proposal to the European Council ("Council") for the Takeover Directive (also knows as the Thirteenth Directive on company law).[61] The next year, on September 10, 1990, the Commission adopted an amended proposal of the Takeover Directive (the "Initial Proposal").[62] The Initial Proposal reflected the opinions of the Economic Committee, the Social Committee, and the European Parliament.[63] The Initial Proposal, however, was never approved due to fierce opposition from certain member states.

A new proposal for a Takeover Directive was presented to the Council and to the European Parliament on February 8, 1996.[64] This new proposal's main objectives were to: (1) provide a framework of common rules for takeovers in the E.U. — that is, to level the playing field by harmonizing takeover rules across the E.U. — and (2) to protect minority shareholders in takeovers in order to facilitate the integration of European markets.[65] After further amendments, the Commission adopted the proposal at the end of 1997.[66] On July 4, 2001, after twelve years of negotiation, the Takeover Directive came to a vote in the European Parliament, but it was defeated by a 273 to 273 deadlock.

The long-awaited initiative failed largely due to narrowly conceived national interests.[67] The effort to water down the Takeover Directive with

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61. *Id*.

62. *Id*. at 2–8.

63. *Id*. The 1990 version of the Takeover Directive "aimed at achieving detailed harmonization" in the E.U.'s market for corporate control. However, the ambitious proposal came at a time "when economic circumstances were propitious" to such a proposal. Inopportunely, the economic situation changed. Strong opposition from certain member states, motivated largely by self interest, swiftly followed the change in economic environment. *Id.*

64. Explanatory Report, *supra* note 6, at 5. The Commission based the new proposal on consultations with Member States. *Id.* Unlike its predecessor, this version of the Thirteenth Directive did not attempt to achieve detailed harmonization across the European Union. *Id* at 2. In light of consultations with the Member States, the proposal "contained a 'framework' directive," merely setting out desired general principles. *Id.*

65. *Id*.

66. As before, the proposal adopted by the Commission reflected opinions of the European Parliament and of the Economic and Social Committee. *Id*.

67. Members of the European Parliament ("MEPs") split along national lines. Under pressure from Berlin, for example, ninety-eight out of ninety-nine German MEPs rejected the proposed Takeover Directive. Raphael Minder, *Elections Expose Flaws in Cross-Border Political Groupings*, FIN. TIMES, May 26, 2004, at 15. Arguably, Germany has been at the forefront of promoting protectionism and the statist approach in the E.U. As early as May 2001, Brussels said it planned to "look into" "Volkswagengesetz," a law that protects the German carmaker from hostile takeovers. The Commission said that the 1960 Volkswagen law "breaks the principle of the free movement of capital by giving a 'special blocking minority right' to Lower Saxony, which holds about 20% of the voting shares." Daniel Dombey, *Final Warning for Germany on Rules Protecting VW*, FIN. TIMES, Mar. 31, 2004, at 8. On March 30, 2004, the European Commission gave Germany a "final warning" to change rules that protect Volkswagen from foreign acquisition. The Commission took several years to issue a formal request due to the political sensitivity of the situation. German Chancellor Gerhard Schroder sat on Volkswagen's board as prime minister of the federal state of Lower Saxony. *Id.* Moreover, Volkswagen demonstrated its political clout by successfully lobbying against the E.U.'s takeover directive in 2001. *Id.* Similarly, the French have

amendments was spearheaded by Germany because the Takeover Directive threatened the "Volkswagengesetz," which shields Volkswagen, a German car manufacturer, from hostile takeovers.[68] Essentially, the Takeover Directive was defeated in the Parliament due to profound divisions concerning the Takeover Directive's four contentious and highly politicized areas: (1) minority shareholder protections contained in Article 5 that required bidders to make an equal offer to all shareholders;[69] (2) prohibitions in Article 9 against defensive measures designed to frustrate takeover bids;[70] (3) limitations on restrictions against multiple voting rights and other restrictions on transferability of stock contained in Article 11;[71] and (4) a contention regarding consulting employees during a takeover.[72]

Despite the initial defeat, the Commission promptly revived its efforts to pass the Takeover Directive because the need for a common framework to govern cross-border takeover bids was perceived as vital to the Commission's goal of achieving the integration of European capital markets.[73] On October 2, 2002, the Commission presented a renewed proposal for the Takeover Directive.[74] In its scope and general underlying principles, the Commission's new proposal was analogous to the previous effort — i.e., it was designed to transform the E.U.'s legal scheme into a more takeover-friendly regime by harmonizing takeover rules among its member states.[75]

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been guilty of hindering takeover bids in favor of national sentiments. Berlin attacked Paris for a "statist" approach in the takeover of a pharmaceuticals group. The French government has been criticized for its controversial involvement in the potential takeover by Sanofi-Synthelabo, the Paris-based pharmaceutical group, to bid for Aventis, its Franco-German rival, worth approximately $59.43bn (€50.8bn). Germany's economic minister, Wolfgang Clement, said that he had asked the French government to remain neutral with respect to the Sanofi-Aventis bid battle but was "rebuffed." Aventis succumbed to the government-backed approach after Sanofi raised its bid by 14%. The French Prime Minister and the finance minister "had openly and actively encouraged the offer." Bertrand Benoit, *Berlin Attacks Paris for 'Statist' Approach in Takeover of Pharmaceuticals Group*, FIN. TIMES, Apr. 30, 2004, at 9. Additionally, there are rumors that Germany had struck a deal with France to give Siemans, the Munich-based engineering group, free rein to acquire parts of Alstom, its "cash-starved French rival." *See id*.

68. Benoit, *supra* note 67, at 10.

69. The purpose for this provision is to prevent speculative attacks and insider deals. McCahery et al., *supra* note 7, at 10–35.

70. This provision is a particularly crucial component of the Takeover Directive. It would require a target company's board to obtain shareholder approval prior to enacting any defensive measures, making it more like its American counterpart. In particular, fierce debates arose over allowing poison pills.

71. An exception was provided early-on for the double share system used in France, where shares carry double voting rights after being held for two years. *See* Explanatory Report, *supra* note 6, at 9.

72. Many opponents of the Takeover Directive vehemently opposed it due to labor concerns in takeover situations — i.e., the codetermination principle that is popular in many European nations. However, this topic is outside the scope of this Note.

73. *See* Explanatory Report, *supra* note 6, at (C 45) E1.

74. *See* Council Directive 2004/25, 2004 O.J. (L 142/12) (EC); *see also* McCahery et al., *supra* note 7, at 5.

75. Council Directive 2004/25, art. 3, 2004 O.J. (L 142/12) (EC). Among others, the principles retained include: the board of the offeree company must act in the interests of the company as a whole; securities holders of the target company must be given equal treatment; sufficient time and information must be

After over a decade of negotiation, an agreement on the Takeover Directive was finally reached on December 16, 2003, when the European Parliament approved the compromised version.[76] The Council gave final approval on March 30, 2004, and the Takeover Directive came into force on May 20, 2004.[77] The Takeover Directive required that all member states pass legislation implementing the Takeover Directive by May 20, 2006.[78] The long-running endeavor to establish standard E.U. rules on takeover bids had thus reached its goal. But, did it really?

B. *Substantive Principles of the Takeover Directive*[79]

1. *Minority Shareholder Protection*

An important policy behind the Takeover Directive is that minority shareholders should be better protected.[80] Commentators on corporate governance have implicitly agreed on one theme: Deep, liquid securities markets arise only under special conditions, which include dispersed ownership structure. In their view, dispersed ownership is possible only when the legal system provides adequate protection for minority shareholders.[81] The Takeover Directive recognizes and establishes a number of protections for minority shareholders, including equal

afforded to securities holders to enable them to reach a properly informed decision on the bid; an offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities; false markets must not be created in the securities of the offeree company, the bidding company, or any other company concerned by the bid. *See id*.

76. *Id*. Legislators approved the compromise text of the Directive by a count of 321 votes in favor to 219 votes against, with 9 abstentions. *See* Press Release, Klause-Heiner Lehne, European Parliament, Internal Market: Takeover Directive Adopted (Dec. 16, 2003), *available at* http://www.europarl.europa.eu/omk/sipade3?SAME_LEVEL=1&LEVEL=0&NAV=X&DETAIL=&PUBREF=-//EP//TEXT+PRESS‡N-20031216-1+0‡OC+XML+V0//EN. Opposition to the vote came from Members on the left, "who felt the clauses on information and consultation of workers were inadequate." *Id*.

77. Council Directive 2004/25, art. 3, 2004 O.J. (L 142/12) (EC).

78. *Id*.

79. From a U.S. legal perspective the E.U. Takeover Directive was unorthodox in that it sought to regulate both internal affairs of companies such as provision in corporate charters (e.g., takeover defenses and voting rights) and matters of securities law (e.g., procedures for tender offers). In the United States, internal affairs of corporations are regulated by state law, whereas matters involving corporate securities are regulated by federal securities law. *See generally* CARNEY, *supra* note 15, at 497–550 (discussing U.S. federal and state legislation on corporate governance).

80. Lehne, *supra* note 76.

81. *See*, *e.g*., Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); John C. Coffee, *Racing Towards The Top?: The Impact Of Cross-Listings And Stock Market Competition On International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002) (noting the effect of dispersed ownership on corporate governance).

treatment of all of the target company's shareholders,[82] an "equitable price" principle,[83] the cash alternative rule,[84] and the mandatory bid rule.

The mandatory bid requirement, contained in Article 5, affords protection to minority shareholders. Article 5 dictates that any company launching a takeover bid must extend its offer to all the target company's shares (mandatory bid) at an "equitable price." Equitable price is defined as "[t]he highest price paid for the same securities by the [bidder] . . . over a period . . . of not less than six months and not more than tweleve months before the bid . . . ."[85] The member state where the target company has its registered office, however, is left to determine the critical control threshold that triggers the mandatory bid requirement.[86] The Takeover Directive does not require a uniform control threshold across the E.U.[87] Consequently, countries like the Netherlands that do not currently have mandatory bid requirements, and presumably do not want one, could potentially set the control threshold at such a high level as to make the entire requirement moot.[88]

The Takeover Directive as adopted makes the mandatory bid requirement's definition of an equitable price more generous to minority shareholders.[89] The adopted compromise text adds, "[i]f, after the bid has been made public and before the offer closes for acceptance, the [bidder] . . . purchases securities at a price higher than the offer price, the [bidder] shall increase his offer" to at least match the highest price paid.[90] This requirement is designed to eliminate structural coercion commonly employed by bidders in hostile takeovers that effectively put shareholders at a significant disadvantage.[91] Nevertheless, the mandatory bid

82. Council Directive 2004/25, art. 3(1)(a), 2004 O.J. (L 142) 15 (EC)[A] states that "all holders of the securities of [a target] company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected."

83. *Id.* at art. 5(4), 2004 O.J. (L 142) 17 (EC).

84. *Id.* at art. 5(5), 2004 O.J. (L 142) 17 (EC).

85. *Id.* at art. 5(4), 2004 O.J. (L 142) 17 (EC) (defining equitable price).

86. *See id.* at art. 5(1), 2004 O.J. (L 142) 17 (EC) ("Where a natural or legal person, as a result of his/her own acquisition . . . added to any existing holdings of those securities of his and the holdings . . . directly or indirectly give him a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company.").

87. *See id*.

88. This includes member states where control groups such as banks are currently particularly powerful, such as Germany.

89. Council Directive 2004/25, art. 5(4), 2004 O.J. (L 142) 17 (EC); *see also* Lehne *supra* note 76.

90. Council Directive 2004/25, art. 5(4), 2004 O.J. (L 142) 17 (EC).

91. In the United States, tender offers (addressed here) are regulated by the Williams Act, section 14(d). The Williams Act was a direct response to "Saturday night specials" such as "front-loaded" two-tier tender offers — by bidders that put shareholders at a significant disadvantage vis-à-vis a bidder due to the coercive effect of such a bid (entailing collective action and prisoner's dilemma concerns), by purporting to purchase only bare majority (51%), making the purchase on first come first served basis at the first stage,

requirement will render takeovers (or takeover attempts) more expensive for bidders; and, anything making an activity more expensive seemingly makes it more rare, which could be a bad policy. Presumably, the Council and the European Parliament tried to strike a proper balance with the Takeover Directive, which will be distorted if member states differ significantly in implementing the Takeover Directive. Consequently, giving member states unfettered discretion in implementing the Takeover Directive could have a chilling effect on the European corporate control market. For this reason, under U.S. law, tender offers and other securities law matters are regulated by federal securities law and individual states generally cannot impose additional requirements.[92] As a practical matter, a mandatory bid rule could be difficult to implement in Continental Europe because of extensive cross-ownership by European corporations of each other's stock. In addition, political and economic obstacles to requiring a purchaser of a control block to bid for *all* of a company's shares are likely to emerge.[93]

2. *Defensive Mechanisms*

Articles 9 and 11 of the Takeover Directive prohibit defensive measures that are often taken by directors of target companies to resist unsolicited takeover attempts without the approval of shareholders. In requiring shareholder approval, the Takeover Directive retains a key principle from a prior proposal — i.e., shareholders, as company owners, should ultimately decide the outcome of a takeover bid. By making defensive measures more difficult to pursue, these provisions aim at eliminating management entrenchment that frequently occurs at the expense of shareholders.[94]

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but offering a lesser price (or a lesser quality of consideration, such as subordinated debt) in the second stage of the tender offer. The effect of such tactic is to create a shareholder stampede, where shareholders rush to get in on the first step of the tender offer out of fear of getting a bad deal later on. *See generally* CARNEY, *supra* note 15. Two-tier offers are a common example of takeover techniques that result in structural coercion. *Id*.

92. Edgar v. MITE Corp, 457 U.S. 624 (1982) (striking down as unconstitutional a state statute that imposed additional requirements on tender offer procedures); *see also* CTS Corp. v. Dynamics Corp., 481 U.S. 69 (1987) (upholding an Indiana statute that mostly concerned the internal affairs of a corporation).

93. Kirchner & Painter, *supra* note 52, at 458–59 & n.3.

94. Council Directive 2004/25, 2004 O.J. (L 142) 20 (EC). It should be noted that these provisions do not apply to securities that carry double or multiple voting rights. "It can be argued that securities with multiple voting rights form part of a system for financing companies and that there is no proof that their existence renders takeover bids impossible. The same applies to securities with double voting rights, which may make for a stable shareholder base." The Commission in its commentary concedes that these measures are largely excluded for practical concerns about the success of the Takeover Directive; suppression of the foregoing rights without compensation, would "in some legal systems give rise to questions of a constitutional nature that could jeopardize or at least delay for a long time the adoption of the Directive." *Id*. However, the reexamination clause in Article 18 would allow for change if it is proven that such securities "are used mainly as defensive mechanisms against takeover bids." *See* Explanatory Report, *supra* note 6, at 10.

Pursuant to Article 9 — the "strict neutrality" rule — once a takeover bid is made, the target company's board of directors[95] must obtain "prior authorization of the general meeting of shareholders" before implementing any defensive measures that may frustrate the takeover bid.[96] Seeking alternative bids from other companies, however, is allowed without shareholder approval.[97] General shareholder approval is also required in situations where decisions outside the normal course of the company's business are made prior to the bid but are not implemented when the takeover bid is made.[98]

Article 11 creates "breakthrough" rights for the bidder, designed to neutralize pre-bid defenses to a takeover bid.[99] This provision bans certain legal restrictions on the transfer of securities and voting rights in the target company's articles of association.[100] Pursuant to this provision, the bidder is granted a so-called "breakthrough" right to do away with obstacles to the transfer of securities. Article 11 stipulates that once a bid has been made public, any restrictions on the transfer of securities in the articles of association or in any contractual agreements will be unenforceable against the bidder during the period for acceptance of the bid. This provision affords a successful bidder the "right to call a general meeting at a short notice" with a view to amending the articles of association and replacing the members of the board.[101] Consequently, any restrictions on shareholders' voting rights will cease to have effect when the general meeting of the target company's shareholders decides on any defensive measures.

3. *Article 12 — The Emptying Provision*

The Takeover Directive's approval this time around was attributable largely to a number of strategic amendments by the European Parliament. Most notably, Article 12 was introduced, which made key provisions of the Commis-

95. Where a company has a two-tier board structure, "board" includes both the management board and the supervisory board. Council Directive 2004/25, art. 9(6), 2004 O.J. (L 142) 19 (EC).

96. *Id.* at art. 9(2), 2004 O.J. (L 142) 19 (EC).

97. *Id*.

98. *Id.* at art. 9(3), 2004 O.J. (L 142) 29 (EC).

99. *Id.* at art. 11, 2004 O.J. (L 142) 20 (EC); *see also* Explanatory Report, *supra* note 6, at 9.

100. Council Directive 2004/25, art. 11, 2004 O.J. (L 142) 20 (EC). "This new Article reflects the need to level the playing field in takeover bids in the European Union by banning certain legal restrictions that can be regarded as hindering bids." Explanatory Report, *supra* note 6, at 9. "Multiple voting rights" can function as a subtle form of defensive measures: Corporations may contain equity structures where some shares carry more voting rights than others, effectively "enabling their holders to block takeover bids" that may be desirable to the majority of shareholders. Kirchner & Painter, *supra* note 52, at 460. These measures are particularly common in Scandinavian countries. *Id.*

101. Council Directive 2004/25, art. 12(2), 2004 O.J. (L 142) 21 (EC). Though the bidder is still subject to and must obey the requirements of the company law rules in force, applicable company law must be without any restrictions on the transfer of securities or exercise of voting rights against the offer. *Id.*

sion's proposal merely optional. Articles 9 and 11[102] could have eliminated significantly the problems associated with management entrenchment and with capital structures having share and voting restrictions, multiple voting shares, and/or special voting shares.[103] These provisions would have sent an emphatic message across Europe — protectionism is not welcome — and would have provided a framework for a robust capital market. But, pursuant to Article 12, member states can decide that Article 9 (requiring that the directors remain impartial during the takeover bid) and/or Article 11 (limiting multiple voting rights and other restrictions on transferability of stock) will not apply to companies with registered offices in their territories.[104]

A law of a member state would be invalid if it conflicted with the E.U. directive, but there would be no such conflict here because the Takeover Directive as adopted, and Article 12 in particular, allows each member state to retain their existing rules on takeovers.[105] The compromise, in effect, rendered moot the strict neutrality provisions in Article 9 and the breakthrough provisions in Article 11. Article 12 states that "Member States may reserve the right not to require companies[106] . . . which have their registered offices within their territories" to apply Article 9's strict neutrality rule and Article 11's breakthrough rule.[107] Thus, member states are free to allow the board to thwart takeover bids by taking (or maintaining) defensive measures designed solely to frustrate takeover attempts without consulting their shareholders. Member states that invoke Article 12 (i.e. choose to opt-out of Article 9 and/or Article 11) must give the companies with registered offices in their territories an option to opt back in into these provisions.[108] Thus, companies can apply the strict neutrality and breakthrough rules even if the member state where their registered office is located does not apply these provisions.

To complicate matters further, Article 12 contains a reciprocity clause: The member states may exempt companies "if [the company] becomes the subject of an offer launched by a company which does not apply the same Articles as they do." It is beyond question that the reciprocity clause aims at eliminating what some

102. There can be no level playing field throughout the E.U. as long as these special rights exist in some countries.

103. *See* Kirchner & Painter, *supra* note 52.

104. Council Directive 2004/25, art. 12(1), 2004 O.J. (L 142) 21 (EC).

105. *Id.* at art. 12, 2004 O.J. (L 142) 21 (EC).

106. *Id.* at art. 1(1), 2004 O.J. (L 142) 14 (EC) (defining the term "company" as "companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market").

107. *Id.* at art. 12(1), 2004 O.J. (L 142) 21 (EC); *see also* Lehne, *supra* note 76 (stating that "[p]arliament voted to allow any Member State to 'opt out' [of this a neutrality requirement] although individual companies in such Member State would be able to 'opt in'" despite its nation's choice to opt out).

108. Council Directive 2004/25, art. 12(3), 2004 O.J. (L 142) 21 (EC).

have argued would become a tilted transatlantic playing field with companies in the United States.[109]

Pursuant to the reciprocity clause, when a company applies strict neutrality rules and/or the breakthrough rules, either due to a mandate from its member state or because it chose to do so, a member state, where the company has its registered office (or its "seat"), can yet again choose to exempt the target company from Article 9 and/or Article 11 if the bidder does not apply such rules. This situation could occur if the bidder is a company from the United States, or a E.U. company, where the bidder operates in a member state that chose to opt out from these rules while the target company operates in a member state which has not invoked Article 12.

D. Article 12: Europe's Clash of Capitalisms

Though few disagree about the need for greater transparency, increasing protection of the interests of minority shareholders, and the need for a "level playing field" Europe,[110] there is considerable controversy — particularly in France, Germany, and Sweden — about "what many suspect to be the true motive of the [Takeover Directive]: to encourage hostile takeovers in Europe and stimulate cross-border mergers."[111] This controversy can be colorfully described as a clash of capitalisms in Europe — between the United Kingdom's free market economy and the more paternalistic economies of Germany and France. Again, the strict neutrality requirement and the breakthrough rights were at the center stage of the debate.[112] These provisions of the Takeover Directive, arguably, would restrict the ability of European target companies' directors to thwart unsolicited takeover attempts far more than their American counterparts.[113] France and Germany, for example, attack the strict neutrality rule of Article 9 by asserting that they fear the risk of creating an unequal transatlantic playing field for hostile takeover activity.[114] The boards of companies in the United States can avail themselves of an "arsenal of defenses, such as issuing new shares, without calling

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109. *See* discussion in Section III *supra* on the Takeover Directive.

110. Paul Betts, *Directive to Fall at Last Hurdle*, FIN. TIMES, Apr. 28, 2003, at 6.

111. *Id*. In continental Europe, many do not perceive corporate takeovers as maximizing shareholder value and increasing efficiency. To the contrary, many see dangers for firms taking on increased debt, which is associated with acquiring control of a company, and insist that takeovers absorb a large proportion of management's time, thereby increasing company's overhead costs. Moreover, the threat of a takeover "encourages the maintenance of excessive liquidity and the pursuit of short-term profit, at the expense of strategic investment that would yield a high return only in the long term." ALEXIS JACQUEMIN ET AL., MERGER AND COMPETITION POLICY IN THE EUROPEAN COMMUNITY 11–12 (P.H. Admiral ed., 1990).

112. Betts, *supra* note 110.

113. *Id.*

114. McCahery et al., *supra* note 7, at 111.

a shareholders meeting."[115] The two countries contend that European corporate boards would be powerless to defend themselves against U.S. corporations that are able to fend off hostile takeovers.[116] Thus, one possible ramification of a strict neutrality rule in Europe would be different rules on two sides of the Atlantic, which would raise the prospect that "U.S. companies could take over their European counterparts more easily, and pay less for doing so."[117] Commentators further argue that "despite the European Commission's strive for uniformity," a strict neutrality rule would have a different practical effect on different member states in the E.U. Some member states, such as France and Portugal, allow "golden shares," usually owned by a government agency after a privatization, to have a decisive voice in the governance of many companies.[118] These shares will almost never be tendered to a hostile bidder, making these companies unattractive tender-offer targets. Many European companies, however, have not issued golden shares, which puts them at a disadvantage by increasing their vulnerability in the face of a takeover.

In opposition to Article 11, the Swedes argued that the "elimination of multiple voting rights would be tantamount to an expropriation and damaging destabilization of a sound company's long-term strategy."[119] The French found the idea of canceling double voting rights appalling. In France, double voting rights are granted to shareholders if they own their shares for more than two consecutive years. Proponents of multiple voting rights point out that this system is used to "have[ing] long-term shareholders . . . offset the high volatility in share

115. *Id*. In the United States, takeover defenses are governed by state law, Delaware's for the most part. Although directors may, under the right circumstances, invoke defensive measures in order to resist unsolicited takeovers, this discretion is not unfettered because U.S. courts act as a check on the directors. *See generally* CARNEY, *supra* note 15. For a seminal case in the development of modern doctrine in the United States see *Unocal Corp.*, 493 A.2d at 954. The court recognized the potential for director abuse at the expense of shareholders:

> When a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholder . . . . There are . . . certain caveats to a proper exercise of this function. Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.

In *Unocal*, the court first articulated the rule that: "if a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." *Id*. at 955.

116. Betts, *supra* note 110. Directors of target corporations in Delaware and other U.S. jurisdictions routinely respond to hostile tender offers with a wide variety of defensive measures. *See* Kirchner & Painter, *supra* note 52, at 452 (listing defensive measures such as a white knights, rights plans, poison pills, sale of crown jewels, lock-up options, green mail, the Pac Man defense, and golden parachutes).

117. Kirchner & Painter, *supra* note 52, at 460.

118. *Id*. (criticizing the proposed directive and instead suggesting an alternative approach that would allow directors to initiate defenses subject to an ex-post shareholder veto that would, if cast by a majority of record shareholders at any time (maybe over the Internet), restrict the company to more stringent rules).

119. Betts, *supra* note 110.

prices these days."[120] With Article 12 included in the final version of the Takeover Directive, strict neutrality opponents seem to have won the debate.

In sum, as a result of the compromise, member states can decide that either or both of Articles 9 and 11 will not apply to companies with registered offices in their territories. Directors of such companies could, thus, be free to take defensive action to thwart takeover bids without shareholder approval and be immune to the Takeover Directive's breakthrough provisions. Such companies, however, could independently choose to apply Articles 9 and 11. Even if the company opted into the neutrality provision, under the compromise it is free to yet again opt out if it subsequently becomes the target of a hostile bid by a firm that itself does not observe the neutrality rule. The result begs the question: Is this needed flexibility or unnecessary confusion?

E. Analyzing the Directive as Adopted

With the introduction of Article 12, the aspirations of achieving uniform takeover regulations throughout the E.U. is drastically hampered. Rather than promoting uniformity in Europe, the "opt-ins" and "opt-outs" could result in legal uncertainty, the increasing protectionism in Europe, and greater fragmentation of capital markets. For instance, in a situation where the United Kingdom chooses to apply both Articles 9 and 11 to companies within its jurisdiction (and does not invoke Article 12), while Germany invokes Article 12 and opts out of Articles 9 and/or 11, a German target company will be able to implement defensive measures to frustrate a takeover bid, while a United Kingdom target company will be able to take such action only with prior, and presumably time consuming and costly, approval from its shareholders.[121] Furthermore, under the current version of the Takeover Directive, a tilted playing field may even result when different bidders battle for the same target company. For instance, take a not unlikely scenario to illustrate this point: If the United Kingdom requires Article 9 to be applied by all U.K. companies, the United Kingdom could nevertheless decide that a U.K. target company could, under Article 12, opt out of Article 9, enabling it to take defensive action without shareholder approval against a takeover bid by a French company incorporated in the E.U. that did not have Article 9-like restrictions. Because Article 9 would apply to any U.K. competing bidder, however, the U.K. target company would not be allowed to opt out of Article 9 with respect to a U.K. competing bidder. Consequently, it would be more difficult for the U.K. bidder company vis-à-vis a French bidder company to acquire corporate control. The result is a partial auction, likely to the detriment of the target's shareholders.

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120. *Id.*

121. Freshfields Bruckhaus Deringer, The Takeover Directive 12 (2005).

Some member states will opt out of Articles 9 and 11, and others will not. Accordingly, member states' legislation must face the following dilemmas: If one member state eases the rules on its corporations, can it long deny its own companies the same ability? Will it be seen as placing its companies at a competitive disadvantage by subjecting them to more burdensome regulation?

The compromise in the Parliament angered the Commission due to fears that the agreed upon version of the Takeover Directive "could tempt member states toward greater protectionism,"[122] which would be in derogation of the Takeover Directive's intended purpose — i.e., to "further the E.U.'s single market by dismantling barriers to cross-border takeovers."[123] The Commission intended for the Takeover Directive to facilitate European mergers and acquisitions as a step towards a genuine single market,[124] whereas the adopted Takeover Directive could allow companies to fend off takeovers without shareholder approval and "will do little to create a level playing field."[125]

The full impact of the Takeover Directive on the E.U.'s takeover market cannot be assessed until it becomes apparent how member states will implement it. Of particular importance is whether member states invoke Article 12. Another important issue is the resolution of the "control threshold" requirement. The image will become clearer over the next year, as the implementation of the Takeover Directive plays out on the national level. It remains very possible that this legislative initiative will not accomplish much at all. Or, it could be that the opt-out provision will actually influence the substance of takeover law by helping to stimulate regulatory competition in the E.U. despite a popular view that it effectively emptied the Takeover Directive of its content.

IV. BEYOND THE TAKEOVER DIRECTIVE: INSPIRE ART

A. Incorporation Theory vs. Real Seat Theory

Within the E.U., some member states have traditionally adhered to the "incorporation" doctrine, while others have embraced the "real seat" doctrine. The United Kingdom, Ireland, Denmark, and the Netherlands belong to the former group, while Germany, Belgium, France, Luxembourg, Austria, Portugal, Spain, Italy, and Greece have traditionally embraced the latter.[126] Under the

122. Daniel Dombey, *Europe: E.U. Directive Raises Concerns*, FIN. TIMES, Nov. 27, 2003, at 26.

123. *Id.*

124. Daniel Dombey, *European Parliament Backs Takeover Directive Compromise*, FIN. TIMES, Dec. 17, 2003, at 4.

125. *Id*. (quoting Chris Huhne, a Member of the European Parliament that spearheaded the final version of the legislation through the Parliament).

126. *See generally* Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 55 n.11 (2005). Germany's law, for example, requires a company having its principal place of business in Germany to incorporate under German law; conversely a company that has its headquarters outside of Germany cannot incorporate under German law. Karsten E. Sorenson & Mette Neville, *Cor-*

real seat doctrine, the internal affairs of a company are governed by the law of the state in which the company has its headquarters or its principle place of business, not by the law of the state of its registration.[127] Under the incorporation doctrine, it is the law of the state of registration, rather than the law of the state in which the company's headquarters is located, that governs the company's internal affairs.[128]

Under the real seat theory, companies that want to take advantage of more efficient corporate law in a certain member state must relocate their headquarters there. Such a move, however, is not practical due to the significant costs entailed. Therefore, the real seat doctrine "effectively prevent[s] free choice."[129] Under the incorporation theory, however, companies are generally free to relocate their headquarters and operations without losing their original legal status, just as a Delaware corporation may jump from state to state within the United States without losing the benefits of Delaware corporate law. Without the costs inherent to the real seat theory, companies are encouraged to form under the laws of countries that have the most favorable corporate laws (e.g., regarding takeovers).[130] Accordingly, a significant characteristic of the incorporation doctrine is that it encourages forum shopping.[131]

As explained above, whether one approach to corporate law prevails over the other is significant for regulatory competition. Moreover, the "two approaches to corporate law allow for different levels of regulatory competition among jurisdictions, which seek benefits of corporate charters [such as] franchise taxes and markets for legal services."[132] Incorporation theory allows for competition solely based on corporate law,[133] whereas under the real seat theory, competition based on corporate law alone cannot occur because competition is possible only for the total package of various laws (labor, antitrust, tax, etc.), and economic and political conditions.[134] Under the real seat theory, a corporation cannot choose to become subject to the corporate laws of a state (or country) without

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porate Migration in the European Union: An Analysis of the Proposed 14th EC Company Law Directive on the Transfer of the Registered Office of a Company from Once Member State to Another with a Change of Applicable Law, 6 COLUM. J. EUR. L. 181, 185–86 (2000).

127. Dammann, *supra* note 126, at 55.

128. Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 162–63 (1985).

129. Dammann, *supra* note 126, at 55.

130. Patrick S. Ryan, *Case Law.C-167/01. Kamer Van Koophandel En Fabrieken Voor Amsterdam v. Inspire Art Ltd. (E.C.J. September 23, 2003)*, 11 COLUM. J. EUR. L. 187, 190 (2004–2005).

131. *Id.*

132. Kirchner et al., *Regulatory Competition in EU Corporate Law After* Inspire Art: *Unbundling Delaware's Corporate Product for Europe* 3 (University of Illinois College of Law and Economics Working Paper Series, Working Paper No. 17LE04-001, 2004).

133. *Id*. at 4 (also known as Type B competition).

134. *Id*. at 3 (also known as Type A competition).

also locating its principal place of business there, thereby coming under the umbrella of that jurisdiction's other laws and economic and political conditions. Accordingly, under the real seat theory, corporate law is likely only one factor in the corporation's decision where to establish itself, which may be trivial compared to, for example, the demand for its products or services. Thus, the traditional acceptance of the real seat doctrine among some E.U. member states has historically hampered regulatory competition in the E.U.[135]

B. Inspire Art: *The European Union's Shift to the Incorporation Doctrine*

The European Court of Justice ("ECJ") cast its vote for cross-border regulatory competition in *Inspire Art* when it held that E.U. companies formed in accordance with the law of one member state had a right to pursue substantial economic activities anywhere in the E.U. under the "freedom of establishment" of the Treaty of Rome.[136] The court held that a host member state that adhered to the real seat doctrine must recognize a company operating in its territory if that company was validly registered in another member state (a "foreign company" or "pseudo-foreign company"). Furthermore, the court asserted that national laws that treat foreign companies differently from companies that are registered under domestic corporate law violate the law of the E.U. Furthermore, the court found that companies could legitimately register in a certain member state for the sole purpose of benefiting from that member state's corporate law.[137] In other words, the court decided that the incorporation theory prevailed over the real seat theory.[138]

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135. *Id*. at 3–4; *see also* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1870 (2002).

136. One of the purposes of the freedom of establishment clause is to encourage movement of companies within the E.U. Ryan, *supra* note 130, at 187–88. This decision by the court was consistent with the trend of its previous decisions — all in favor of freedom of establishment. Case 81/87, The Queen v. H.M. Treasury and Commissoners of Inland Revenue, ex Parte Daily Mail and General Trust plc, 1988 E.C.R. 5483; Case C-212/97, Centros Ltd, 1999 E.C.R. I-1459; Case C-208/00, Uberseering, 2002 E.C.R. I-1459. The court expanded upon its earlier holding in *Uberseering*, which held that member states could not compel companies to reincorporate in their states, that a company's legal personality must be respected in the entire E.U. and extended the full recognition of the pseudo-foreign company in the E.U.'s single market to all areas of corporate law. *See generally* Christian Kersting & Clemens P. Schindler, *The ECJ's* Inspire Art *Decision: It's Effects on Practice*, 4 GERMAN L.J. 1277, 1282–84 (2003) (analyzing *Inspire Art* and its effect on the E.U.).

137. Case C-167/01, Inspire Art, 2003 E.C.R. I-10155; *see also* Kersting & Schindler, *supra* note 136, at 1280–81.

138. Kersting & Schindler, *supra* note 136, at 1282–84; *see also* Kirchner et al., *supra* note 6 (arguing that a way to encourage regulatory competition for corporate charters in the E.U. is to offer substantive law without the adjudication system, leaving it up to companies to decide on where to adjudicate disputes).

Inspire Art, Ltd., was a privately held company that dealt in art.[139] It was registered in the United Kingdom, under U.K. corporate law.[140] Immediately after its formation, however, Inspire Art started doing business in the Netherlands, the home country of its sole shareholder and director.[141] From the very beginning, the shareholder only intended to take advantage of the liberal rules of U.K. law and never intended to do business in the U.K.[142] Inspire Art was rendered a "pseudo-foreign company" under Dutch law (Wet op de Formeel Buitenlandse Vennootschappen) ("WFBV") because it was formed under the law of another member state. WFBV imposed additional legal requirements and conditions on foreign companies, such as Inspire Art, that were operating in the Netherlands.[143] As a penalty for not complying with these domestic requirements — a minimum capitalization requirement — shareholders were stripped of limited liability protection. A Dutch national court found that Inspire Art was a "pseudo-foreign" company under WFBV,[144] but asked the ECJ to rule whether E.U. law proscribed member states from imposing additional conditions and legal requirements on companies that are validly registered in another member state.[145]

Inspire Art argued that additional requirements demanded by WFBV for foreign companies violated the E.U.'s freedom of establishment because these requirements "render[ed] the right of establishment markedly less attractive" for foreign companies.[146] The Netherlands contended that the added requirements for foreign companies were justified due to public interest reasons such as "countering fraud," "protecting creditors," and making sure that "business dealings are fair."[147] The court held that under European law member states could not compel foreign companies, validly registered in another member state, to adjust to national laws that imposed prohibitive requirements on foreign companies.[148] The court thus struck down a minimum capital requirement under Dutch law that was not prescribed by U.K. law. The *Inspire Art* court further held that the

139. Case C-167/01, Inspire Art, 2003 E.C.R. I-10155.

140. *Id*.

141. *Id*.

142. *Id.*

143. These requirements included a minimum capitalization requirement and many additional disclosure requirements. *See* Wet op de formeel buitenlandse vennootschappen (WFBV), Articles 2–5; *see also* Case C-167/01, Inspire Art, 2003 E.C.R. I-10155.

144. *See* WFBV, Article 1 (stating that Dutch branches of pseudo-foreign companies are required to disclose the fact that they are pseudo-foreign companies), *available at* http://www.international-ukbusiness.com/english/eu_nl.htm; Kersting & Schindler, *supra* note 136, at 1280.

145. *See* Kersting & Schindler, *supra* note 136, at 1280.

146. Case C-167/01, Inspire Art, 2003 E.C.R. I-10155 at ¶90.

147. *Id*. at ¶132.

148. *Id*. The court struck down additional disclosure requirements imposed by WFBV because they were contrary to an E.U. Directive.

requirement could not be saved by public interest justifications.[149] In particular, the court stated that the protection of creditors could not justify imposing restrictions on companies registered in other member states.[150] This holds true even if the purpose is to circumvent the application of more rigid company laws of the member state where the company conducts most of its business.[151] Thus, with the narrow exception of cases involving fraud, the result would be the same if the company's main, or even entire business operations were carried out in the host state — in this case the Netherlands.[152] In other words, the only prerequisite for the application of the freedom of establishment is incorporation in a member state, not the existence or extent of operations in the state of incorporation. By holding that European companies were free to choose an E.U. jurisdiction only for its permissive rules,[153] the ECJ embraced the incorporation doctrine, an American style of corporate system.

C. Reexamining Regulatory Environment in the European Union after Inspire Art

After *Inspire Art*, it seems safe to conclude that companies are now free to register in any jurisdiction that they view as having the most favorable corporate law. Commentators say that the ECJ has "widely opened the door for corporate restructuring within European company law."[154] The court certainly has laid the groundwork for increasing regulatory competition as to corporate law in the E.U. among member states, which could be an important influence on the substance of takeover law.[155] In the post–*Inspire Art* era, member states can compete based on corporate law alone because companies can choose the corporate law of a member state without having to conduct its business there, thus avoiding the effect of other laws and negative economic and social conditions under the jurisdiction of that member state. So, will we see a "Delaware of Europe" emerge?

Despite the potential for extraordinary change after *Inspire Art*, the practical effect may fall short. It is important to note the realities that distinguish European jurisdictions from U.S. jurisdictions, even in cases of general application of the incorporation doctrine. Unlike U.S. investors, European investors

149. *Id*. at ¶135.

150. *Id.* at ¶142.

151. As a result of this judgment, an English Limited Company or a Dutch B.V. operating entirely in Germany must now be recognized, and only the laws of the state of incorporation (the U.K. or the Netherlands) will govern its corporate existence.

152. Kersting & Schindler, *supra* note 136, at 1281 (*citing* Case C-212/97, Centros, 1999 E.C.R. K-1459 (discussing the exception in fraud cases)).

153. Case C-167/01, Inspire Art, 2003 E.C.R. K-10155, at ¶¶ 95–97.

154. Kersting & Schindler, *supra* note 136, at 1290.

155. John Armor & David Skeel, Jr., *Who Makes the Rules for Hostile Takeovers and Why? — Peculiar Divergence of US and UK Law*, at 4 (2005) (working draft) (on file with author).

seem to be culturally biased towards investing in their home country, which seems to favor incorporation under national laws and listing at the domestic stock exchanges.[156] For European companies, reincorporating in another jurisdiction may prove more expensive than for U.S. companies due to language differences, which do not exist among U.S. jurisdictions. Reincorporating in another jurisdiction involves costs resulting from the fact that a corporation has gained expertise in handling legal problems and established important relationships in their initial jurisdiction, which would be lost if the company reincorporates in another jurisdiction.[157] Nationalistic antagonisms may bring additional disincentives to reincorporating in a more favorable jurisdiction. Furthermore, fear of judicial bias in a foreign member state is another eminent concern. In short, these cultural factors will remain an impediment to the free competition of corporate law in the E.U.

Yet another reason for skepticism is that Europe lacks an established adjudication system that is appealing to corporate investors and managers, which is the keystone of Delaware's success.[158] Indeed, some skeptical commentators suggest that current levels of regulatory competition and economic integration in the E.U. more closely resemble the United States of the 1800s than the United States of today.[159]

Nonetheless, the potential effect of the ECJ's recent judicature, endorsing the incorporation doctrine over the real seat doctrine, should not be dismissed. There have been some indications that fundamental shifts are beginning to take place. Lawyers have begun to recommend that clients consider incorporation in the U.K. or the Netherlands.[160] Scholars have noted that "at least 141 companies with German names containing the designation GmbH (the designation meaning German private company) have been reorganized as private limited companies under U.K. company law" since the ECJ first addressed the incorporation doctrine in *Centros*, while only four companies reorganized before *Centros*.[161] Since *Inspire Art*, at least forty-eight more companies have followed this

156. Kirchner et al., *supra* note 6, at 21–23.

157. *Id.*

158. *See id*. (proposing that to be successful in Europe, member states should consider using an "unbundled product" of substantive corporate law without the adjudication system); *see also* Armor & Skeel, *supra* note 155, at 4 (providing a historical account of corporate legal systems in the U.S. and U.K. and arguing that the choice of rule-maker — judicial body or a self-regulatory body—is just as important on substantive corporate law as regulatory competition).

159. Kirchner et al., *supra* note 6, at 7.

160. *The* "Inspire Art" *Judgment of the ECJ: New Ways to Structure Acquisitions in the European Union* (Debevoise & Plimpton) Spring 2004, at 4, *available at* http://www.debevoise.com/newsevents pubs/publications/detail.aspx?id=02b668fa-9866-4f51-8890-faf634f24b77 (discussing problems within German corporate law, such as codetermination, rigid procedures for issuing share capital, strict rules on capital maintenance, supermajority (75%), mergers, and certain other corporate actions).

161. Kirchner et al., *supra* note 6, at 6.

trend.[162] Moreover, while the costs and barriers discussed above could be unduly prohibitive with respect to E.U. leaders such as the United Kingdom, France, and Germany, the less influential newcomers to the E.U. such as Poland or the Czech Republic, having infant corporate law regimes,[163] could undertake revisions to its corporate law without much controversy and provide an efficient corporate law product to companies doing business in the E.U. After all, in the United States, it is not New York, Texas, or California that dominate the game; it is the tiny Delaware.

D. Regulatory Competition as an Alternative to Harmonization of Takeover Rules

As the Takeover Directive illustrates, achieving uniformity of takeover rules is a burdensome undertaking in the E.U. Animosities among the most powerful member states have become increasingly common. Moreover, among the member states there is an increasing resistance to (and distrust of) the centralization of power. This trend is likely to continue and exacerbate with the expansion of the E.U. to twenty-five member states.

There is, however, evidence suggesting a contrary result. The effect of ECJ's holding in *Inspire Art* may be that the E.U. will gradually begin to function more like the United States, where corporations chartered in one state can have offices and carry on most of their business activities in one or more other states. This could create regulatory competition among the different nations, and prove to have a material effect on takeover rules and accomplish that what the Takeover Directive has failed to achieve.

Consider the following hypothesis: The Takeover Directive will result in a diversity of rules governing takeovers as some member states embrace Article 12 while others do not. As investors realize that strong takeover rules — for example, those prohibiting takeover defenses — maximize the value of their shares, companies will begin to re-incorporate and issue securities in those jurisdictions that are takeover-friendly. And, as member states compete for charter revenues, market forces could put pressure on other countries to enact similar statutes. Indeed, one such phenomenon has already occurred in the post–*Inspire Art* era. France has substantially reduced its capitalization requirement for its SARL.[164]

162. Although some of these companies may have some ties to the United Kingdom, and it is not clear whether they have completely opted out of German corporate law. Kirchner et al., *supra* note 6, at 7 n.13 (citing Companies House, CD-ROM Directory, Aug. 2004).

163. It is important to remember that very recently, these nations were a part of the Soviet Block, operating without private enterprises under the Communist system. These nations did not have corporate law. Any corporate law that emerged as a result of privatization is still mostly untested and certainly is not deeply rooted in the national psychology.

164. France lowered its minimum capital requirement for its SARL to one Euro. Kirchner et al., *supra* note 6, at 30 n.83.

Hence, it is possible that the market will eventually force member states into aligning their regulatory regime into one that is more favorable for takeovers.

In 2005, immediately after four British companies received takeover bids, a flurry of takeover activity followed. As a result of this activity, "European stock markets enjoyed their best day for two years."[165] The bids drove the FTSE 100 index to its best one-day performance in two and a half years, up 2% to 5317.3.[166] In one of the mergers, Spain's Telefonica bid for English O2; the all-cash deal was priced at £2 a share — a 22% premium for target's shareholders over the closing price. Thus, we see that as European companies come to embrace the hostile takeover as a device for maximizing shareholder value, shareholders are rewarded. What remains to be seen is whether European regulators will embrace the same market forces that their industries have already begun to accept.

V. CONCLUSION

In a free market system, the market determines winners and losers. This same market-driven competition should prevail in the regulatory market as member states vie for revenues from the incorporation of companies. This Note predicts that, in the post–*Inspire Art* era, E.U. companies will flock to jurisdictions where Article 9 and Article 11 of the Takeover Directive are mandatory. By the same token, obsolete products — management entrenching rules detrimental to shareholders — will sit on the shelf until modified or simply will be simply taken off the shelf. If this prediction proves true, other member states will succumb to the market pressure and will opt-in to Article 9's strict neutrality rules and Article 11's breakthrough rules as they compete for incorporation revenues. If this forecast proves accurate, a takeover friendly environment will prevail in the E.U. and stockholders will no longer be at the mercy of management.

The Takeover Directive is an attempt to put into law corporate conduct that is slowly becoming more common in the E.U. As Professor Coffee put it, the Takeover Directive is not a force leading a movement, but rather a reaction to changes that have gained acceptance throughout the corporate community in Europe. Corporate law reform generally has been responsive to economic developments rather than initiating or leading it.[167] Whether market pressure alone will lead to the harmonization of takeover regulation in Europe and eliminate protectionist measures such as defensive devices and multiple voting rights re-

165. Christopher Brown-Humes, *Fireworks Light Up an Otherswise Dark Month for Equities*, FIN. TIMES, Nov. 1, 2005, at 30.

166. Mark Mulligan et al., *The Bidders Conspicuous by Absence*, FIN. TIMES, Nov. 1, 2005, at 23. The surge in U.K.-targeted mergers and acquisitions is fuelled by European companies. *Id*.

167. Coffee, *supra* note 47, at 12–13. Professor Coffee notes that his data is consistent with Bebchuk and Roe's prediction that the proper environment where formal legal changes can occur is in transitional economies, "where strongly entrenched interests that were aligned with the existing legal structure did not already exist." *Id.* at 13 n.24.

mains to be seen. Nonetheless, with recent developments in technology, market conditions, and the ECJ's decision in *Inspire Art*, this much seems clear — the era of forum and company law shopping has already begun.