

# **Takeover Law in the EU and Germany: Comparative Analysis of a Regulatory Model**

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The search for an optimal regulatory model for takeovers keeps academics and practitioners busy around the world – not least in Japan and Germany. The more one examines this fascinating topic from a comparative and interdisciplinary perspective, the more confusing it becomes: economies with similarly structured capital markets and ownership patterns have chosen opposing takeover regimes, while differently structured economies have opted for an identical regulatory model.<sup>1</sup> A brief overview of what happened where and when shows a highly diverse picture. The U.K. and the U.S. set the pace when choosing opposing regulatory strategies for their takeover regimes; Japan and Germany followed somewhat later, again opting for opposing models (I.). The differences between the German and the Japanese takeover regulation are illustrated by some practical examples (II.). Thereafter the German takeover regime will be contrasted with its British role model to reveal some structural flaws (III.). Finally, the riddle of the widespread public aversion against takeovers as an efficient means of adapting to change will be addressed (IV.).

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<sup>1</sup> For a comprehensive analysis of different takeover regimes, see DAVIES/HOPT, Control Transactions, in: Kraakman et al (ed.), *The Anatomy of Corporate Law. A Comparative and Functional Approach* (Oxford 2004) 157 ff.; BAUM, Funktionale Elemente und Komplementaritäten des britischen Übernahmeregimes, in: *Recht der Internationalen Wirtschaft* 2003, 421 ff.; LEKKAS, L'harmonisation du droit des offres publiques et la protection de l'investisseur. Étude comparée des règles en vigueur en France, au Royaume-Uni et aux États-Unis d'Amérique (Paris 2001); SLAUGHTER, Rights offerings, takeovers and U.S. shareholders, in: *The Company Lawyer* 2002, 72 ff.; MILLER, Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England, in: *Columbia Business Law Review* 1998, 51 ff.; KARMEL, Transnational Takeover Talk—Regulations Relating to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia, in: *University of Cincinnati Law Review* 1998, 1133 ff.

## I. Different Models of Takeover Regimes

### A. The British Experience

Some 40 years ago in the late 1960s, British managers suffered a rude awakening when the first hostile bids for what they saw as “their” companies were put forward in the U.K.<sup>2</sup> Since then the U.K. has developed the most active takeover market in the world in relation to its size. At that time, however, hostile takeovers were still regarded as bad behavior in the city. The usual cries for government help followed but, somewhat surprisingly, government seemed to have refused to regulate good takeover behavior; instead, it came down to self-help by the financial industry. In 1968 the *City Code on Takeovers and Mergers*<sup>3</sup> was promulgated as a piece of self-regulation. The City Code introduced rules for fair procedure, namely transparency rules, and the so-called “mandatory bid rule” that became its centerpiece. Roughly speaking, the latter imposes the obligation to acquire all shares offered if a person or company acquires one-third of voting rights in public companies, and to pay the same price to all shareholders willing to sell. The aim is to guarantee an exit route for minority shareholders in case of a change of control, and to secure equal treatment of all shareholders in substance – i.e., financially – in the case of the takeover.

These measures were of some help to the incumbent management of a target company confronted with a hostile takeover because, in effect, transparency rules and especially the mandatory bid rule make takeovers more costly. However, these “advantages” were at least partly offset by the introduction of a strict neutrality principle that essentially binds the hand of managers. According to the “non-frustration” rule laid down in the Code’s General Principle 7 and supplemented by Rule 21 and Rule 37, the management of a target company may not take any action that might frustrate a bid without express up-to-date consent of the company’s shareholders. Thus the decision in the U.K. about a change in control has rested since then firmly with the shareholders as the residual risk takers.

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<sup>2</sup> An analysis of historical developments can be found with JOHNSTON, *The City Take-Over Code* (Oxford 1980); ROSSKOPF, *Selbstregulierung von Übernahmeangeboten in Großbritannien* (Berlin 2000).

<sup>3</sup> *The City Code on Takeovers and Mergers. Rules, Appendices and Notes*, 7<sup>th</sup> edition of 1 May 2002 as amended on 7 November 2005; for a short but profound overview, see DAVIES, *Gower’s Principles of Modern Company Law* (6<sup>th</sup> ed., London 1997) 772-816; a comprehensive commentary can be found with BUTTON (ed.), *A Practitioner’s Guide to the City Code on Takeovers and Mergers* (Old Woking, Surrey, 2001); WEINBERG/BLANK/ RABINOWITZ, *Weinberg and Blank on Takeovers and Mergers* (5<sup>th</sup> ed., London 2002).

## **B. Developments in the U. S.**

The United States adopted a takeover regulation in the same year as the U.K., in 1968. However, interestingly, the chosen regulatory approach laid down in the Williams Act<sup>4</sup> differed substantially from the British, notwithstanding the fact that a predominance of public companies with widely spread shareholdings was (and still is) characteristic for both countries, along with a market- and outsider-oriented corporate governance model. These features differ crucially from the concentrated ownership structures and the insider-oriented governance model we find in continental European economies such as Germany or France.<sup>5</sup> The Williams Act has no self-regulatory basis; it is a piece of state legislation on the federal level. Nevertheless, it can be characterized as a light regulation of purely procedural nature which focuses on disclosure. It applies if and when a bidder makes a tender offer to purchase shares regardless of whether this leads to a change of control.<sup>6</sup> The latter has no regulatory consequences under the Williams Act, as that does not provide for a mandatory bid rule.<sup>7</sup> The aim of the Act is to protect and to guarantee an equal treatment of all shareholders with respect to information and procedure so as to prevent a premature and under-priced selling of shares. Thus, in effect, rather than facilitating the exit of shareholders as in the British takeover regime, the U.S. regulation seems to encourage shareholders to stay invested in the target company.<sup>8</sup>

Furthermore, the Williams Act differs from the City Code in its silence about management's role in the acquisition process. Only some ten years later, in the wake of a wave of hostile takeovers in the late 1970s and early 1980s and after corporate management cried foul, did numerous states start to grant them protection in the form of so-called anti-takeover statutes.<sup>9</sup> Also, court decisions allowed bid-frustrating defensive

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<sup>4</sup> Law of 29 July 1968, codified as part of the Securities and Exchange Act of 1934; 15 U.S.C. §§78m(d)-(e), 78n(d)-(f).

<sup>5</sup> Cf. BARCA/BECHT (eds.), *The Control of Corporate Europe* (Oxford 2001) 319.

<sup>6</sup> For a short overview, see BLOOMENTHAL/WOLFF, *Securities and Federal Corporate Law* (2<sup>nd</sup> ed., St. Paul, Minn. 2000) Chap. 25; LOSS/SELIGMAN, *Securities Regulation* (3<sup>rd</sup> ed. 1990, Supplement 2004, Boston u.a.) Chap. 6; a comprehensive commentary of the U.S. takeover regulation is GILSON/BLACK, *The Law and Finance of Corporate Acquisitions*, (2<sup>nd</sup> ed., Westbury 1995).

<sup>7</sup> When discussing a possible reform of the Williams Act in 1983, the SEC voted against the introduction of a mandatory bid rule it regarded as too heavy an interference in the market for corporate control, cf. QUINN/MARTIN, in: Steinberg (ed.), *Tender Offers. Developments and Commentaries* (London 1985) 9, 18 f.

<sup>8</sup> Cf. R.H. SCHMIDT, in: Boettcher et al. (eds.), *Jahrbuch für Neue Politische Ökonomie*, Vol. 6 (Tübingen 1987) 180 ff.

<sup>9</sup> Cf. ROMANO, *The Political Economy of Takeover Statutes*, in: 73 Va.L.Rev. (1987) 111 ff.

actions, especially in Delaware.<sup>10</sup> This approach is more or less the opposite of the British approach; as a consequence, the decision in the U.S. about the change of control rests to a large extent with management and *not* with the shareholders as in the U.K.

### C. A Wakeup Call in Germany

In contrast to their British or American counterparts, German managers enjoyed another 20 years of relative peace before having to stand up to the disciplinary threat of hostile takeovers in the market for corporate control (notwithstanding some earlier hostile package deals<sup>11</sup>). But then came the hostile takeover of Mannesmann AG – a traditional German manufacturer successfully turned into a mobile phone operator – by the British Vodafone plc, a foreign bidder, in 1999/2000. This was the biggest hostile takeover ever, amounting to more than 150 billion Euros. It sent shockwaves down the spine of corporate Germany, and the German government went into red alert. However, the takeover did make perfect economic sense: the shareholders enjoyed a nearly 100% gain, no one except the Mannesmann management and some trade union functionaries lost their jobs, and even most of those were highly compensated (though the legality of these compensation packages is actually still the subject of an intense and ongoing legal battle).

As a result of this political turmoil, the German Takeover Law of 1 January 2002, the WpÜG, was enacted.<sup>12</sup> The WpÜG was the end of the German self-regulatory takeover regime based on the Takeover Codex of 1995.<sup>13</sup> The Codex had some functional shortcomings and mainly failed because it was not accepted by a sufficient number of listed companies.<sup>14</sup> The legislators obviously accepted that, in Germany as elsewhere, a market for corporate control as a means of external corporate governance existed, and it needed effective regulation to work properly. Whether they succeeded in

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<sup>10</sup> A discussion can be found with GILSON/BLACK, *supra* note 6, at 801 ff., 1317 ff.

<sup>11</sup> Cf. PRIGGE, A Survey of German Corporate Governance, in: Hopt / Kanda / Roe / Wymeersch / Prigge (eds.) *Comparative Corporate Governance – The State of the Art and Emerging Research* (Oxford 1998) 943, 972 ff.

<sup>12</sup> Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen (WpÜG), Law of 20 December 2001, Federal Gazette I (2001) p. 3822; the law was accompanied by four ordinances dating from 27 December 2001, Federal Gazette I (2001) p. 4263 et seq.; an English translation can be found with PELTZER / VOIGHT *German Securities Acquisition and Takeover Act* (Cologne 2002).

<sup>13</sup> Übernahmekodex der Börsensachverständigenkommission beim Bundesministerium der Finanzen of 14 July 1995, amended 1 January 1998; see SCHUSTER/ZSCHOCKE, *Übernahmerecht / Takeover Law* (1996).

<sup>14</sup> See KIRCHNER/EHRICKE, Funktionsdefizite des Übernahmekodex bei der Börsensachverständigenkommission, in: *Die Aktiengesellschaft* 1998, 105 ff.

achieving that goal is not as clear as it might appear at first sight, however.<sup>15</sup> The law has triggered extraordinary academic attention. Within three years, 11 commentaries, various short handbooks and introductions to the law, about 30 monographs dealing with specific issues, and more than 100 articles in journals and edited books have been published.<sup>16</sup> The topic is obviously regarded as trendy, though given the fewer than 50 takeovers that have been concluded so far under the new law, some speak of an academic overkill. Because no other major hostile takeover has occurred since the Mannesmann takeover, the law has not yet been tested.

According to the official legislative texts, in substance – though not in form and structure – the WpÜG is modeled after the British City Code. A core element is the mandatory offer a bidder has to make if he has gained control of the target company.<sup>17</sup> The relevant threshold is 30 percent of the voting rights.<sup>18</sup> Based on the price regulation of the bid – the average share price or a higher price paid by the bidder during the previous three months<sup>19</sup> – minority shareholders participate in a possible control premium. To secure this outcome, the WpÜG – like the City Code – is necessarily characterized by a high regulatory intensity. However, all “public” offers for shares of a listed company – not only the mandatory bid – are regulated by the law. If an offer stays below the control threshold (and the bidder owns no shares already), the procedural regulations concerning information and an equal opportunity for selling shares apply. Originally – at least in principle – the non-frustration rule was to be adopted as well. However, during the legislative proceedings, lobby groups of management and organized labor got the upper hand and gained significant protection of their interests. As a result, the non-frustration rule originally proposed in the Takeover Law was significantly watered down, and in its present form it is clearly inconsistent with the British model.<sup>20</sup> The regulation also would have violated core principles of the earlier

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<sup>15</sup> *Cf. infra* at III. C.

<sup>16</sup> A comprehensive legal analysis can be found with HOPT, Grundsatz und Praxisprobleme nach dem Wertpapiererwerbs- und Übernahmegesetz, in: Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 166 (2002) 383 ff; for an economic evaluation, see SCHMIDT/PRIGGE, Übernahmekonzeption und Übernahmegesetz, in: Die Betriebswirtschaft 62 (2002) 225 ff; major commentaries are: ASSMANN/PÖTZSCH/SCHNEIDER (eds.), Wertpapiererwerbs- und Übernahmegesetz (Cologne 2005); BAUMS/THOMA (eds.), Kommentar zum Wertpapiererwerbs- und Übernahmegesetz (Cologne 2004); HIRTE/VON BÜLOW, (eds.), Kölner Kommentar zum WpÜG (Cologne 2003); commentaries in English: APFELBACHER ET AL. German Takeover Law – A Commentary (Munich 2002); ADOLFF ET AL, Public Company Takeovers in Germany (Munich 2002).

<sup>17</sup> § 35 (2) WpÜG.

<sup>18</sup> § 29 (2) WpÜG

<sup>19</sup> § 31 WpÜG, §§ 3 – 7 WpÜG-Angebotsverordnung (Ordinance of 27 December 2001, Federal Gazette I (2001) p. 4263).

<sup>20</sup> *Cf. infra* at III. C.

versions of the EU Directive on Takeovers, but it is consistent with the finally enacted – and equally watered down – version of that Directive.

#### **D. The European Takeover Directive**

As is known, the Takeover Directive went into force in May 2004,<sup>21</sup> after 30 years of discussion that started with the *Pennington Report* dealing with European takeover regulation in 1974.<sup>22</sup> The underlying structure of the Directive is modeled on the British City Code. In accordance with the aims of the European Council at Lisbon in March 2000, its fundamental aim is to facilitate takeover bids within the EU as a means to restructure and better allocate capital within the Common Market. It can be characterized by transparency rules, a mandatory bid rule, and, at least in principle, it also still adheres to the neutrality rule. However, it is very different from an earlier version that was essentially killed by some rather bizarre political maneuvering of the German government, which suddenly withdrew its support in 2001 of what it previously had actively promoted. A new Art. 12 of the Takeover Directive now allows the member states of the European Union to opt out of the neutrality principle codified in Art. 9. This effectively means that each member state may allow its listed companies to keep their anti-takeover defenses legal under their pertinent national laws. In effect, this grants management a major influence in deciding on the acceptance of a bid. The (only) price that such a state has to pay is that other member states which have *not* opted out may allow their companies, if targeted by a bidder from such a member state, to use otherwise forbidden defensive measures.<sup>23</sup>

This regulatory arrangement is highly complex, prone to inconsistencies, and probably not functional. *Jonathan Rickford*, a leading company lawyer in the U.K. and the British member of the High Level Group of Company Law Experts who paved the way for the Directive in 2002 (though one *without* an opt out-rule<sup>24</sup>), regards this outcome of the political process as a substantial failure and probably worse than no Directive at all.<sup>25</sup> Nevertheless, most if not all member states will probably make use of the opt-out possibility when implementing the Directive into their national laws. As

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<sup>21</sup> Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, OJ of 30. 4. 2004 No. L 142, 12.

<sup>22</sup> EC-Com. Doc. XI/56/74.

<sup>23</sup> Art. 9 (3) of the Directive.

<sup>24</sup> Cf. THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS, Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, 10. 1. 2002.

<sup>25</sup> RICKFORD, The Emerging European Takeover Law from a British Perspective, in: European Business Law Review 2004, 1379, 1421; equally critical, GATTI, Optionality Arrangements and Reciprocity in the European Takeover Directive, in: European Business Organization Law Review 2005, 553 ff.

expected, the pertinent German draft law of 19 December 2005 does indeed opt out of the neutrality principle.<sup>26</sup>

### **E. The Japanese Experience**

Like Germany, corporate Japan was spared the horrors of takeover fights until very recently. But from about 2003 onward the situation started to change. The fights between Steel Partners & Soto, Livedoor & Fuji TV, and then Rakuten & TBS seem to indicate the end of the cozy world of consensual and reciprocal corporate governance. The usual management cries for help were heard and, in contrast to the experience in the U.K., the bureaucracy – precisely the Ministry of Economy, Trade, and Industry and later on the Ministry of Justice – got into high gear and started an immediate rescue operation. This came in the form of sophisticated joint guidelines issued on 27 May 2005 by both ministries.<sup>27</sup> These were based on a comprehensive report of the so-called Corporate Value Study Group (*Kigyô Kachi Kenkyû-kai*) that recommended rules similar to those developed by the Delaware courts.<sup>28</sup> The guidelines clarify what kind of defensive measures are acceptable in certain circumstances. In effect, management has been given wide discretion in implementing defensive measures. Now Japanese managers have similar powers to frustrate a bid as their American counterparts have, possibly even more so, as there might be some leeway in interpreting the rather vague standards differently from U.S. courts.<sup>29</sup>

The guidelines supplement the sophisticated procedural regulations in the Securities and Exchange Act<sup>30</sup> that are – after a major amendment in 1990 – actually much more refined than those in the Williams Act they were initially modeled on.<sup>31</sup> As with the Williams Act, the Japanese regulations are focused on procedural issues and only at the margin on a change of control. There is no mandatory bid rule like those of the British City Code and other EU takeover regimes. Unfortunately, the well-balanced Japanese takeover regulations in the Securities and Exchange Act and its accompanying

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<sup>26</sup> Cf. § 33a of the (Referenten) Entwurf eines Gesetzes zur Umsetzung der Richtlinie 2004/25/EG des Europäischen Parlaments und des Rates vom 21. April 2004 betreffend Übernahmeangebote.

<sup>27</sup> The English version is titled “Guidelines Regarding Takeover Defenses for the Purpose of Protection and Enhancement of Corporate Value and Shareholders’ Common Interests.”

<sup>28</sup> An English summary can be found at [www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf](http://www.meti.go.jp/english/information/downloadfiles/Corporate%20Value.pdf).

<sup>29</sup> For a comprehensive comparative analysis, see MILHAUPT, In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan, Columbia Law School, The Center for Law and Economics Studies, Working Paper No. 278 (2005).

<sup>30</sup> *Shôken torihiki-hô*; Law No. 25/1948 as amended.

<sup>31</sup> For a comparative analysis in German, see BAUM, Der Markt für Unternehmen und die Regelung von öffentlichen Übernahmeangeboten in Japan, in: *Die Aktiengesellschaft* 1996, 399 ff.

ordinances did not find appropriate attention in the European reform discussion. Seen from a comparative perspective, it is safe to say the Japan oriented herself both in the 1990 and the 2005 reforms in form and substance – at least in principle – on the U.S. model rather than on the European one. Maybe 30 years of discussion were not overly attractive to comparative lawyers from Japan.

## **F. Mixed Picture**

So far our overview has produced a very mixed picture. Obviously, we see distinctly different models of takeover regimes at work in the world's major economies. The U.K. and the U.S. were the first countries to introduce explicit regulations for takeovers in the same year of 1968. But in spite of the fact that both economies are characterized by a market- and outsider-oriented corporate governance model and a predominance of public companies with widely spread shareholdings, they followed highly different regulatory paths. Japan and Germany, on the other hand, have been prime examples of the so-called “embedded capitalist economies” with corporatist and insider-based corporate governance models and concentrated ownership, including widespread cross-holding of shares. Also, both still seem to have a somewhat hidden but deep-running mistrust of markets, liberalization, and light regulation. However, these two countries have also chosen significantly different regulatory regimes for takeovers. While Japan followed the U.S. model by and large, the German approach focused on the U.K. model. The far-reaching practical differences between these choices can best be illustrated by taking the perspective of a Japanese investor interested in buying a company listed in Germany.

## **II. The German Takeover Regime Viewed from a Japanese Perspective**

If our model Japanese investor erroneously assumes that all modern takeover regulations are more or less similarly structured, and that especially Germany and Japan share many common regulatory concepts in general and thus probably in the takeover context as well, he is bound for a surprise. To set the stage for a few practical examples, it should be noted that the German takeover law is mandatory law and applies in cross-border acquisitions under two conditions: the target company has its principal headquarters in Germany,<sup>32</sup> and its shares are listed at an organized market (stock exchange) within the European Economic Zone.<sup>33</sup> The domicile or incorporation of the bidder is of no interest in this regard. The differences can be illustrated by four examples.

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<sup>32</sup> Or is incorporated in Germany – the issue is under intense discussion because of the groundbreaking decisions of the European Court of Justice about the freedom of movement and incorporation within the Common Market (in res *Centros* (1999), *Überseering* (2002), *Inspire Art* (2003)).

<sup>33</sup> I.e., the EU member states plus Norway, Iceland, and Liechtenstein.

(i) Let us say that our model investor acquires 30 percent of the voting stock of such a listed German company from different U.S. investors in the form of a few block deals that take place in New York. These connections to the U.S. notwithstanding, he has to make public his stake in the company in appropriate form in *Germany* within seven days, and within four weeks he has to make a mandatory bid for *all* outstanding shares of the company.<sup>34</sup>

(ii) Even if the investor gains control over the German target company only *indirectly* – for example, by acquiring in Tokyo a 30 percent stake of a *Japanese* company, which in turn controls the German company – again he has to make a mandatory bid for all outstanding shares of that company in accordance with the German procedural rules.

(iii) If our Japanese investor owns 20 percent of the German company (for example) and coordinates beforehand in Tokyo his next general meeting votes regarding a long-term business strategy and the election of the supervisory board members with two other Japanese shareholders who each own 5 percent or more – so that counted together their shares reach the 30 percent threshold – this will be qualified as “acting concert” and, again, a mandatory bid for all outstanding shares has to be made.<sup>35</sup>

(iv) But even if our investor manages to keep clear of any control issue, he might still run into trouble. Suppose he regards the share price of the German company as attractive and makes *simultaneous* offers to four or five selected international institutional investors located in different places to buy up a percentage of its shares well below the 30 percent trigger. If these deals are done *outside* the exchange and for a price slightly *above* the market price, the German Takeover Act would regard these offers as a public offer that triggers its applicability. Accordingly, the formal proceedings under the WpÜG would have to be followed.<sup>36</sup> Besides various disclosure duties and the need to draft a prospectus, this would mean that our investor has to acquire *all* shares offered on a *pro rata basis*. This means that if more shares are offered than he wants to buy, the acquisition has to be done on a proportional basis. The shareholders willing to sell are entitled to sell at least parts of their holdings to our investor. If he cannot rescind the contracts concluded with the institutional investors he started with, in the end he will be stuck with many more shares and accordingly higher costs than he initially planned for.<sup>37</sup>

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<sup>34</sup> § 35 WpÜG.

<sup>35</sup> § 35, § 30 (2), § 2 (5) WpÜG.

<sup>36</sup> § 10, § 2 (1), § 1 WpÜG.

<sup>37</sup> For a critical analysis of the concept of a “public offer” under the WpÜG, see BAUM, “Öffentlichkeit” eines Erwerbsangebots als Anwendungsvoraussetzung des Übernahmerechts? – eine rechtsvergleichende Analyse, in: Die Aktiengesellschaft 2003, 144 ff.

None of this would happen if our investor as the bidder were based in Germany and the public company as the target were listed on one of Japan's exchanges. Together with that of Austria, the German takeover regime is probably the most intensely regulated takeover law worldwide. However, I doubt that such a strict takeover regime is in the best interest of our takeover market. Instead, in my view at least, the law has some fundamental structural flaws – and that is true of the Takeover Directive also. The flaws are partly due to a misconceived reception of a foreign legal institution, and partly to a muddled legislative process. This can be demonstrated when the German regulation is contrasted with its role model, the British takeover regime.

### **III. The German Takeover Regime Contrasted with the British Model**

#### **A. The German Discussion**

The German discussion about the pros and cons of a takeover regulation was curiously more or less *exclusively* focused on the issue of whether to adopt the British model with its mandatory bid as an exit option in case of a change of control, or to keep relying on the rather sophisticated German law of groups of companies – the so-called *Konzernrecht*. In contrast to the one-time protection that the mandatory bid rule supplies at the time of a change of control, *Konzernrecht* aims at a long-term minority protection independent of a change of control. Also, it not only protects the monetary interests of the shareholders as owners of the company – like the mandatory bid does – but also their participation rights as members of the company. It is probably no coincidence that the German *Konzernrecht* was conceived more or less simultaneously with the drafting of the takeover rules in the U.K. and the U.S. Given the structure of the German enterprise landscape, the *Konzernrecht* is actually more important than the takeover regulation because most German companies list only part of their shares, have a majority owner, and are parts of enterprise groups or *Konzerne*. Thus, if anything, one would expect regulatory efforts to have been focused on improving that regulation because an ongoing protection of the minority shareholders of such companies is indispensable with or without a takeover regulation in place. However, it was impossible to persuade a sufficient number of even those EU member states with similar ownership patterns and governance models to follow that pattern.

Once it was clear that a takeover law would have to be introduced within the EU, one would have expected a discussion of the different models of takeover law to take place, namely of the U.K. *and* the U.S. regime as contrasting role models. But, for whatever reason, no alternatives to the British model were put on the table, neither the U.S. concept of the Williams Act nor, as already mentioned, the more refined Japanese version of it. The German legislators, as well as the Austrians before them in 1999, clearly had their eyes locked over the Channel toward London when drafting the WpÜG. However, in at least two aspects, the new German Takeover Law is strangely

*inconsistent* with the British concept. This becomes obvious if we look briefly at the checks and balances that are characteristic of the British takeover regime.

### **B. Checks and Balances of the British Takeover Regime**

It is probably the interplay of two major functional counterbalances that make the British takeover regime highly successful.<sup>38</sup> One can be found at the level of institutional arrangements, the other in the substance of the regulation in the City Code. At the level of institutional arrangements we find a counterbalance between the high regulatory intensity that necessarily comes along with a mandatory bid rule on the one hand, and a remarkable flexibility when it comes to applying the Code on the other. A lot of detailed regulation is necessary with respect to the price of the bid, as this cannot be set by the bidder but has to be adjusted to previous purchases by the bidder and/or the average stock price over a certain period of time if a mandatory bid rule is designed to guarantee a functional exit option. Also, various questions with respect to the threshold that triggers the bid have to be necessarily regulated; the most thorny of these is the question that arises when two or more parties are acting in concert as mentioned earlier. This heavy interference in the market is somewhat counterbalanced by what a former president of the takeover panel once called “a crucial characteristic of the Code . . . its flexibility.”<sup>39</sup> This flexibility can be seen in various aspects. Because of its self-regulatory basis, the City Code is characterized by a high degree of adaptability. Its application is a very flexible one oriented at the “spirit” of the Code rather than the wording of its provisions. Furthermore, the Takeover Panel enjoys wide discretion in its decisions. It is not a governmental institution and is manned only with practitioners from the financial industry. Lawyers are usually not involved in proceedings with the panel; in fact, representation by lawyers is actively discouraged. Decisions are extremely speedy and are not contested at the courts. The U.K. experiences next to no law suits in relation to takeovers. Although its takeover market has been very active for decades, no more than *four* law suits were brought before British courts in over 35 years.

With respect to the substance of the regulation in the City Code, we find a counterbalance between the high costs for a bidder caused by the mandatory bid rule on the one hand and the strict neutrality rule for the board on the other. The mandatory bid rules regularly force the bidder to acquire more shares than he needs to exercise control. Of course, this raises the costs for a potential bidder substantially, and these high costs in turn act as a detriment for an active takeover market. On the other hand, the strict

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<sup>38</sup> For a comprehensive analysis, see BAUM, Funktionale Elemente und Komplementaritäten des britischen Übernahmerechts, in: *Recht der Internationalen Wirtschaft* 2003, 421 ff.

<sup>39</sup> DEFRIEZ, in: Button/Bolton (eds.), *A Practitioner’s Guide to the City Code on Takeovers and Mergers* (Old Woking, Surrey 1997) at 4.

neutrality rule stipulated by the City Code hinders the board of the target company to frustrate the bid or to substantially raise the costs for the bidder, for defense measures such as poison pills are only allowed with express and up-to-date approval of the shareholders, and these must be sought after the bid has been made public. This non-frustration rule has a potential of keeping the cost of a bid controllable for a potential bidder. Thus, we see in effect a kind of functional counterbalance to the high costs associated with the mandatory bid rule.

### **C. Missing Functional Counterbalances in the German Takeover Regime**

The British characteristics of informal, speedy, business-oriented proceedings with de facto no recourse to the courts are just the opposite of typical administrative proceedings by a governmental authority or agency. But the latter is exactly what we see in Germany. The takeover regime is part of the public law area and is implemented by a government agency, the Federal Financial Supervisory Authority, which is responsible for the oversight of the German financial markets in general.<sup>40</sup> All decisions can be and are challenged in court. During the four years after the WpÜG went into force and even without any major hostile takeover, some 20 court cases can be counted – five times as many as in Britain since the enactment of the City Code more than 35 years ago. German lawyers are actively involved at every stage of the takeover process, and the flood of publications written by them clearly indicates that they see a market in this field. In other words, the City Code's flexibility as a functional counterbalance for its regulatory intensity is all but non-existent under the new heavy-handed German takeover regime.

Furthermore, the German takeover law provides for a strict mandatory offer rule; however, contrary to the British model, it contains only a very watered-down version of the non-frustration rule as mentioned before. The watering down of the neutrality principle in Germany happened in the course of the legislative proceedings which were hijacked by lobby groups and trade unions, but it struck a familiar chord with the German public. As a result, the German WpÜG adheres to the non-frustration rule only in principle and only according to the official legal texts, but not in substance. Rather, the management of a German target of a hostile bid has a fairly free hand to implement measures to frustrate a pending bid. Under the law, the following four defense measures are legal:<sup>41</sup> the search for a White Knight as well as actions in the normal course of business are allowed, including the selling off of important assets; furthermore, all kinds of actions that have been approved by the general meeting in abstract from up to 18 months in advance of a bid may be used as defensive measures, depending entirely on the discretion of the target's managing board; fourth and worst of all, literally all actions

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<sup>40</sup> Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

<sup>41</sup> Cf. § 33 WpÜG.

approved by the supervisory board in the face of a bid are allowed, and no approval of the shareholder assembly is necessary. This has to be seen in the context of the corporate governance structure of large German stock corporations. These have a two-tier board structure with a managing and a supervisory board. The supervisory boards of large public companies are half manned with representatives of the employees and the trade unions and the other half represents the owners. The latter are rarely represented by outsiders, but mostly by former members of the managing boards and other insiders who have switched to the supervisory board. It is an easy guess how a board stuffed with employees and former managers will vote in the face of a hostile bid, especially if that is by a foreign company. One other aspect should be mentioned that grants management additional leeway. As the managing board, the supervisory board also has to act “in the interest” of the company. In the legislative materials, this interest is defined as the interest of shareholders and employees as well as the general interest of the company as such. This leaves much room for discretion and is a dangerous step backward toward the previous infamous concept of the “*Unternehmen an sich*” (the enterprise as such).<sup>42</sup>

The cumulative effects of this unhappy combination of a mandatory offer and a limited non-frustration rule make hostile takeovers in Germany even more unlikely than before. Instead of following either the U.K. or the U.S. model, German legislators seem instead to have assembled a combination of the takeover-averse elements of both regimes. Not surprisingly, the new law has been dubbed by a prominent American observer as a piece of “anti-takeover legislation.”<sup>43</sup> Some commentators regard the U.S. power shift from shareholders to management on the one hand and the British mandatory bid rule on the other as two functionally interchangeable institutional arrangements, meaning that you have to have either the one or the other in order to secure an optimal outcome of a takeover process. Even if one agrees with this view, the result of the German legislative process is somewhat absurd, for we are stuck with *both* legal institutions at the same time. But, actually, this argument may not be as convincing as it looks at first sight, because these two regimes are probably not functionally equivalent. Instead, one can make do with sophisticated procedural rules and the neutrality principle alone without having a mandatory bid rule as a “price” attached. The latter seems to be some kind of path-dependent development that might have suited the British enterprise landscape but is ill-suited to the German one.

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<sup>42</sup> For a critical analysis, see VON NUSSBAUM, *Die Aktiengesellschaft als Zielgesellschaft eines Übernahmeangebotes* (Baden-Baden 2003).

<sup>43</sup> GORDON, *Das neue deutsche “Anti”-Übernahmegesetz aus amerikanischer Perspektive*, in: *Die Aktiengesellschaft 2002*, 670 ff.

#### IV. The Riddle of Public Aversion Against Restructuring by Takeovers

Not long after the German government finally managed to sell a part of its public waste management system to the American investment firm KKR – which quickly succeeded in turning around the formerly inefficient unit – the former German Vice Chancellor felt compelled to denounce (foreign) private equity firms, hedge funds, and other institutional investors in 2005 as “locusts” devastating German firms. In spite of being economic nonsense, his remark struck a familiar chord with the general public in Germany. A similar sentiment can obviously be found in another European “embedded capitalist economy” – France – where about the same time a rumored takeover of the national yogurt by the American PepsiCo raised serious “cultural” if not “security” concerns. While it is possible to understand – though not to approve of – the opposition of employed corporate management and the trade unions as special interest groups against the discipline of hostile takeovers as a means of external corporate governance, it is rather difficult to understand what causes the aversion among a significant part of the general public against an efficient way of adapting to change and of restructuring. But it was this public prejudice that effectively led to the shift of power in decision making about the acceptance of a bid from the shareholders to the board by watering down the neutrality principle – first in Germany and later at the European level.

It may be useful to distinguish between two different aspects that are normally mixed up: the benefits or dangers of takeovers as such, and the question of a level playing field, meaning the danger that foreign firms will acquire domestic companies while they are protected in their home markets.

There are two main arguments against impeding the takeover process and thus against a softening or abolishing of the strict neutrality principle. The first argument comes in two parts. One aspect is the acknowledgement that hostile takeovers speed up a necessary restructuring of industries and create value – at least on average – as has been shown by numerous studies.<sup>44</sup> Another aspect is the insight that it is illusionary to try to distinguish *ex ante* between good and bad takeovers by law or bureaucracy. As

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<sup>44</sup> *Cf.*, e.g., MCCAHERY ET AL, The Economics of the Proposed European Takeover Directive, in: Ferrarini et al (eds), *Reforming Company and Takeover Law in Europe* (2004) 575 ff; HOLMSTROM/KAPLAN, Corporate Governance and Merger Activity in United States: Making Sense of the 1980s and 1990s, in: *The Journal of Economic Perspectives* 15 (2001) 121 ff; MULHERIN/BOONE, Comparing acquisitions and divestitures, in: *Journal of Corporate Finance* 2000, 117 ff; BLACK, The First International Merger Wave (and the fifth and last U.S. wave), in: *University of Miami Law Review* 54 (2000) 799 ff; JENSEN / CHEW, U.S. Corporate Governance: Lessons from the 1980s, Paper 1997; ROMANO, A Guide to Takeovers: Theory, Evidence, and Regulation, in: *Yale Journal of Regulation* 9 (1992) 119 ff; JARRELL / BRICKLEY / NETTER, The Market for Corporate Control: The Empirical Evidence since 1980, in: *The Journal of Economic Perspectives* 1988, 49 ff; JENSEN, Takeovers: Their Causes and Consequences, in: *The Journal of Economic Perspectives* 1988, 21 ff; a case study is BAKER/SMITH, *The New Financial Capitalists. Kohlberg Kravis Roberts and the Creation of Corporate Value* (1998).

stated by the well-known American securities and corporate lawyer *Bernhard Black* analyzing the takeover waves in the U.S. in the 1980s and 1990s:

On average, there is a lot of value creation [by takeovers]. ... I wish I knew a good way to cut down on the bad takeovers while preserving the good ones. I do not. ... So, we have to take the good with the bad.<sup>45</sup>

The EU, and Germany especially, obviously want it the other way around: preferring fewer hostile takeovers – even if they are value-creating on average – than allowing for an occasional bad one that might destroy value. This, of course, is a political decision rather than an academic one, and we have to live with it as well as with the suboptimal outcome of the political struggle about the Takeover Directive. But doubts remain over whether these regulatory regimes will do much good to the German economy and those (large) parts of the European economy that are in dire need of restructuring.

The second argument is functional. If the decision-making power is shifted to the board, severe conflicts of interest arise and the temptation for managers to use company resources to advance their own interests is given undue scope. Furthermore, if the board is obliged to serve a broad array of interests, i.e., to take competing interests of different groups of stakeholders into account (acting in the “interest of the company”) instead of being focused on creating corporate value in the sense of shareholder value, it becomes next to impossible to effectively sanction a self-interested company management. Instead of embarking on the adventurous course of further empowering management, the optimal location of control is with the shareholders as the residual risk takers.

As for the fear of a “selling out” of domestic firms to foreign investors, this appears even more questionable than the general concern against takeovers. If one sets aside specific circumstances such as national security in the narrow sense – e.g., a takeover of a domestic weapons manufacturer by a state-owned company of a country that actively promotes terrorism – it is hard to understand what might cause problems. The successful British example of a market that has been open to foreign takeovers for some four decades speaks for itself. More generally, if we rightly promote the free exchange in trade and services as the basis of our present wealth, why not promote direct cross-border investments in the form of acquisitions instead of hampering it? The Vodafone Mannesmann takeover is a good example. The deal did make a lot of economic sense, and who actually acquired whom or in what form the deal was concluded did not matter much. If we follow the protectionist road instead, we should not be surprised if we end up with governments publicly wondering whether the

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<sup>45</sup> BLACK, *supra* note 44, at 813.

production of dairy products might be qualified as a “strategic industry” to thwart a foreign bid.