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Protectionism and the EU market for corporate control: Is it possible to get the best of both worlds?

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Recent reports of the Commission and the European Parliament have revisited the concerns of protectionism in the EU. This article discusses these concerns in light of the liberal and protectionist divide in the EU market for corporate control, focusing on the board neutrality rule during takeovers. The arguments advanced in this article are threefold. First, that liberal markets are likely to encourage takeovers, but breed short-termism. Second, that protectionist markets are likely to discourage takeovers, but facilitate long-termism. Third, that short-termism in the UK and the so-called protectionism in Germany are the result of entrenched policy choices made in those jurisdictions in regard to the interests they protect in regulating the market for corporate control. The article draws a conclusion that it is hard for the UK and Germany to get the best of both worlds, that is, the liberal market and long-termism.

I. Introduction

While the discussion on protectionism in the EU market for corporate control is not new,[1] this article contextualises the discussion in the context of the board neutrality rule ('BNR').[2] Whilst the BNR would have overcome protectionist barriers that stand in the way of the EU market for corporate control, 'protectionist resistance from numerous Member States has hampered the efforts to promote a free market for corporate control.'[3] Protectionism is generally a negative phrase. In EU takeovers, the phrase is used negatively to characterise choices made by Member States to insulate national companies from takeovers and thereby failing to promote the wider interests of the EU. This type of protectionism is arguably seen in the manner that some Member States implemented the Takeover Bids Directive ('TBD'),[4] opting out of Article 9, essentially to protect their national companies from takeovers. This is reflected in the Commission's statement that 'the number of Member States implementing the Directive in a seemingly protectionist way is unexpectedly large.'[5]

The allegation of protectionism in the EU market for corporate control stems from the failure by the Commission to achieve census on certain controversial provisions of the draft directive. The TBD was a product of over 30 years of negotiations, characterised by

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[1] See P Davies, EP Schuster, and E Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105.

[2] The BNR (also known as 'non-frustration rule') is contained in Article 9 of the Takeover Directive. It prohibits boards from taking any action to frustrate a takeover bid without shareholders' approval.

[3] Mariana Pargendler, 'The Grip of Nationalism on Corporate Law' (20 March 2018), available at https://ssrn.com/abstract=3144451 (last accessed 10 April 2018).

[4] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ 2004 L 142/12 of 30 April 2004.

[5] European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007) SEC(2007) 268, para 3.

drawbacks, frustration, opposition and compromises.[6] Some Member States opposed the draft directive because they perceived one of the controversial provisions, the BNR, was influenced by the UK and merely designed to break down the laws of Germany, the Netherlands and other continental European countries that were hostile to takeovers.[7] To silence this opposition, a compromise was reached to make Article 9 optional in the TBD. As a result of this optionality, implementation failed to create a level playing field in the EU market for corporate control, and allegation of protectionism ensued. The Commission had envisioned a mandatory BNR across the EU. The optionality, which maintained the status quo of entrenched national economic interests and barriers to takeovers, was adopted to the disappointment of the Commission. It is from this perspective that the Commission equates opting out of the BNR with 'implementing the Directive in a seemingly protectionist way.'

This article examines the implications of the choices made by Member States on the BNR, creating a liberal and protectionist divide in the EU market for corporate control. It argues that liberal markets are likely to encourage takeovers, but breed short-termism. It also argues that protectionist markets are likely to discourage takeovers, but facilitate long-termism. It observes that the application of the BNR in Germany and in the UK is, respectively, illusory and strict, and argues that this diverse regulation of takeovers in the two jurisdictions reflect the interests they protect. It argues that short-termism in the UK and the so-called protectionism in Germany are the result of entrenched policy choices made in the respective jurisdictions on the interests they protect in regulating the market for corporate control. It concludes that it is hard for the UK and Germany to get the best of both the liberal market and long-termism.

Discussing these implications, the paper proceeds as follows. First, it contextualises the allegation of protectionism in the EU market for corporate control. Second, it highlights the context of board hostility that feeds into the allegation of protectionism in the EU. Third, it highlights the disadvantages of the UK regulatory regime with its BNR in the context of lack of a reciprocal playing field in most major EU countries. Fourth, it argues that the UK's liberal market attracts short-termism, which militates against long-term industrial economic growth. Fifth, it examines the illusion of a BNR in Germany and its industrial economic growth. Sixth, it looks at the historical policy choices that inform the liberal/short-termism and protectionist/long-termism divide. The final section concludes.

II. Contextualising protectionism in EU takeovers

The phrase 'protectionism' is commonly used but rarely defined. It is mostly used as a negative phrase. In EU takeovers, the phrase is used in relation to how Member States have implemented the TBD in a manner protecting their national interests instead of furthering the collective EU interests. But whatever 'protectionism' means, most of us would 'intuitively understand attempts to prevent foreign takeovers of local markets and companies as being protectionist.'[8] In the EU, it is protectionism when a Member State adopts a policy that insulates its takeover market contrary to the EU economic freedoms that are founded on 'the

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[6] Jonathan Mukwiri, *Takeovers and the European Legal Framework: A British Perspective* (London: Routldge-Cavendish, 2009) 8.

[7] KJ Hopt, 'Takeover regulation in Europe – The battle for the 13th directive on takeovers' (2002) 15 Aust JCL 1, 9.

[8] Crispin Waymouth, 'Is 'Protectionism' a Useful Concept for Company Law and Foreign Investment Policy? An EU Perspective' In Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 32, 37.

principle of an open market economy with free competition.'[9] But it is legally hard to accuse Member States of protectionism when the TBD allows options that feed into protectionism.

The phrases 'protectionism' and 'protectionist' have been common parlance in the rhetoric employed by the Commission in seeking to strengthen the internal market via free movement of capital. The stance against protectionism stems from the need to strengthen the unity of the Single Market. To those ends, the Commission has pointed out that the commitment to openness to investments and free movement of capital has been a long standing principle of the EU and is key to success in an increasingly globalised international system.[10] In the area of takeovers, national interests are still stronger than EU interests.[11] For example, in its review of the implementation of the TBD, the Commission found that 'a large number of Member States has shown strong reluctance to lift takeover barriers' and 'the number of Member States implementing the Directive in a seemingly protectionist way is unexpectedly large.'[12] The Commission, referring to the benefits of the Single Market, and seeking to promote the same values, stated that 'protectionism and a retreat towards national markets can only lead to stagnation, a deeper and longer recession, and lost prosperity.'[13]

The European Parliament echoes the same rhetoric employed by the Commission, even calling upon 'the Commission to take a strong lead in fighting protectionism.'[14] On a number of occasions, while discussing ways of strengthening the Single Market, the European Parliament 'expresses its concern that the re-emergence of economic protectionism at national level would most probably result in fragmentation of the internal market and a reduction in competitiveness, and therefore needs to be avoided.'[15]

The newspapers have also not been silent, as they have reported instances seen as national protectionism. Four examples from the newspapers will suffice. First, a 2005 article in the *Financial Times* reported that one Commissioner observed 'that protectionism was on the rise' not only in 'certain Member States' but also 'all over Europe' – citing the examples of the governments of Italy, France, and Germany, which were putting up 'proposals to shelter companies from foreign takeovers' and having 'a situation with financial institutions that can take-over somebody else, but nobody can take-over them.'[16] Second, a 2014 article in the *Independent* reported that 'France is the advanced country most prone to protectionism' and the French 'Government has just appropriated new powers to block foreign takeovers.'[17]

[9] Article 119 of the Treaty on the Functioning of the European Union (TFEU).
[10] Commission, 'Global Europe: competing in the world' 04/10/2006, COM(2006) 567; and Commission, 'The European Interest: Succeeding in the age of globalisation' 03/10/2007, COM(2007) 581.
[11] Jonathan Mukwiri, 'Free movement of capital and takeovers: a case-study of tension between primary and secondary EU legislation' (2013) 38 European Law Review 829.
[12] European Commission, 'Report on the implementation of the Directive on Takeover Bids' (Brussels, 21 February 2007) SEC(2007) 268, para 3.
[13] Commission, 'Communication for the spring European Council - Driving European recovery - Volume 1' 04/03/2009, COM(2009) 114 final.
[14] European Parliament, 'Financial, economic and social crisis: Recommendations concerning the measures and initiatives to be taken (mid-term report)' (2012) Official Journal C 70E, 08/03/2012 p. 19, para 26.
[15] European Parliament, 'Delivering a single market to consumers and citizens' (2011) Official Journal C 161E, 31/05/2011 p. 84, para 6; European Parliament, 'Financial, economic and social crisis: Recommendations concerning the measures and initiatives to be taken (mid-term report)' (2012) Official Journal C 70E, 08/03/2012 p. 19, para 127; and European Parliament, 'Governance and partnership in the single market' (2012) Official Journal C 296E, 02/10/2012 p. 51, para 21.
[16] Tobias Buck, 'Protectionism Threatens Internal Market' (2005) *Financial Times*, 18 October.
[17] Ben Chu, 'Takeovers: Why don't we protect like the French?' (2014) *Independent*, 15 May; also reported in a BBC article: Linda Yueh, 'Public interest or protectionism? Britain vs France redux' (2014) *BBC New*, 21 May.

Third, a 2017 article in the *Telegraph* reported that 'the German government has approved a measure to make it easier for the state to veto takeovers of certain firms by foreign investors;' and that the move 'come just days after the G20 summit in Hamburg where members reached a compromise to "fight protectionism", while allowing nations to use "legitimate trade defence instruments" to protect markets.'[18] Fourth, a 2017 article by *Reuters*, reporting on Italy, stated that Italy's 'new rules on takeovers signals protectionist sentiment is on the rise in Italy after years of relatively open approach to foreign acquisitions which French companies, in particular, have taken advantage of.'[19] It is not in the collective EU interests for Member States to be protectionist in insulating their markets against other Member States.

Protectionism is a tool used to insulate economic interests either at EU level or at national level. Armour and Ringe made this observation: 'It is important to note that protectionism is not only a problem at the national level. Even trade blocks like the European Union, which were set up to overcome trade barriers, are also tempted to use the opportunity to regulate particular issues in a protectionist way.'[20] Amour and Ringe cited an example of the EU Directive on Alternative Investment Fund Managers (AIFM) in which the proposed Directive placed undue restrictions to marketing of non-EU alternative investment funds. During the consultation stage, the UK's House of Lords observed that the AIFM was 'protectionist and disproportionate' and concluded that 'the Directive will seriously damage the EU and UK economy unless it is fully compatible with the global approach to the regulation of AIFM and it permits the marketing of non-EU funds in the EU' and recommended that 'restrictions on non-EU managers operating in the EU should also be removed.'[21] Whilst protectionism is seen as a problem, it is nonetheless used as a tool to protect collective economic interests.

In takeover law, EU protectionism seems to have been at the heart of the formulation of the TBD. This protectionism is evident in the proposal by the Commission of 2002, which, in part, stated: 'the Commission considers it essential to provide a European framework for cross-border takeover bids as part of the Financial Services Action Plan. Such transactions can contribute to *the development and reorganisation of European firms*, a key condition for *withstanding international competition* and developing a single capital market.'[22] Arguably, the Commission, in subtle ways, sought to use the TBD as an EU protectionist tool to enable European firms to withstand international competition.

Protectionism at EU level is seen in the recent proposals to halt a wave of mergers and acquisitions of EU firms by foreign investors from China. In a 2017 staff working document, the Commission published the concern about the 'rising number of takeovers of European companies by foreign investors, resulting in a potential loss of control and ownership of strategic technologies.' 'For example,' the Commission observed, 'between 2010 and 2015, the number of European companies bought by Chinese companies grew from 91 to 183. In turn, European companies only bought 20 Chinese companies.'[23] Protectionism at EU level is proposed as solution to this rising wave of Chinese takeovers of EU companies. Thus, in a

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[18] Melanie Hall, 'Germany moves to block takeovers by foreign investors' (2017) *Telegraph*, 12 July.
[19] Giselda Vagnoni, 'Italy passes decree to ward off foreign takeovers' (2017) *Reuters*, 13 October.
[20] John Armour and Wolf-Georg Ring, 'European Company Law 1999-2010: Renaissance and Crisis' (2011) 48 Common Market Law Review 125, 172-173.
[21] House of Lords, European Union Committee, Directive on Alternative Investment Fund Managers, 3rd report of session 2009–10 (Volume I, The Stationery Office Limited, 10 February 2010) para 10 and para 29.
[22] European Commission, Proposal for a Directive of the European Parliament and of the Council on Takeover Bids, COM(2002) 534 final (Brussels, October 2002) 3 (*italics* added for emphasis).
[23] European Commission, 'Review on the implementation of the Digital Single Market Strategy A Connected Digital Single Market for All' SWD(2017) 155.

2017 communication to the EU legislators (European Parliament and Council), the Commission pointed to the need 'to modernise world trade rules,' 'especially at a time of increasing protectionism' – in effect, calling for EU level protectionist rules that would strike a balance between the need to be open to foreign investment and 'to protect assets against takeovers that would be detrimental to the vital interests of the EU or its Member States.'[24]

When we talk of protectionism, arguably from the Commission's perspective, the negative connotation of the phrase excludes EU level protectionism, and refers instead to national level protectionism. The legitimacy of acceptability of EU regional level protectionism at the exclusion of national level protectionism is derived from the supremacy of EU. By joining the EU, 'Member States have limited their sovereign rights,'[25] agreed to give up their national economic interests in exchange for their collective EU economic interests. A clash between national protectionism and EU protectionism is thus resolved in favour of the latter.

Arguably, in the interest of their collective EU economic interests, Member States ought to have implemented the TBD in a manner that furthers 'the development and reorganisation of European firms' and not merely furthering national firms. But collective EU interests could only be secured by a mandatory BNR, which the Commission failed to secure. But 'achieving regulatory differentiation by granting flexibility to the Member States does create a risk that the Member States will act strategically in pursuit of protectionist goals.'[26] Having conceded to allowing Member States to opt out of Article 9, it is then 'difficult – and politically impossible – for the European Commission to challenge decisions made by Member States by taking up options explicitly provided for in the Takeover Directive.'[27] With some Members States opting out of Article 9 or opting to have a reciprocity provision (Article 12(3)), there was 'a significant shift away from bidder friendliness.'[28] Unable to challenge their choices, the Commission could only resort to using the phrase 'protectionist' to characterise the effect of Member States opting out of Article 9.

The EU project of protecting collective economic interests through the TBD to replace national protectionism, has ostensibly failed due to lack of a mandatory BNR. There was no level playing field before the TBD and there is none after the TBD was implemented. There was protectionism of some national markets before the TBD, and making core provisions of the TBD optional only entrenched protectionism in some Member States. Whilst it is hard to legally accuse any Member State of protectionism in taking advantage of the options provided for in the TBD, such choice reveal that the choices taken in 'the revision of takeover rules has been influenced by the growth of economic nationalism and a desire by Member States to preserve corporate headquarter and employing entities within their own territories.'[29]

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[24] European Commission, 'A Balanced and Progressive Trade Policy to Harness Globalisation' COM(2017) 492.
[25] Case 6/64 *Flamino Costa v ENEL* [1964] ECR 585, 593.
[26] Andrew Johnson, 'Varieties of Corporate Governance and Reflexive Takeover Regulation' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 161, 170.
[27] P Davies, EP Schuster, and E Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 143.
[28] P Davies, EP Schuster, and E Ghelcke (2010) 105, 170.
[29] P Davies, EP Schuster, and E Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 155.

III. Board hostility during bids and protectionism in the EU

It is here argued that had Article 9 of the TBD been adopted as a mandatory provision, it would have curbed any protectionist tendencies and would have underpinned the importance of standardised and uniform takeover rules in the EU. Enriques, Gilson, and Pacces have proposed a revision of the TBD so that it is "unbiased" – arguing that 'takeover regulation should neither hamper nor promote takeovers, but instead allow individual companies to decide the contestability of their control.'[30] Fedderke and Ventoruzzo have, quite convincingly, rejected the "unbiased" EU takeover law proposal as likely to 'multiply existing variations of company-specific rules.'[31] On the same page, in rejecting the "unbiased" EU takeover law proposal, Fedderke and Ventoruzzo pose an interesting question: 'Are we sure that municipal protectionist tendencies would not find a fertile ground in such a scenario, and actually ring-fence national markets for corporate control in Europe, therefore killing the development of a continental market?' Arguably, these protectionist tendencies would have been curbed by a "biased" mandatory BNR. In the optionality of Article 9 of the TBD we have, in Member States that have opted out under Article 12 of the TBD, traces of board hostility during takeover bids, which feeds into protectionist tendencies.

For Germany, securing board hostility during takeover bids in order to protect national interests can be traced back to the negotiations leading up to the adoption of the TBD. Leading up to the vote on the second draft of the framework takeover directive, the Council had unanimously agreed a Common Position on 19 June 2000, which would have included a mandatory BNR. While the majority Members States were posed to vote in favour of the provision, Germany's Chancellor Schroder had a sudden change of mind due to national interest to protect the giant German carmaker, Volkswagen. It is said that the 'representatives of car maker Volkswagen had met with Schroder just before and convinced him of the threat to Volkswagen by the draft directive.'[32] To protect national interests of Germany, Chancellor Schroder rejected the Common Position, and lobbied to reject the draft takeover directive. Germany opposed the draft directive in 2001 by threatening not to back the directive 'unless shareholder approval for frustrating action were eliminated from Article 9 or the entire article were removed from the directive.'[33] Following this threatening from Germany, in a 273-273-tie vote on 4 July 2001, a German MEPs-led coalition rejected a draft directive text that was heavily influenced by the UK's City Code on Takeovers and Mergers.[34] Alluding to national protectionism that led to the rejection of the draft directive, the then Internal Market Commissioner, Frits Bolkestein, commented that, 'it is tragic to see how Europe's broad interests can be frustrated by certain narrow interests.'[35]

[30] Luca Enriques, Ronald J Gilson, and Alessio M Pacces, 'The Case for the Unbiased Takeover Law (with an Application to the European Union)' (2014) 4 Harvard Business Law Review 85.
[31] Johannes W Fedderke and Marco Ventoruzzo, 'The Biases of an "Unbiased" Optional Takeover Regime: The Mandatory Bid Threshold as a Reverse Drawbridge' In Umakanth Varottil and Wai Yee Wan (eds), *Comparative Takeover Regulation: Global and Asian Perspective* (Cambridge University Press, 2018) 163, 179.
[32] KJ Hopt, 'European Company and Financial Law: Observations on European Politics, Protectionism, and the Financial Crisis' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (Oxford: OUP, 2010) 13, 21.
[33] KJ Hopt, 'Takeover regulation in Europe – The battle for the 13th directive on takeovers' (2002) 15 *Australian Journal of Corporate Law* 1, 10.
[34] M Gatti, 'Optionality Arrangements and Reciprocity in the European Takeover Directive' (2005) 6 *European Business Organization Law Review* 553, 561.
[35] European Commission, 'Commission regrets rejection of Takeover Directive by the European Parliament' (Press Release IP/01/943, Brussels, 4 July 2001).

Germany opted out of the BNR of Article 9 in order to protect German companies. It is argued in favour of Germany that, 'owing to the lack of a level playing field, German companies still require protection. This protection through the opt-out from the neutrality duty is necessary in order to compensate for the lack of protective hindrances brought about by the comparatively wide opening of the German capital market.'[36] It is interesting to note that, the refusal of Germany to accept the unanimous Common Position of the Council of June 2000 opened the way to the subsequent optionality of the BNR, which entrenched the lack of a level playing field, and now this lack of a level playing field is argued by some as the justification for protectionism in Germany. Having opted-out of Article 9, Germany retained the ability to frustrate takeovers without shareholder approval, as the management may take actions with supervisory board's consent, or actions which a prudent and conscientious manager of a company not affected by a takeover bid would have taken.[37]

Interestingly, protectionism in Germany seems to correlate to long-term investor culture. The traditional German corporate governance model tends towards long-term sustainability of the company, with its ethos of managerial primacy, even in takeovers. Although the traditional German corporate model of 'Deutschland AG' is said to be eroding,[38] managers in German companies are still able to pursue long-term investment policies, such as product quality and innovation, because they are less affected by outside pressures from short-term takeover traders. In all, managers within the traditional German corporate governance model have significant discretion upon which the major constraint is the interests of employees probably followed by the interests of families, banks, affiliated companies and the government, which discretion has been sustained historically by a notion of long-term commitment between the company and its various stakeholders.[39] Thus, the BNR in Article 9 of the Directive goes against the basic tenet of company law in Germany and many other Member States: that it is not for the shareholders to decide the future of the company, but for the management taking all stakeholders' interest into account.[40]

Thus, the board hostility position in Germany is borne from the policy choice of what constitutes the interests of the company that must be protected. Arguably, although Germany opted out of Article 9, Germany is still subject to Article 3(1)(c), which requires that the offeree board must act in the 'interests of the company as a whole' and must not deny shareholders the opportunity to decide on the bid. In the context of the TBD, 'interests of the company as a whole' is not a reference to the shareholders, but rather to the company as an

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[36] Hildegard Ziemons, Jochen Schlotter, and Karsten Hilmer, 'Germany', In Dirk Van Gerven (ed), *Common Legal Framework for Takeover Bids in Europe* (Volume I, Cambridge: Cambridge University Press, 2010) 181.
[37] Section 33(1) of the Securities Acquisition and Takeover Act (WpUG) provides: 'After publication of the decision to make an offer and until publication of the result pursuant to section 23 (1) sentence 1 no. 2, the board of management of the target company may not take any actions which could prevent the success of the offer. *This does not apply to* actions which a prudent and conscientious manager of a company not affected by a takeover bid would have taken, to endeavours to find a competing offer, or to *actions consented to by the supervisory board of the target company*.' (*italics* supplied for emphasis). (Version of WpUG last amended by Art. 2(46) of the Act of 22 December 2011 (Federal Law Gazette I, p. 3044)).
[38] See Wolf-George Ringe, 'Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG' (2015) 63 American Journal of Comparative Law 493.
[39] Alan Digman and Michael Galanis, *The Globalization of Corporate Governance* (Ashgate, 2009) 301-302.
[40] Jesper Lau Hansen, 'Cross-Border Restructuring – Company Law between Treaty Freedom and State Protectionism' In Ulf Berntz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 176, 187.

enterprise.[41] Article 3 require balancing between acting in the interest of the enterprise and not denying shareholders the opportunity to decide on the bid. In Germany, interests of the company is the sum of multiple interests of all stakeholders, as such, 'in a takeover situation, management may take action frustrating the bid if this appears justified in balancing the different interests involved.'[42] Arguably, for Germany, a protectionism charge is rebuttable.

For Belgium, adopting a board hostility position was a natural consequence of not having a strict BNR before the transposition of the TBD. It was reported that 'Belgium has opted out of the so-called "rule of passivity" enshrined in Article 9 of the Takeover Directive.'[43] For companies having their registered office in Belgium and having their securities traded on the regulated market in Belgium, during a takeover bid, the board may take action to frustrate the bid without having to obtain shareholder approval. Two easy provisos are placed on the board. First, the proviso that all actions taken by the board to frustrate a takeover bid are subject to the supervision of competent authority, the Financial Services and Markets Authority.[44] Second, the proviso that all actions taken by the board to frustrate a takeover bid are subject to the general companies law, to act in the interest of the offeree company as a whole (i.e. interests of shareholders, creditors and employees).[45]

Other two Member States that maintain out right opt-out of Article 9 of the TBD are Luxembourg and Denmark. In Luxembourg, pursuant to the law of 19 May 2006 on takeover bids, the board of the offeree company can take action to frustrate a takeover bid without first obtaining shareholder approval. This is still subject to taking such action in the interest of the company as a whole, which the board often will justify. It is interesting to note that this law was adopted during the audacious hostile takeover for the Luxembourg steel giant Arcelor by Mittal Steel. Here is a brief background: in January 2006, Mittal announced a hostile takeover of Arcelor; in February 2006, the Luxembourg Government announced a Bill to implement the TBD; in May 2006, the Luxembourg Parliament voted the Bill into law; and in June 2006, Mittal succeeded to takeover Arcelor. In the course of the Bill in Parliament, the Luxembourg Chamber of Commerce tabled an amendment aimed at protecting Arcelor and swatting the takeover of Arcelor by Mittal.[46] Whilst the Chambers' amendment would have rendered the law more protectionist, thereby interfering with an ongoing takeover bid and probably frustrate it, the Luxembourg Parliament preserved freedom of trade and did not adopt the Chamber's position.[47] Nonetheless, by empowering directors to take defensive measures without shareholder approval, the Luxembourg takeover law of 19 May 2006 confined hostile takeover to history. In Denmark, the board is not subject to Article 9 of the TBD, and therefore can take action to frustrate a takeover bid without shareholder approval. In both Luxembourg and Denmark, companies may provide in their articles of association for the board to maintain neutrality during bids, though this is rare.

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[41] Beate Sjåfjell, 'The Core of Corporate Governance: Implications of the Takeover Directive for Corporate Governance in Europe' (2011) 22 European Business Law Review 641, 645-652; Jonathan Mukwiri, 'Takeovers and Incidental Protection of Minority Shareholders' (2013) 10 European Company and Financial Law Review 432, 439.

[42] William Underhill and Andreas Austmann, 'Defence Tactics' In Jennifer Payne (ed), *Takeovers in English and German Law* (Oxford: Hart Publishing, 2002) 87, 96.

[43] Marc van der Haegen and Dirk van Gerven, 'Belguim' In Dirk van Gerven (ed) *Common Legal Framework for Takeover Bids in Europe* (Volume I, Cambridge: Cambridge University Press, 2008) 94, 117.

[44] Articles 35 and 36 of the Belgian Takeover Act 2007.

[45] Article 9(3) of the Belgian Takeover Act 2007.

[46] Ambrose Evans-Pritchard, 'Move to "Sabotage" Mittal Takeover' (2006) *The Telegraph*, 15 March.

[47] Marc Meyers, 'Luxembourg Tansposes Takeover Directive Against the Backdrop of Mittal Steel's Bid for Arcelor' (2006) 3 European Company Law 261.

IV. The BNR in the UK

The importance of the BNR in shaping takeover law and facilitating takeover bids should not be underestimated. A common argument against the BNR is that it is only relevant in dispersed structures like the UK and not in concentrated structures like Germany. Davies, Schuster, and de Ghelcke, convincingly, 'argue that the view that the BNR has importance only in the UK is misplaced.'[48] Among other reasons, they argue that, in insecure blockholder control situations, which are common in Europe, restriction on the board's power to prevent the bid being put to all shareholders facilitate bids even in concentrated structures. It is here argued that a strict BNR removes the potential for board conflict of interest even in concentrated structures. In Germany, where the management board may take defensive measure with the approval of the supervisory board, Mathias Habersack argues that 'the conflict of interest in the person of the management board is intensified' because 'the supervisory board fear to be dismissed once the takeover is completed', and 'the employee representatives also fear reorganisation.'[49] Arguably, such conflict of interest would be removed by a strict BNR. Marco Ventoruzzo argues that the fact that several continental European countries, such as Italy and France, that have concentrated ownership structures, had adopted the BNR long before the TBD, suggests the importance of the rule goes beyond the divide of dispersed and concentrated ownership structures.[50] Although Italy and France had adopted the BNR before the TBD, both have since introduced protectionist takeover rules. France has since promoted protectionist reforms, passing in 2014 the openly protectionist *Loi Florange* and repealing the BNR.[51] Arguably, in most major continental jurisdictions the BNR is not negated by shareholdings structures, but by protectionism.

Increasingly, most major continental states are moving towards protectionism. Compared to other major European jurisdictions, the UK operates the strictest BNR. 'All the major continental jurisdictions make it possible for companies to avoid the "no frustration" rule (with varying degrees of flexibility).'[52] 'To complicate matters further, with Brexit the very member state which is seen by many to offer model takeover regulation with a mandatory [BNR] will leave the EU and will, therefore, loose its influence over EU law.'[53] Some have taken issue with measuring failure or success of EU takeover law by the use of the BNR, contained in Article 9 of the TBD, and suggested that the BNR is trivial in the sense that takeover defences could be regulated at company level without this rule.[54] Convincingly,

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[48] Paul Davies, Edmund-Philipp Schuster, and Emilie van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 122-123.

[49] Mathias Habersack, 'Non-frustration Rule and Mandatory Bid Rule – Cornerstones of European Takeover Law?' (2018) 15 European Company and Financial Law Review (forthcoming).

[50] Marco Ventoruzzo, 'Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe' (2008) 11 University of Pennsylvania Journal of Business Law 135, 137.

[51] Mariana Pargendler, 'The Grip of Nationalism on Corporate Law' (20 March 2018), available at https://ssrn.com/abstract=3144451 (last accessed 10 April 2018).

[52] Paul Davies, Klaus Hopt, and Wolf-Georg Ringe, 'Control Transactions' In Reinier Kraakman et al, *The Anatomy of Corporae Law: A Comparative and Functional Approach* (third edition, OUP, 2017) 205, 212.

[53] Mathias Habersack, 'Non-frustration Rule and Mandatory Bid Rule – Cornerstones of European Takeover Law?' (2018) 15 European Company and Financial Law Review (forthcoming).

[54] Carsen Gerner-Beuerle, David Kershaw, and Matteo Solinas, 'Is the Board Neutrality Rule Trivial? Amnesis About Corporate Law in European Takeover Regulation' (2011) 22 European Business Law Review 559.

others have rejected the triviality argument, defending the BNR as a general rule that covers any defensive action and a rule that is not open to evasion by the creation of new defences.[55]

The members of the High Level Group of Company Law Experts[56] were fully convinced that the UK model of takeover regulation with its BNR[57] would best serve EU economic interests. Takeovers in the UK are subject to the BNR, and the UK opted into Article 9 of the TBD.[58] The BNR has been a feature of regulations of takeovers in the UK since the early 1960s. Partly due to this long history of maintaining the BNR, hostile takeovers[59] are common in the UK than in any other EU Member State. In their study of European M&A, Marina Martynova and Luc Renneboog found that 'most hostile bids are concentrated in the UK' than in other European countries.[60] Although only a small number of takeovers tend to be hostile, the fact that they mostly occur in the UK, is in itself evidence of the importance of the BNR: it effectively facilitates a liberal market for corporate control. But in light of concerns of increasing short-termism in the UK, if, as it seems, easy facilitation of takeovers encourage short-termism, then it suggests that it is hard to have both the regulatory advantage of a liberal market and long-termism.

But for the core provision of the TBD, Article 9, having been reduced to an optional provision, the Directive would have provided for the EU what the City Code provides for the UK – removal of barriers that may frustrate free movement of capital by way of takeover activities. One problem with having on one hand the UK applying the BNR and on the other hand some of the major capital markets in the EU opting out of the rule, is it creates 'discrimination with respect to defensive measures against hostile takeovers.'[61] In EU Member States that have opted out of Article 9, hostile takeovers are not facilitated, offeree boards may take actions to frustrate bids without shareholder approval, and that makes bidding for shares in those jurisdictions less attractive to investors.[62] The optionality of Article 9 creates a liberal/protectionist divide in the EU market for corporate control, with some EU states offering a liberal and some EU States a protectionist market.

It is ironic that, whilst the TBD was modelled on the UK's City Code, owing to the optionality of the BNR in the TBD, most of the EU Member States do not share the UK's regulatory approach. Arguably, but for the optionality of the BNR, for over 30 years the

[55] Paul Davies, Edmund-Philipp Schuster, and Emilie van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In U Bernitz and WG Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 108-125.
[56] European Commission, *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids* (Brussels: 10 January 2002).
[57] UK's BNR ('non-frustration rule'): 'During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, without the approval of the shareholders in general meeting: (a) take any action which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits; or (b)(i) issue any shares or transfer or sell, or agree to transfer or sell…' (Rule 21.1 City Code).
[58] Article 9 of the TBD provides, in part: during takeover period, '… the board of the offeree company shall obtain the prior authorisation of the general meeting of shareholders given for this purpose before taking any action, other than seeking alternative bids, which may result in the frustration of the bid…' (9.2).
[59] Hostile takeovers refer to takeovers that management are not in favour of.
[60] Marina Martynova and Luc Renneboog, 'Mergers and Acquisitions in Europe' In Luc Renneboog (ed), *Advances in Corporate Finance and Asset Pricing* (Amsterdam: Elsevier, 2006) 13, 32.
[61] Mathias Siems, '*SEVIC*: Beyond Cross-Border Mergers' (2007) 8 *European Business Organization Law Review* 307, 315.
[62] Jonathan Mukwiri, *Takeovers and the European Legal Framework: A British Perspective* (London: Routldge-Cavendish, 2009) 20.

Commission sought to model the Directive on the UK rules, so that the EU shares the UK's regulatory advantage. The TBD has since created new standards based on optionality – opting into Article 9 to create a free liberal market, or opting out of Article 9 to create a protectionist market. Some have suggested that the UK may need to meet the new standards or lose its regulatory advantages if its rules are more stringent.[63] It is here suggested that the UK would lose its position as a regional financial centre and a liberal market if the UK were to take a protectionist standard.

V. Short-termism in the UK market for corporate control

Some have argued that the UK's liberal market has led to easy hostile takeovers that have led to the 'financialisation' of many British businesses. One 2010 article in *Financial Times* was very critical of the UK liberal market, observing that: 'this liberal openness is a great asset, but it must be proportionate. Takeovers are a crucial part of capitalism, but the current regime is a charter for a great sell-off of British assets. The rules of the game are tilted to favour hostile takeovers. Too many great UK companies have disappeared.'[64] Despite these criticisms, UK regulation of takeovers still provides the most liberal market in the world.

The UK liberal market for corporate control is well placed to attract and protect investors. This is borne from the policy choice of having a strict BNR, which focuses on the interests of shareholders, and disarms incumbent offeree boards of the ability to mount defensive in a bid to secure their jobs. Given that shareholders own the shares, the City Code places the decision to transact in shares squarely in the hands of shareholders. It provides a free platform for even foreign bidders to acquire shares in UK companies, which investment in turn boasts the UK economy. It provides a market for shareholders to cash in for shares and obtain the often much needed liquidity and return on investment. But this often means that long-term shareholders sell their shares to short-term traders. As such, this highly acclaimed liberal market for corporate control is both UK's strength and its weakness.

In recent years, an example of the weakness of the UK's liberal market was demonstrated by the controversial takeover of Cadbury (a UK chocolate maker company) by Kraft (a US food company). The history of Cadbury is traced back to 1824 when John Cadbury first begun his chocolate shop in Birmingham (UK), which over the century and decades developed into a giant UK chocolate company until taken-over by Kraft in 2010.[65] The controversial story of the takeover of Cadbury was well summarised in the 2010 report of the House of Commons Select Committee.[66] In 2007, Cadbury announced its plan to close one of its factories, Somerdale Factory (near Bristol, UK), and by 2010 move the factory's production to Poland. In a bid to take over Cadbury, in 2009 Kraft announced it would reverse Cadbury's decision and keep the Somerdale Factory opened in the UK. Just a week after the takeover, Kraft announced that it was closing the Somerdale Factory and moving production to Poland. A number of Reviews were conducted into the Cadbury/Kraft takeover, and commendably so, the Reviews rejected taking a protectionist standard against foreign takeovers, as this would weaken the UK's position as a regional financial centre.

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[63] KJ Hopt, 'European takeover reform of 2012/2013 - time to re-examine the mandatory bid' (2014) 15 EBOR (2), 143-190.

[64] Will Hutton and Phillip Blond, 'End of this charter for selling off top British companies' (2010) *Financial Times*, 21 January.

[65] Cadbury history available at: https://www.cadbury.co.uk/the-story (last visited 23 February 2015).

[66] House of Commons, Business, Innovation and Skills Committee, *Mergers, Acquisitions and Takeovers: the Takeover of Cadbury by Kraft* (HC 234, London: The Stationery Office Limited, published 6 April 2010).

In April 2010, the House of Commons Select Committee published its review of the Cadbury takeover. In its report, the House of Commons stated that, 'Kraft acted both irresponsibly and unwisely in making its original statement that it believed it could keep Somerdale open' and that it left Kraft to a charge that Kraft may have 'used a "cynical ploy" to cast a positive light on Kraft during its takeover of Cadbury.' The House of Commons Committee was 'deeply concerned by reports that the takeover of Cadbury by Kraft was ultimately decided by institutional investors motivated by short-term profits rather than those investors who had the company's long-term interests at heart.'[67] In its conclusion, the House of Commons Committee welcomed the plans of the UK Government and the Takeover Panel to review UK's takeover legislation and rules, but advised that: 'any review should not be a disguise for protectionism against foreign takeovers. It needs to address all takeover activity, whether entirely domestic or by foreign companies, to ensure that such activity is conducted in the best interests of the UK economy.'[68] Ruling out protectionism was commendable, for it was unlikely to negate short-termism. Subsequently, a number of reviews were published.

In October 2010, the Code Committee of the Takeover Panel published a response report following a public consultation.[69] This was in response to public concerns over the fact that, (i) it had become too easy for hostile offerors to succeed, and (ii) outcome of hostile offers being influenced unduly by the actions of short-term investors. Addressing the former, the Code Committee promised to bring proposal forward to amend the Code to reduce offeror tactical advantage and redress the balance in favour of the offeree company.[70] The unfairness of inducement fees is that where they give the first offeror a significant advantage, other offerors may be deterred from bidding thus depriving shareholders of additional premium the competing bid would have brought.[71] The prohibition of inducement fees levels the playing field for offerors, it facilitates fairer hostile takeovers and increases fairness in the market. Addressing the latter, it had been suggested that the ability of short-term investors to influence the outcome of offers should be restricted by (a) disenfranchising shares acquired during the offer period, and (b) introducing a qualifying period prior to shares carrying votes. While the Code Committee was of the view that (a) could be introduced through changes in company law and could be consistent with the Code, it was of the view that (b) would run contrary to the concept of 'equivalent treatment' for all shareholders in the same class as enshrined in General Principle 1.[72] This principle is reflected in Article 3(1)(a) of the TBD.

In July 2012, a review of the short-term investment in UK equity markets, conducted by Professor John Kay, as commissioned by the UK Government, was published.[73] One of the weaknesses of the UK's liberal market is that it is open to attract short-term investors whose only interest may lie in making quick gains and then reselling their shares without regard for the long-term industrial and economic growth. The central question for the Kay Review was on the extent of short-termism, 'whether capital markets in Britain dissuade or stimulate the

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[67] House of Commons (2010), p 23, para 62.
[68] House of Commons (2010), p 25, para 69.
[69] The Takeover Panel, Code Committee, 'Review of Certain Aspects of the Regulation of Takeover Bids' (London: The Takeover Panel, 21 October 2010).
[70] Takeover Panel (2010), para 2.7.
[71] Blanaid Clarke, 'Reviewing takeover regulation in the wake of the Cadbury acquisition – regulation in a twirl' (2011) Journal of Business Law 299, 301.
[72] Takeover Panel (2010), para 4.5 and para 4.6.
[73] Kay Review, 'The Kay Review of the UK Equity Markets and Long-Term Decision Making' (London, July 2012.

search for instant gratification in the corporate sector.'[74] The Kay Review examined the possibility that short-term decisions may have led to the disappearance of British companies ICI and GEC, resulting into loss of British industrial lead, and as a result of this loss, 'German competitors BASF and Siemens are now respectively the leading chemical and engineering companies in the world.'[75] Whilst acknowledging that the rise of companies is central to the dynamic of a market economy, the Kay Review asked, rhetorically, 'where are Britain's Amazons, Apples or Googles?' The Kay Review blamed this to short-termism culture. It also noted with regret, 'the financialisation of UK business, the rise of the would-be meta-fund manager, and the tendency for some chief executives to be preoccupied with deal making rather than developing competitive advantages in operating businesses.'[76]

In February 2013, an independent review of the growing short-termism problem in UK equity markets, conducted by Sir George Cox, as commissioned by the Labour Party, was published.[77] The Cox Review made a number of observations. The Cox Review observed that the UK market is amongst the most open in the world for inward foreign investment. The Cox Review observed that whilst welcoming foreign investment in UK companies, there was widespread concern that the openness of UK markets both lays UK open to predators and puts key industries in the hands of organisations for which the UK operation was not necessarily a priority consideration. The Cox Review observed that in other jurisdictions, takeovers are subjected to national interest. It cited for example, in the US, regulation prohibits a majority foreign ownership of companies in several key industries. It also cited for example, in China one can only get involved in joint ventures that guarantee a measure of skills transfer. Despite examples of US and China, the Cox Review advised, 'for the UK to erect any such barrier to international investment would be a backward step in the opening up of global capital markets where the UK has been a leader.'[78]

In July 2013, the House of Commons Select Committee published another review into the issues raised the previous year in the Kay Review.[79] The Select Committee heard evidence to the effect that the nature of UK's liberal market for corporate control meant that long-term shareholders often chose to sell their shares to short-term investors. But the Committee also heard evidence that, 'overall, takeovers detract value from companies.' The Committee noted the commitment of the Secretary of State to 'consider introducing differential votes (i.e. encouraging the principle that short-term traders should have no influence over the takeover vote).'[80] The House of Commons Select Committee made a recommendation that the Department of Business, Innovation and Skills should study the feasibility of 'introducing a policy that differentiates between shareholders and voting rights based on the length of time a share has been held.'[81] The effect of introducing such a differential voting policy or legislation would be to limit short-term shareholders' ability to influence takeover outcome.

In October 2014, the Department of Business Innovation and Skills published its feasibility study report into the practical and legal implications of a 'differential votes' policy designed

[74] Kay Review (2012), para 1.3.
[75] Kay Review (2012), para 1.27.
[76] Kay Review (2012), para 8.14.
[77] Cox Cox Review, *Overcoming Short-Termism within British Business: The Key to Sustained Economic Growth* (London: Labour Party, 2013).
[78] Cox Review (2013), pp 38-41.
[79] House of Commons, Business Innovation and Skills Committee, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (London: The Stationery Office Limited, 25 July 2013).
[80] House of Commons (2013), para 23.
[81] House of Commons (2013), para 24.

to resolve the short-termism problem.[82] According to the Government, limiting short-term shareholders' ability to influence takeover outcome, would require a 'differential votes' legislative mechanism, in that, (a) voting rights would be limited to rights the shares had at the offer period commencement date; (b) any shares sold after that point would result in the loss of the voting rights attached to those shares for those purposes; and (c) any shares purchased after that point would not have voting rights for those purposes for the duration of the offer period. One legal question was whether 'differential votes' legislative mechanism would be compatible with Article 3(1)(a) of the TBD, which states: 'all holders of the securities of an offeree company of the same class must be afforded equivalent treatment.' That it is contentious legal question and there are no easy legal answers to short-termism, is revealed by the Department's findings that 'there was no clear agreement among the lawyers present on this question,' as 'some argued that it would not be compatible with the requirement for equal treatment,' while 'others expressed the view that the measure could be designed in a way which was consistent with this principle.'[83] The Department abandoned the legislative mechanism on three broad grounds: '[i] there were a series of legal and technical implementation issues which would be extremely difficult to overcome; [ii] the practical consequences and impacts of a disenfranchisement measure risked being at best ineffective and at worst damaging; and [iii] it appeared unlikely that a disenfranchisement measure would eliminate the influence of short-term shareholders in a takeover bid.'[84]

The use of differential voting rights as, albeit a limited, solution to short-termism, was in 2011 proposed by the Reflection Group, who recommended that EU regulation should allow companies across the EU to have the option to include clauses allowing for differential voting rights in their Articles of Association.[85] The Commission proposed to amend the Shareholder Rights Directive into what has become known as Shareholder Rights Directive II (SRD II). In its report of 12 May 2015, the Committee on Legal Affairs proposed amendments to the European Parliament, which would include inserting into the SRD II a provision grating additional voting rights to long-term shareholders who have held their shares for not be less than two years.[86] Similarly, in France, the Florange Act, adopted 29 March 2014, provides for automatic double-voting rights to shares held by the same shareholder for at least two years, unless the company prohibits double-voting rights in articles of association. Inserting differential voting rights into the SRD II met with resistance from institutional investors who argued that "differential voting rights can have unintended consequences leading to the disenfranchisement of minority shareholders" and would "impact on the attractiveness of European markets for global investment."[87] In the final text of the SRD II, the European Parliament and the Council did not adopt differential voting rights.[88]

With differential voting not included in the SRD II, to provide, albeit a limited, solution, short-termism is posed to remain not only a UK problem, but also a EU problem. Earlier in a

[82] Department of Business, Innovation and Skills, 'Practical and legal issues related to limiting the rights of short-term shareholders during takeover bids' (October 2014).
[83] Department of Business, Innovation and Skills (2014), para 15.
[84] Department of Business, Innovation and Skills (2014), para 6.
[85] European Commission, Report of the Reflection Group on the Future of EU Company Law (Brussels, 15 April 2011) pp 45-46, http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf (last accessed 6 April 2018).
[86] European Parliament, Draft Legislation Resolution, Report A8-0158/2015 of 12 May 2015.
[87] Letter by ICGN to EU commissioner for DG Justice and Consumers (29 January 2015), available at https://www.icgn.org/sites/default/files/EC%20-%2029.01.2015.pdf (last accessed 6 April 2018).
[88] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (OJ L132, 20 May 2017).

2011 Green Paper, the Commission found that, 'the majority of shareholders are passive and are often only focused on short-term profits.'[89] As if conceding to short-termism, the Commission accepted 'that not all investors need to engage with investee companies' and that 'investors are free to choose a short-term-oriented investment model without engagement.'[90] This lack of engagement tends to short-termism, creating a cyclical effect in equity markets. Jonathan Mukwiri and Mathias Siems have argued that the backdrop to this lack of shareholder engagement is the fact that investors who largely contribute to corporate liquidity tend to be short-term investors. Mukwiri and Siems observe that boards of financial firms striving to keep solvent and therefore in need of liquidity, pushed by stock market price index performance measures, are likely to have little choice but to focus on short-term demands of short-term liquidity providers.[91] As rejected by the UK Reviews, taking a protectionist standard is unlikely to resolve the problem of short-termism, as it would most likely weaken UK's position as a regional financial centre. With no clear legal answers to short-termism, given that the UK market is more liberal than the EU market, it is likely that UK will continue to suffer with the short-termism problem more than the rest of the EU.

It is here argued that, in the UK, the focus on the interests of shareholders, rather than the company at large, in the context of takeovers, is linked to short-termism. Short-termism is facilitated by the regulatory framework that focuses on serving the interests of shareholders. A most influential class of shareholders whose interests are served by UK Takeover Code is institutional shareholders. According to Armour and Skeel, institutional shareholders have historically influenced the Code to serve their own interests. Armour and Skeel argued that,

> 'given that investors cannot easily exit the market, each institution recognizes that if it is not involved in influencing a change, others might do so in a way that harms its interests. Hence, the observed strategy was one of coordinated lobbying for rules that were expected to maximize the joint welfare of institutional investors. The Takeover Code is a good example. Institutional investors were involved at every stage of the drafting of the Code, right from its beginnings as the "Notes." Because institutional investors have a clear interest in rules that maximise expected gains to shareholders, it is not surprising that the emergence of a pro-shareholder approach to takeover regulation coincided with the emergence of institutional investors as a significant force in British share ownership.'[92]

Having influenced the Code to provide easy entry and easy exist, institutional shareholders who are inclined to short-term profits are quick to sell their shares to hostile bidders. Such shareholders often have a short-term focus, as they may have purchased the shares after the bid has been announced in order to make a quick gain, should the takeover succeed, with no interest in the future of the company once they have accepted the offer and exited the company.[93] With short-term shareholders, regulators have no easy solution to short-termism.

One reason why regulars have no easy solution to short-termism is because shareholders have a right to sell their shares and have no duty of loyalty to the company. This right stems from

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[89] European Commission, 'Green Paper: The EU corporate governance framework' (COM(2011) 164 final.

[90] European Commission (2011), para 2.3.

[91] Jonathan Mukwiri and Mathias Siems, 'The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?' (2014) 21 Journal of law and Society 51, 60-61.

[92] John Armour and David Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) 95 Georgetown Law Journal 1727, 1771.

[93] Jennifer Payne, 'Minority shareholder protection in takeovers: A UK perspective' (2011) European Company and Financial Law Review 145, 163; Jonathan Mukwiri and Mathias Siems, 'The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?' (2014) 41 Journal of Law and Society 51, 60.

the fact that in English law, whilst shareholders do not own the capital of the company, they own the share, for 'the share, although it is a fraction of the capital, is the property of the corporator.'[94] In other words, 'the shares or other interest of a member in a company are personal property.'[95] Shareholders are free to sell their shares in contractual offers. 'As the company as a legal entity is unaffected by the sale of the shares resulting from a contractual offer, we might expect that the company as an entity has no role in deciding whether or not the share sale from A to B should take place.'[96] Whilst companies may, in their articles of association, restrict share transfers and therefore prevent shareholders selling their shares to short-term investors, listed companies must have their shares freely transferable.[97] Unless the culture of shareholders changes from short-term to long-term orientation, regulators have no easy solution to short-termism, as shareholders may freely sell to short-term investors.

VI. Illusion of a BNR in Germany

Unlike in the UK, hostile takeovers are alien in Germany. Hostile takeovers are just not the way the Germans do business. As such, German boards do not sit neutral to watch hostile raiders taking over and stripping the assets of the company they have built up. Germany is among the largest and richest industrial economies, and many German companies are world leaders in their fields.[98] It is understandable that Germany, having recovered from the 1870s long depression and developed its industrial economy, would seek to protect the country's threatened industrial economy. To recover from economic depression, Germany focused on long-term investment in human capital – hence employee protection and employee co-determination in corporate governance – and on long-term technological and organisational investment. Thus, the German economic power lends itself to the historical corporate governance structures and legal framework in Germany. To protect against the effects of the 1873 stock market collapse, by 1884 corporate law reform in Germany had introduced a corporate governance structure composed of a two-tier board: the supervisory board (*Aufsichtsrat*) and the management board (*Vorstand*) – a structure that had its roots in the *Verwaltungsrat*, a body on which shareholders, bankers and other entrepreneurs were represented – a structure designed not per se for shareholders to hold directors accountable, but to protect the public interest and to avoid exploitation of stakeholders.[99] While hostile takeovers, and to a large extent the stock markets, generally favour shareholders' interests, German corporate governance favour wider corporate interests, which boards are duty bound to protect. As it is discussed below, German law empowers boards to resist hostile takeovers.

Hostile takeovers are alien in Germany. 'The successful hostile takeover by the UK-headquartered Vodafone of the Germany-based Mannesmann might seem to be a spectacular counter-example, but arguably this was not in ownership terms a cross-border acquisition as more than two-thirds of the shares in Mannesmann were held by foreigners, mainly institutional investors based in the UK and the US.'[100] The nature of shareholding in Mannesmann, who were mostly foreigners, facilitated for the hostile takeover. 'While some

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[94] *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 at 767 per Lord Wrenbury.
[95] Companies Act 2006, s 541.
[96] David Kershaw, *Principles of Takeover Regulation* (Oxford: Oxford University Press, 2016) 38.
[97] UK listed companies are subject to the FCA's Listing Rules – Listing Rule 2.2.4 requires securities or shared listed on a regulated market to be 'freely transferable.'
[98] Marco Becht and Ekkehart Bohmer, 'Ownership and Voting Power in Germany' In Fabrizio Barca and Marco Becht (eds), *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001) 128.
[99] Alan Dignam and Michael Galanis, *The Globalization of Corporate Governance* (Ashgate, 2009) 264-270.
[100] David Faulkner, Satu Teerikangas and Richard Joseph (des), *The Handbook of Mergers and Acquisitions* (Oxford: Oxford University Press, 2012) 287.

German funds were thought to be loyal to Mannesmann, foreign investors held over 60% of shares, including 40% held by US and British investors alone.'[101]

Moreover, a hostile takeover would not have succeeded but for managers being in breach of the fiduciary duty to protect the interest of Mannesmann by continuing to resist the takeover by Vodafone. In November 1999, Vodafone approached Mannesmann for a friendly merger/takeover. This was rejected. A hostile takeover ensued. The deal closed in March 2000 after Mannesmann mangers were persuaded to recommend the offer; and after the takeover, they received almost 60 million euros in awards and pensions. A criminal trial against former Mannesmann managers followed. Prosecutors argued that the payments were illegal because they were designed to persuade managers to drop their resistance to Vodafone's bid after the long takeover battle.[102] The case was settled in 2006 with managers agreeing to pay back some of the money. As the Vodafone/Mannesmann takeover succeeded partly due managerial misconduct, it is arguable that it is not a good example of hostile takeovers in Germany, and that hostile and/or foreign takeovers remain alien in Germany.

Turning to 're-emergence of economic protectionism,'[103] in regards to Germany, this may probably refer to the protectionism of the 1880s. In 1873, Germany experienced the *Grunderkrise*, a term referring to the German stock market collapse. In the aftermath of that stock market collapse, having recovered from the long depression, Germany moved 'away from liberal economic policies such as free trade and competition, to protectionism, a distrust of stock exchange finance and the encouragement of cartelization.'[104] Germany was seeking long-term stability, which the stock exchange did not seem to provide. Small or dispersed holdings, prevalent players on stock exchange, were discouraged in favour of block or concentrated holdings. One feature of stock exchange is to provide shareholders easy entry and exit from companies by the market of their shares. This encouraged short-termism, which the German lawmakers were cautious to avoid. To the German lawmakers, 'such "democracy" that would give voice to small shareholders was widely considered undesirable due to their short-term interests and ability to exit.'[105] In order to protect long-term industrial economy, Germany developed a corporate governance model that views the interests of the company to be wider than shareholders, to include all stakeholders: shareholders, employees, creditors, and industrial partners. Thus, in the German corporate governance, the interests of the company that are protected during takeover bids are 'defined as the sum of the multiple interests of all company stakeholders, that is, shareholders, employees, creditors and the concerned general public (for instance, the municipality where production facilities are located).'[106] Call it protectionism, but while in the UK, short-term/liberalism led to the disappearance of British firms such as ICI and GEC, resulting into loss of British industrial lead, in Germany, due to long-term/protectionism, 'German competitors BASF and Siemens are now respectively the leading chemical and engineering companies in the world.'[107]

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[101] Martin Höpner and Gregory Jackson, 'Revisiting the Mannesmann takeover: how markets for corporate control emerge' (2006) 3 European Management Review 142, 147.
[102] Reported in the Study by Marccus Partners, The Takeover Bid Directive Assessment Report (2010) 83.
[103] European Parliament, 'Financial, economic and social crisis: Recommendations concerning the measures and intiatives to be taken (mid-term report' (2012) Official Journal C 70E, 08/03/2012 p 19, para 26.
[104] Alan Dignam and Michael Galanis, *The Globalization of Corporate Governance* (Ashgate, 2009) 264.
[105] G Jackson, 'The Origins of Non-Liberal Corporate Governance in Germany and Japan' In W Streeck and K Yamamura (eds), *The Origins of Non-Liberal Capitalism: German and Japan* (Ithaca: Cornell University Press, 2001) 121-170.
[106] William Underhill and Andreas Austmann, 'Defence Tactics' In Jennifer Payne (ed), *Takeovers in English and German Law* (Oxford: Hart Publishing, 2002) 87, 96-97.
[107] Kay Review (2012), para 1.27.

In historical German corporate law, prior to the TBD, there was no place for a strictly English-equivalent of a BNR, even as contained in Article 9 of the TBD. A strict BNR favours hostile takeovers and militates against German corporate governance model of protecting, even during takeovers, wider company interests. German law, in opting out of Article 9 of the TBD, reinforces the historical duty of boards to protect the wider company interests beyond shareholders. Analysing the German law in relation to a strict BNR, Davies, Schuster, and Ghelcke give a number of reasons arguing that a BNR in Germany would have been a significant departure from the existing law.[108] They make an observation that German law contained in the Securities Acquisition and Takeover Act, starts from a board neutrality principle, but dilutes the BNR by creating three exceptions to it. First, the management board may take defensive measures with a post-bid approval of the supervisory board. Second, the management board may obtain pre-bid shareholder approval for defensive measures. Third, the Act authorises the management board to take actions which a diligent and conscientious manager not subject to a takeover offer would have also taken – without imposing requirement for supervisory board approval. Mathias Habersack affirms that 'with regards to German law it cannot be denied that a strict [BNR] would have a "constitutive" effect, i.e. that it would prohibit the management board from taking defensive actions which pursuant to general stock corporation law it would be allowed to take.'[109] Referring to some examples, Habersack argues that those 'examples show very clearly that the management board and the supervisory board of a German company which is confronted with a takeover bid are well placed to take such defensive measures, which they would not be able to take if a strict [BNR] applied.'

The BNR is found in section 33 of the German Securities Acquisition and Takeover Act. The relevant part is subsection 1, sentences 1 and 2, which states:

> After publication of the decision to make an offer and until publication of the result pursuant to section 23 sentence 1 no.2, the board of management of the target company may not take any actions which could prevent the success of the offer. This does not apply to actions which a prudent and conscientious manager of a company not affected by a takeover bid would have taken, to endeavours to find a competing offer, or to actions consented to by the supervisory board of the target company.

The reference in sentence 2 above to 'prudent and conscientious manager of a company not affected by a takeover bid' needs to be read in conjunction with section 93 paragraph 1 sentences 1 and 2 of the German Stock Corporation Act, which states:

> In conducting business, the members of the management board shall employ the care of a diligent and conscientious manager. They shall not be deemed to have violated the aforementioned duty if, at the time of taking the entrepreneurial decision, they had good reason to assume that they were acting on the basis of adequate information for the benefit of the company.

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[108] Davies, Schuster, and van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 115-116.

[109] Mathias Habersack, 'Non-frustation Rule and Mandatory Bid Rule – Cornerstones of European Takeover Law?' (2018) 15 European Company and Financial Law Review (forthcoming).

How should we read the BNR contained in the German law above? Most important, one implication is that it provides an illusion of board neutrality, which in effect is taken away by the exceptions, especially the third exception – the actions of 'a prudent and conscientious manager of a company not affected by a takeover bid.' What in essence section 33(2) of Securities Acquisition and Takeover Act does is to authorise the management board to completely ignore the takeover bid situation as longer as the board is within the boundaries contained in section 93(1) of the Stock Corporation Act, that is, 'acting on the basis of adequate information for the benefit of the company.' Keep in mind that 'the benefit of the company' or its interests, in Germany, are wider than shareholder interests. So, for example, on the question of whether new shares should be issued, the target's directors need not consider the effects of the share issuance on an outstanding public offer and the financial interests of the company's shareholders, and can go ahead with the share issuance even if this will frustrate the bid and even if this is an unwelcome side-effect of an otherwise sound business measure.[110] The former Act permits the management board to perform the duty of loyalty to balance stakeholder interests required by the latter Act without taking into account that shareholder interests in the bid might be frustrated. Thus, 'a company already pursuing an acquisition strategy could continue (and even accelerate?) it in the face of a bid, even if fully aware that the acquisition would render the company a less attractive target.'[111]

But one may ask, if the above reading of the German law exception is correct, how do we read the first sentence: 'the board of management of the target company may not take any actions which could prevent the success of the offer' (section 33(1) Securities Acquisition and Takeover Act)? Given the exception discussed above, it is submitted that the prohibited actions only refer to those actions that would not be taken by a 'diligent and conscientious manager' and actions that would not be for 'the benefit of the company' outside a takeover bid situation. For example, if the management board where, in order to frustrate a bid, sell off corporate assets and divide among themselves the proceeds. As general rules of company law (fiduciary duties) would still apply to frustrating actions, the prohibition in section 33(1) simply says directors may frustrate a takeover bid subject to fiduciary duties to the company.

VII. Get the best of both worlds?

The foregoing has discussed the short-term and long-term investment goals, and the liberal and protectionist divide in the EU market for corporate control. But can liberal markets and long-term goals coexist? As company law experts have said, 'we do not have a very sophisticated understanding' of what such strategies may achieve for individual companies. 'Some intervention by investors with short-term goals is good because it brings about change which long-term investors want but cannot themselves cheaply bring about. Sometimes long-term support for a company means keeping inefficient incumbent management in place. But equally, the opposites of these propositions also hold true in some cases.'[112] But can we get both liberal market and long-term investment at national level? The EU market for corporate

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[110] William Underhill and Andreas Austmann, 'Defence Tactics' In Jennifer Payne (ed), *Takeovers in English and German Law* (Oxford: Hart Publishing, 2002) 87, 97.

[111] Davies, Schuster, and van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' In Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism* (New York: Oxford University Press, 2010) 105, 115.

[112] Paul Davies, Guido Ferrarini, Klaus Hopt, Alain Pietrancosta, Rolf Skog, Stanislaw Soltysinski, Jaap Winter, Eddy Wymeersch, 'Response to the European Commission's Green Paper: "The EU Corporate Governance Framework"' (22 July 2011) 12-13.

control is affronted by two problems: the so-called protectionism and short-termism. These two problems are the antitheses of liberal market and long-term investment, respectively.

In the UK, the market has long acquiesced to the normative notion that companies should be run primarily in the interests of shareholders, and directors are perceived as primarily serving the interests of shareholders. Performance of directors in listed companies is measure against share price index. The Myners Review found that the culture of institutional shareholders favours short-termism, as their fund managers cling closely to share market indices, making the work of directors in pursing long-term goals near-impossible.[113] Often, 'due to the threat of hostile takeovers, some directors may tend to act in the short term interests of their shareholders – to keep the shareholders satisfied so they would reject any takeover offer and, therefore, to keep the directors (it is hoped) in control of the management of the company.'[114] The backdrop to the problem is the culture of shareholders who provide capital to the companies. Investors who largely contribute to corporate liquidity tend to be short-term investors; and boards of firms striving to keep solvent and therefore in need of liquidity, pushed by stock market price index performance measures, are likely to have little choice but to focus on short-term demands of short-term liquidity institutional investors.[115]

The policy choices that the UK and Germany have long made on what interests are protected in regulating their markets have respectively resulted in liberal/short-termism and protectionist/long-termism. During takeovers, UK disarms managers to promote shareholder interests, while Germany empowers managers to promote corporate interests. Whilst the scope of this paper is not to discuss the normative value and effect of takeovers,[116] suffice to state that economists have long argued that takeovers have a disciplinary effect that corrects the non-value-maximising practices of managers of target companies.[117] Both UK and Germany economies have long entrenched their varied policy choices that a solution that gets both worlds is hard. It has been decades since Richard Roberts and Alfred Chandler wrote about the policy choices taken by the UK and Germany, yet their works are still relevant.

Richard Roberts observed that, in the UK, regulatory measure in 1951 and 1953 to curb 'speculation' restricted the growth of takeovers, but subsequent regulatory measures in 1958 and 1959 opened the market that led to the takeover booms of the 1960s – this change, a positive regulatory attitude to takeovers, came about, 'because by then the authorities had come to regard take-overs as a means of promoting industrial rationalisation and instilling discipline in management.'[118] We turn to the works of Alfred D Chandler. Chandler argued

[113] Paul Myners, 'Institutional Investment the United Kingdom: A Review' (6 March 2001).

[114] Joan Loughrey (eds), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham: Edward Elgar, 2013) 81.

[115] Jonathan Mukwiri and Mathias Siems, 'The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?' (2014) 41 Journal of Law and Society 51, 60-61.

[116] For a detailed discussion of the value and effect of takeovers, see the seminal works: Henry Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110; FH Easterbrook and DR Fischel, 'Corporate Control Transactions' (1982) 91 Yale Law Journal 698; J Coffee, 'Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145; Julian Franks and Colin Mayer, 'Hostile Takeovers and Correction of Managerial Failure' (1996) 40 Journal of Financial Economics 163; and Simon Deakin and Giles Slinger, 'Hostile Takeovers, Corporate Law, and the Theory of the Firm' (1997) 24 Journal of Law and Society 124.

[117] See Randall Morck, Andrei Shleifer, and Robert W Vishny, 'Characteristics of Targets of Hostile and Friendly Takeovers' In Alan J Auerbach (ed), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press, 1998) 101.

[118] R Roberts, 'Regulatory Responses to the Rise of the Market for Corporate Control in the 1950s' (1992) 34 Business History 183, 197.

that it was by following the logic of dynamic managerial enterprise, allowing managers to take company decisions, which ‘helped to make Germany Europe’s most powerful industrial nation before World War I.’ That ‘more serious to the long-term health of enterprises and industries was the deliberate ignoring of that logic by managers who decided on a strategy of growth of acquiring companies in business in which they had little or no product-specific organizational capabilities that gave them a competitive edge.’ The wave of acquisitions in the UK in late 1960s suggests that managers ignored the logic of industrial growth, as they perceived, according to Chandler, ‘that often more money was to be made in buying and selling companies than in operating them.’[119] In the UK, the 1960s saw a shift in business of financial firms from funding long-term reinvestments to funding short-term acquisitions.

The rise of short-termism in the UK, and the trend of long-termism in Germany, fits the above historical account of policy choices. In the UK, the authorities accepted hostile takeovers as a means of disciplining managers. To escape being disciplined, managers became active, not in running companies, but in buying and selling companies, as more money was made that way than in operating companies, which in turn breeds short-termism. In Germany, rather than seek to discipline managers, authorities empowered them to take company decisions. Germany’s takeover rules favour wider corporate interests for which boards are duty bound to protect, which in turn facilitates long-termism.

VIII. Conclusion

To address the question posed in the title of this paper, we must concede that it is hard in the current varied EU regulatory regimes. Examining and comparing takeover law regimes, especially the application of the BNR, of the UK and Germany, has revealed that there are strongly entrenched policy positions in both jurisdictions. There is a strict board neutrality regime in the UK, but also both the UK government and independent Reviews found prevalence of short-termism in the acclaimed liberal takeover market. The BNR in Germany is illusory, hostile takeovers are not welcome, and recent European Parliament reports and Commission reports found a re-emergence of national protectionism. It has been observed that, despite short-termism, the UK’s liberal market positions and affirms the UK as a regional financial centre, a position that would be weakened by protectionism. It has also been observed that, despite protectionism, Germany’s long-termism positions and affirms Germany as one of the largest industrial economies.

Germany opted out of Article 9, and although that was seen as protectionism, it enabled Germany to retain the traditional German corporate law model that serves wider corporate interests to ensure long-term sustainability of companies. The UK regulatory framework gives credence to the normative notion that companies should be run primarily in the interests of shareholders. Long-term investment is hard because the interests of most institutional shareholders lie in making short-term profits. Unless the culture of shareholders changes from short-termism to long-termism, UK regulators have no easy solution to short-termism, as shareholders may freely sell to short-term investors. It has been argued that short-termism in the UK and the so-called protectionism in Germany, are the respective result of entrenched policy choices made in their regulation of the market for corporate control, and that it is hard for the UK and Germany to get the best of both worlds: liberal market and long-termism.

[119] AD Chandler, ‘Managerial Enterprise and Competitive Capabilities’ (1992) 34 Business History 11, 36-37.