# Free Movement of Capital and Takeovers: a case-study of the tension between primary and secondary EU legislation

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## Abstract

*One of the objectives of the Takeover Directive is to reinforce the single market by enabling the free movement of capital throughout the EU. This requires takeover rules to be in harmony with capital movement rules, yet both 2007 and 2012 European Commission reports reveal a continuing tension. Whilst Article 63 TFEU prohibits obstacles to free movement of capital, Article 12 of the Directive makes the removal of obstacles that would frustrate takeover bids optional. In order to harmonise takeovers with free movement of capital, this paper examines the extent to which the tension between capital movement and takeover rules could potentially be resolved with negative integration. The conclusion is that negative integration could resolve tension. However, the suggestion is made that strict negative integration is inadvisable since there seems to be a lack of political will in member states to eliminate takeover obstacles and an uncertain economic situation in the EU at present.*

## Introduction

This paper examines the means by which Article 12 of the Takeover Directive 2004/25/EC (hereinafter referred to as the "Directive") can be harmonised with Article 63 of the Treaty on the Functioning of the European Union (TFEU). It argues that the essence of the Directive is to facilitate the aim of the TFEU, which is to create an internal market as an area without internal frontiers in which the free movement of capital is ensured.[1] The Directive would aid the free movement of capital by providing rules that 'prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures.'[2] Article 63 of the TFEU prohibits all restrictions on the free movement of capital; Article 9 of the Directive prohibits actions that would frustrate takeover bids; nevertheless, Article 12 of the Directive makes Article 9 optional. In order to harmonise takeovers with free movement of capital, this paper examines the extent to which the tension between capital movement and takeover rules might be resolved by the Court of Justice of the European Union (hereinafter referred to as the "Court"). Whilst this paper argues for negative integration to resolve the tension, it also suggests that strict negative integration is inadvisable since there seems to be a lack of political will in member states to eliminate takeover obstacles and an uncertain economic situation in the EU at present.

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[1] Article 26 of TFEU (Ex Article 14 TEC).

[2] Recital 3, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, Official Journal L142/12. The Takeover Directive is based on Article 50 of TFEU (ex Article 44 TEC).

This paper focuses on the free movement of capital and not freedom of establishment. Although among the four EU law freedoms[3] freedom of establishment and free movement of capital are the most relevant freedoms to company law, the latter is more important in the case of takeovers. The applicability of freedom of establishment to takeovers may often be seen to have been infringed when a takeover bidder has found it difficult to 'establish' him- or herself through takeovers of companies situated in another Member State. Nevertheless, the applicability of free movement of capital does not depend on the takeover bidder seeking to become established abroad, but it is relevant when a potential investor wishes to invest in company shares in another Member State.[4] Whilst Article 12 of the Directive makes both Articles 9 and 11 optional, either option being capable of creating tension between takeovers and TFEU provisions, this paper focuses on Article 9. In some Member States such as the UK, opting out of Article 11, which prohibits restrictions on share transfers, has a very limited effect on the free movement of capital, as the UK listing rules prevent listed companies from restricting the sale of shares.[5] This explains why this paper does not also consider freedom of establishment, Article 49 TFEU, and the breakthrough rule set out in Article 11 of the Directive.

One of the core provisions of the Directive is Article 9. This provides for Board neutrality during a takeover bid so as to prevent distorting patterns of corporate restructuring from occurring. Due to disagreements in the run-up to the adoption of the Directive, this core provision was made optional but this attracted negative criticism. In the UK, the then Chairman of the Takeover Panel concluded that the Directive 'is hardly a triumph for harmonisation since the contentious areas remain a matter for Member States to decide for themselves';[6] further, Eilis Ferran concluded that the Directive 'is an embarrassment for the EU: as much time and effort was spent to achieve so little'.[7] In its 2007 review of the implementation of the Directive, in reference to a number of Member States that have opted out of Article 9 of the Directive, the Commission found that 'a large number of Member States have shown strong reluctance to lift takeover barriers.'[8] In its 2012 review of the application of the Directive, the Commission found that 19 Member States have transposed Article 9, with 13 of those 19 Member States applying the reciprocity rule;[9] the findings of which hardly represent a 'success' for Article 9, as only 6 Member States have opted in to Article 9. The Directive's optionality has resulted in Member States' takeover rules being located somewhat further away from the Commission's ideal of a comprehensive mandatory board neutrality rule than was the case before the Directive was introduced.[10]

Article 12 of the Directive, which allows Member States to opt in or out of Article 9, effectively weakened the Directive and consequently made it incapable of effectively preventing patterns of corporate restructuring from being distorted. Optionality creates both differential applications of the Directive and obstacles to takeovers in the EU. Such an

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[3] See C. Barnard, *The Substantive Law of the EU: The Four Freedoms*, 3rd edn (Oxford: Oxford University Press, 2010).
[4] W.G. Ringe, "Company law and free movement of capital" (2010) 69 *Cambridge Law Journal* 378, 381.
[5] See G. Morse, *Charlesworth's Company Law*, 17th edn (London: Sweet & Maxwell, 2005) 223.
[6] P. Scott, "The Takeover Panel Report on the year ended 31 March 2004" (London: The Takeover Panel, 2004) 8.
[7] E. Ferran, *Building EU Securities Market* (Cambridge: Cambridge University Press, 2004) 117.
[8] European Commission, "Report on the implementation of the Directive on Takeover Bids" (Brussels, 21 February 2007) SEC(2007) 268, paragraph 3.
[9] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 7.
[10] P. Davies, E.P. Schuster and E. van de Walle de Ghelcke, "The Takeover Directive as a Protectionist Tool?" in U. Bernitz and W.G. Ringe (eds), *Company Law and Economic protectionism* (Oxford: Oxford University Press, 2010) 105, 152.

'optionality device ends up setting forth (or, better, tolerating) a Babel-like system for takeover defences around the various national legislations.'[11] Legal certainty is weakened by the reciprocity provision in Article 12(3), which allows companies in Member States that have opted in or out of Article 9 to change their decision when faced with a bidder who is not subject to the same rules.

The impact of accepting the Directive without Article 9 is that the Directive fails to meet its objective which is to facilitate corporate restructuring by removing takeover barriers. As a result of opting out of Article 9 of the Directive, as assessed by the Commission in its 2007 review, 'there is a risk that the Board neutrality rule, as implemented in Member States will hold back the emergence of a European market for corporate control, rather than facilitate it.'[12] With its aiming to make takeover safeguards uniform throughout the EU,[13] and to prevent patterns of corporate restructuring within the EU from being distorted by arbitrary differences in governance and management cultures (thereby removing barriers to takeovers),[14] the Directive intended to liberalise the market for corporate control. However, given the range of exemptions available and the current antipathy to hostile takeover activity in continental Europe, it is unlikely to be successful in liberalising the market for corporate control.[15]

This paper explores the effect of allowing Members States to opt out of Article 9 of the Directive and thereby creating barriers to takeovers, in the light of Article 63 of the TFEU. The 'acquisition of shares in a company incorporated in a Member State is covered by' Article 63 of the TFEU, 'and any restrictions on such an acquisition are prohibited.'[16] It argues that the creation of obstacles to takeovers undermines the free movement of capital. Free movement of capital for the purpose of Art 63(1) TFEU includes, in particular, investments in the form of a shareholding which confers the possibility of effective participation in the management and control of an undertaking ('direct investment') and the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence its management and control ('portfolio investments').[17] Member States have an obligation under Article 63 of the TFEU to refrain from adopting measures infringing the free movement of capital. Since the Directive allows for the creation of obstacles to takeovers under the optionality and reciprocity provisions in Article 12, it is unlikely that it acts as a defence for the breach of Member State's obligation under Article 63 TFEU.

The second section of this paper explores the need to harmonise takeovers and capital movement, considering the three levels of tension inherent in the Directive: the choice

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[11] M. Gatti, "Optionality Arrangements and Reciprocity in the European Takeover Directive" (2005) 6 *European Business Organization Law Review* 553, 567.

[12] European Commission, "Report on the implementation of the Directive on Takeover Bids" (Brussels, 21 February 2007) SEC(2007) 268, paragraph 3.

[13] Recital 1, Directive 2004/25/EC [2004] OJ L142/12.

[14] Rectal 3, Directive 2004/25/EC [2004] OJ L142/12.

[15] N. Moloney, "Financial Market Regulation in the Post-Financial Services Action Plan era" (2006) 55 *International Comparative Law Quarterly* 982, 983.

[16] D.A. Wyatt, "Horizontal Effect of Fundamental Freedoms and the Right to Equality after Viking and Mangold and the Implications for Community Competence" (2008) 4 *Croatian Yearbook of European Law & Policy* 1, 40; see also T. Papadopoulos, *EU Law and the Harmonisation of Takeovers in the Internal Market* (Kluwer Law International, 2010) 189.

[17] See Case C-222/97 *Manfred Trummer and Peter Mayer* [1999] ECR I-1661, para 21; Case C-483/99 *Commission v France* [2002] ECR I-4781, para 36-37; Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641, para 39-40; Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141, para 19); see also W.G. Ringe, "Is Volkswagen the new Centros? Free movement of capital's impact on company law" in D. Prentice and A. Reisberg, *Corporate Finance Law in the UK and EU* (Oxford: Oxford University Press, 2011) 465.

between permissive and prescriptive rules, minimum and exhaustive harmonisation measures, and optional and mandatory rules. The third section of this paper considers the extent to which the tension could be resolved by negative integration – looking at the jurisprudence of the Court and arguing that the Court is likely to find Member States that have applied Article 12 of the Directive in breach of their obligation under Article 63 TFEU. The fourth section of this paper looks at alternative means of harmonising takeovers and capital movement other than by negative integration and cautions against a strict negative integration approach, given the uncertainty of the political will in Member States to eliminate takeover obstacles and the uncertainty of the economic situation in the EU.

## The tension between takeovers and capital movement

Whilst Article 63 TFEU prohibits obstacles to capital movement,[18] supplemented by the board neutrality rule of Article 9 of the Directive that precludes directors from frustrating takeover bids,[19] Article 12 of the Directive makes the removal of obstacles that would frustrate takeover bids optional.[20] It is argued here that Article 12 of the Directive creates a tension between takeovers and capital movement, which occurs on three levels. Firstly, there is tension created by the choice between prescriptive rules and permissive rules. Secondly, there is tension created by the choice between minimum and exhaustive harmonisation. Thirdly, there is tension created by the choice between optional rules and mandatory rules. All three levels of tension between takeovers and capital movement are discussed in turn.

As regards the tension created by the choice between prescriptive and permissive rules, one of the objectives of the Directive is legal certainty on the conduct of takeover bids and community-wide clarity and transparency in respect of takeover bids.[21] It should therefore follow that rules adopted should create legal certainty for takeovers. On the one hand, 'without legal certainty, without reliable information, without clear framework rules, markets cannot work for long', and on the other hand, it 'is economic freedom that lets markets best play their role – legislation has to help, not hinder, this process.'[22] The question is whether, to achieve the objective of legal certainty, takeovers are best regulated under company law, which tends to be prescriptive, or under capital markets law,[23] which tends to be permissive.

Whereas takeovers belong to securities regulation in most Member States, the EU deals with takeovers under company law.[24] Furthermore, while the Directive relates to company law and its harmonisation process, it also seeks to regulate an important element of the functioning of capital markets: the public bid for all the shares of a company. This is unproblematic, except when capital markets law imposes substantial corporate governance

[18] Article 63(1) TFEU states: "Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

[19] Article 9(2) of the Directive provides: "…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 and in particular before issuing any shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company …"

[20] Article 12(1) of the Directive provides: "Member States may reserve the right not to require companies as referred to in Article 1(1) which have their registered offices within their territories to apply Article 9(2) …"

[21] European Commission, *Report on the application of Directive 2004/25/EC on takeover bids* (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 1.3.

[22] C. McCreevy, "The Commission's Financial Services Policy 2005-2010" (2005) Exchange of Views on Financial Services Policy 2005-2010 Conference, Brussels, 18 July 2005.

[23] Capital markets law also refers to securities regulation, which terms are often used interchangeably.

[24] E. Wymeersch, "About techniques of regulating companies in the EU" in G. Ferrarini (ed), *Reforming company and takeover law in Europe* (Oxford: Oxford University Press, 2004) 150.

rules on all companies accessing its market.[25] It is therefore argued that Article 9 of the Directive is a typical company law measure, which strikes at the heart of the diverse corporate governance structures in the EU, but simultaneously imposes a prescriptive requirement of Board neutrality during any bid on an important capital markets law element of regulation of public takeover bids. This is an imposition which most Member States see as a measure beyond the confines of their understanding of capital markets law.

The use of company law and capital markets law in the Directive is problematic. Whereas the EU deals with takeovers as part of company law and to that extent applies prescriptive rules under Article 9 of the Directive, it also applies a capital markets law permissive approach in making Article 9 optional under Article 12. The permissive rule of Article 12 was reached as a compromise due to the varied corporate structures across the EU, especially as takeovers belong to capital markets law in most Member States. For example, Germany with its highly concentrated share-ownership structures found no room for Article 9 of the Directive. In fact, it 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'.[26] In a 273-273-tie vote on 4 July 2001 a German MEP-led coalition in the European Parliament rejected a text that was heavily influenced by the UK's City Code on Takeovers and Mergers.[27] In the UK, takeovers belong to company law and apply the prescriptive rule of board neutrality, which most Member States do not welcome.

The diverse equity markets in the EU, with dispersed and concentrated ownership structures, make the policing of takeovers by prescriptive rules of company law difficult. In such social markets, with concentrated ownership structures, takeovers hardly thrive. In concentrated ownership markets, management often have a close relationship with shareholders or own substantial numbers of shares; this means it is easy for them to dissuade shareholders from tendering their shares. As a result, David Hahn observes that management would be likely to persuade large stable shareholders not to tender their shares to outside bidders.[28] As observed by Hahn, Germany, France and Italy are concentrated ownership markets with less developed equity markets,[29] while the UK has a well-developed liquid equity market, with more corporations listed per capita than in any other country.[30] Takeovers thrive in dispersed ownership markets like the UK, as does the prescriptive rule of Board neutrality. With the EU's diverse equity market structures, it is no wonder that agreeing on a prescriptive rule for Article 9 of the Directive proved to be such an arduous task until a permissive Article 12 was agreed.

It is argued here that to achieve legal certainty prescriptive rules are necessary. The question then is how to apply a prescriptive approach of company law to a Directive which itself implicitly admits a permissive approach of capital markets law by virtue of Article 12 of the Directive. One answer to this question is to appeal to the jurisprudence of the Court. In its broader jurisprudence, the Court regards EU treaties as having the effect of limiting

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[25] J. Winter, "EU Company Law at the cross-roads" in G. Ferrarini (ed), *Reforming company and takeover law in Europe* (Oxford: Oxford University Press, 2004) 12.
[26] K.J. Hopt, "Takeover regulation in Europe – The battle for the 13th directive on takeovers" (2002) 15 *Australian Journal of Corporate Law* 1, 10.
[27] M. Gatti, "Optionality Arrangements and Reciprocity in the European Takeover Directive" (2005) 6 *European Business Organization Law Review* 553, 561.
[28] D. Hahn, "Concentrated ownership and control of corporate reorganisations" (2004) *Journal of Corporate Law Studies* 117, 129.
[29] D. Hahn, "Concentrated ownership and control of corporate reorganisations" (2004) *Journal of Corporate Law Studies* 117, 132.
[30] D. Hahn, "Concentrated ownership and control of corporate reorganisations" (2004) *Journal of Corporate Law Studies* 117, 134.

Member States' 'sovereign rights' and creating 'a body of law which binds' Member States and 'their nationals'.[31] In its specific case law on takeovers, the Court has shown through the golden shares cases that certain measures in share dealings can restrict the free movement of capital under the TFEU.[32] This calls for an analysis of how opting out of Article 9 of the Directive might be interpreted as a restriction on the free movement of capital and a breach of Article 63 TFEU. First, though, it is necessary to consider the second level of tension between takeovers and capital movement rules, i.e. the tension created by the choice between minimum and exhaustive harmonisation.

One of the objectives of the Directive is to facilitate takeover bids by ensuring the freedom to deal in and vote on the securities of companies and to prevent operations which could frustrate a bid.[33] The Directive requires takeover rules to help shareholders to deal in and vote on the securities of a company and for management to be neutral during a takeover bid. Reinforcing such shareholder freedom to deal in and vote on securities across the EU, involves a choice between minimum and exhaustive harmonisation. Takeovers are at the heart of the internal market. Certainly, minimum harmonisation is not appropriate for areas that are at the heart of the internal market.[34] However, since the Directive was adopted as a minimum harmonisation measure,[35] this choice creates tension between takeovers and capital movement, in the context of the internal market.

Since EU law is by definition supranational, harmonisation is one of its *raisons d'etre*.[36] Thus, it is argued here that, with hindsight, minimum harmonisation was not the best way to adopt the Directive, especially given the need to align it with the free movement of capital. With diverse corporate structures, dispersed and concentrated ownership structures, it is difficult to have rules that will appeal to all Member States. For example, the mandatory bid rule impedes the takeover of a typical German company, with its controlling owner, but not that of a typical UK company, with its dispersed ownership.[37] The mandatory bid rule would have brought a gloss of exhaustive harmonisation across the EU, if it were not for the wide range of national derogations.[38] Whilst the Directive had envisioned making takeover safeguards uniform throughout the Union,[39] exhaustive harmonisation would have secured equivalent safeguards and a mandatory Article 9 would have met the objective of reinforcing the freedom to deal in and vote on securities. Unfortunately, the diverse corporate structures meant the Directive was adopted as a harmonisation measure.

Adopting the Directive as a harmonisation measure was bound to fail to harmonise takeovers and align them with capital movement in the internal market; to that extent the Directive hardly achieved any harmonisation. Perhaps it is this mismatch of the choice

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[31] Case 6/64 *Flaminio Costa v ENEL* [1964] ECR 585.

[32] See Case C-463/00 *Commission v Spain* [2003] ECR I-4581; Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641.

[33] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 3.

[34] M. Dougan, "Minimum harmonisation and the internal market" (2000) 37 *Common Market Law Review* 853, 860.

[35] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 2.

[36] M. Burkart and F. Panunzi, "Mandatory bids, squeeze-out and the dynamics of the tender offer process" in G. Ferrarini and Others (eds), *Reforming Company and Takeover Law in Europe* (Oxford: Oxford University Press, 2004) 737, 744.

[37] M. Burkart and F. Panunzi, "Mandatory bids, squeeze-out and the dynamics of the tender offer process" in G. Ferrarini and Others (eds), *Reforming Company and Takeover Law in Europe* (Oxford: Oxford University Press, 2004) 737, 744.

[38] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 17.

[39] Recital 1, Directive 2004/25/EC [2004] OJ L142/12.

between minimum and exhaustive harmonisation measures that led to the conclusion that most EU 'corporate law rules can be categorised as optional, market-mimicking, unimportant or avoidable'.[40] Minimum harmonisation creates a tension between takeovers and capital movement. This perhaps explains why, in its review of the implementation of the Directive, the Commission found that 'a large number of Member States has shown strong reluctance to lift takeover barriers,' and by applying Article 12 of the Directive, the Commission observed that 'the number of Member States implementing the Directive in a seemingly protectionist way is unexpectedly large.'[41]

The tension created by the choice between optional rules and mandatory rules also needs careful consideration. One of the objectives of the Directive is to reinforce the single market by enabling the free movement of capital throughout the EU.[42] One way of reinforcing the single market as an area without internal frontiers in which free movement of capital is ensured[43] is to facilitate corporate restructuring by regulating takeovers. This requires takeover rules to be in harmony with movement of capital rules, so as to prevent frustrating takeover bids and to facilitate the free flow of capital. While the free movement of capital is one of the fundamental freedoms laid down in the TFEU[44] and in this context a mandatory rule, reinforced by the board neutrality rule of Article 9 of the Directive, it is rendered illusory by the optionality provision in Article 12 of the Directive. Since some Member States have opted to apply Article 12 of the Directive, while other Member States have not done so, this not only creates tension of rules across the EU but also creates 'discrimination with respect to defensive measures against hostile takeovers.'[45] The argument here is that to reinforce the single market aims takeovers are best regulated by mandatory rules rather than optional rules.

The question is whether Article 12, which reduces what would have been a mandatory measure of Article 9 of the Directive to an optional measure, can be applied or interpreted to conform to Article 63 TFEU. This leads to the question of whether Article 63 TFEU has a direct effect such that the optional provision of Article 12 of the Directive could be bypassed. The Court historically construed the earlier version of Article 63 TFEU on free movement of capital, Ex Article 67 EEC, as only effective 'to the extent necessary to ensure the proper functioning of the common market'.[46] By then, Ex Article 67 EEC had not abolished all restrictions to free movement of capital. In reinforcing the single market, the abolition of all restrictions to free movement of capital was introduced by secondary legislation under Directive 88/361.[47] This was later adopted thanks to an amendment to the primary legislation, now contained in Article 63 TFEU, which the Court has held to have direct effect.[48] It is argued here that the mandatory nature of Article 63 TFEU requires mandatory takeover rules in order to harmonise takeovers with the free movement of capital. It is further

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[40] L. Enriques, "EC company law Directives and Regulations: how trivial are they?" (2005) ECGI Law Working Paper number 39, 5.
[41] European Commission, "Report on the implementation of the Directive on Takeover Bids" (Brussels, 21 February 2007) SEC(2007) 268, para 3.
[42] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 1.3.
[43] Article 26 of TFEU (Ex Article 14 TEC).
[44] For a detailed discussion of free movement of capital, see P. Oliver and W.H. Roth "The internal market and the four freedoms" (2004) 41 *Common Market Law Review* 407; L. Flynn, "Coming of age: The free movement of capital case law 1993-2002" (2002) 39 *Common Market Law Review* 773.
[45] M. Siems, "*SEVIC*: Beyond Cross-Border Mergers" (2007) 8 *European Business Organization Law Review* 307, 315.
[46] Case 203/80 *Casati* [1981] ECR 2595 para 10.
[47] [1988] OJ L178/5.
[48] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 41; Joined Cases C-358/93 and C-416/93 *Aldo Bordessa and Others* [1995] ECR I-361 para 33.

argued that in cases where Article 12 of the Directive is not in harmony with Article 63 TFEU, the latter should prevail.

As one of the objectives of regulating takeovers is to reinforce the single market by enabling the free movement of capital throughout the EU, it is important that any secondary legislation is not applied in a manner that trumps the provisions of primary legislation. The Directive facilitates the free movement of capital if the Directive removes all restrictions to the acquisition of shares in the process of corporate restructuring in the EU. To the extent that Article 63 TFEU has this direct effect,[49] it can arguably be invoked independent of the Directive. As such, a measure that is allowed in secondary legislation, the Directive, can be found to be in violation of Article 63 TFEU. Contrary to the single market aim, opting to frustrate takeover bids by virtue of Article 12 of the Directive would be a breach of Article 63 TFEU, if Article 12 of the Directive is construed as (a) a State measure, which (b) restricts or renders illusory the free movement of capital, and (c) the State has no justification under EU law to so restrict.

This all assumes that the acquisition of shares is movement of capital. Whilst what amounts to movement of capital is not defined in the TFEU, it is certainly not to be construed literally as in filling a car with money and moving it across the border.[50] In defining what capital is, the Court adopted the definition contained in the annex to Directive 88/361, and held that acquisition of shares on the capital market for the purpose of a financial investment constitutes movement of capital,[51] and, further, that the resale of shares to the issuing company constitutes movement of capital.[52] As such, the application of Article 63 is broad enough to cover all kinds of investments by both natural and legal persons, and includes shares or any form of share capital.[53] Article 12 of the Directive violates Article 63 TFEU to the extent that it restricts cross-border acquisitions. Thus, it would be a violation of EU law if companies from one Member State were prohibited from buying the shares of a company in another Member State.[54]

Article 9 of the Directive seeks to reinforce the single market by outlawing internal obstacles to the free movement of capital in the form of share acquisitions. Paradoxically, the Directive is a secondary legislation duly enacted by EU institutions. Nevertheless, its optional provision is at odds with the mandatory provision of Article 63 TFEU, which creates uncertainty in the legal situation of its Member States. However, Member States would not be justified in restricting capital movement by virtue of Article 12 of the Directive. The Court has ruled that it is not possible to justify a failure to fulfil an obligation by invoking the uncertainty of the legal situation in which the Member State finds itself, and against which the Treaty affords it means of action.[55] In an analogous case that concerned the free movement of goods, the Court said that it is 'not for the Community institutions to act in place of the Member States and to prescribe for them the measures which they must adopt in order to safeguard the free movement of goods.'[56] As such, the Court is likely to find that notwithstanding Article 12 of the Directive, Member States ought to adopt measures that effectively safeguard the free movement of capital. It is for the Member States to resolve the

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[49] Joined Cases C-358/93 and C-416/93 *Aldo Bordessa and Others* [1995] ECR I-361 para 33; Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 41.
[50] Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 33.
[51] Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-000 para 19.
[52] Case C-265/04 *Bouanich v Skatteverket* [2006] ECR I-923 para 29.
[53] See M. Andenas, T. Gutt and M. Pannier, "Free movement of capital and national company law" (2005) 16 *European Business Law Review* 757, 766.
[54] M. Siems, "*SEVIC*: Beyond Cross-Border Mergers" (2007) 8 *European Business Organization Law Review* 307, 315.
[55] Case 7/71 *Commission v France* [1971] ECR 1003 (Judgment of the Court of 14 Decmber 1971), para 47.
[56] For example, in Case C-265/95 *Commission v France* [1997] ECR I-6959, paras 33-35.

conflict between the mandatory Article 63 TFEU and the optional Article 12 of the Directive by refraining from applying the latter.

**Negative integration of takeovers and capital movement**

Appealing to the jurisprudence of the Court is here suggested as one means of ensuring that there will be legal integration of takeovers and capital movement so as to avoid any apparent tension. This is based on the understanding that, negative integration, striking down by the Court of national barriers to cross-border business activity, has become more influential.[57]

Paul Davies and colleagues observed that it is politically impossible, for the Commission to challenge decisions made by Member States by taking up options explicitly provided for in the Takeover Directive.[58] However, they also noted that any association between choices under the Directive and economic nationalism can be tested indirectly by looking at Commission challenges to non-takeover but related national legislation on the ground that it infringes either or both of the Treaty provisions on free movement of capital and freedom of establishment within the EU.[59] In these situations, according to Davies and colleagues, the Commission would be explicitly acting to protect the interests of acquirers from other Member States.[60] Relying on the jurisprudence of the Court, this paper assesses the potential infringement of Article 63 TFEU given the choices of Member States.

Gerard Hertig and Joseph McCahery observe that the shift from a mandatory towards a legal options oriented approach probably reflects opportunistic considerations.[61] They point out that the repeated failures in getting the Directive adopted and the need to finally show some results (regardless of their substance) paved the way for what many observers considered to be a desperate one-off move. They further observe that, 'the EC probably also hoped to thus reignite support for (mandate-oriented) EU corporate law-making by those Member States likely to suffer from emerging regulatory arbitrage and competition.'[62] What needs to be highlighted here is the significance of assessing, in regard to the Directive, one of the arguments Hertig and McCahery make, which states that 'the use of options should permit the EC and Member States to limit the risk of disruptive ECJ intrusions in the company lawmaking process.'[63]

The question is whether the intrusion of the Court can be limited where the Directive defeats the aim of establishing a single market under the Treaty. The Directive is meant to reinforce the single market by enabling the free movement of capital throughout the EU. However, the lawmaking process that shifted from mandatory provisions to optional

[57] W.G. Ringe, "Is Volkswagen the new Centros? Free movement of capital's impact on company law" in D. Prentice and A. Reisberg, *Corporate Finance Law in the UK and EU* (Oxford: Oxford University Press, 2011) 461, 462.
[58] P. Davies, E.P Schuster and E. van de Walle de Ghelcke, "The Takeover Directive as a Protectionist Tool?" in U. Bernitz and W.G. Ringe (eds), *Company Law and Economic protectionism* (Oxford: Oxford University Press, 2010) 105, 143.
[59] P. Davies, E.P Schuster and E. van de Walle de Ghelcke, "The Takeover Directive as a Protectionist Tool?" in U. Bernitz and W.G. Ringe (eds), *Company Law and Economic protectionism* (Oxford: Oxford University Press, 2010) 105, 143.
[60] P. Davies, E.P Schuster and E. van de Walle de Ghelcke, "The Takeover Directive as a Protectionist Tool?" in U. Bernitz and W.G. Ringe (eds), *Company Law and Economic protectionism* (Oxford: Oxford University Press, 2010) 105, 143.
[61] G. Hertig and J.A. McCahery, "Optional rather than mandatory EU company law: Framework and specific proposals" (2006) 3 *European Company and Financial Law Review* 341.
[62] G. Hertig and J.A. McCahery, "Optional rather than mandatory EU company law: Framework and specific proposals" (2006) 3 *European Company and Financial Law Review* 341, 345.
[63] G. Hertig and J.A. McCahery, "Optional rather than mandatory EU company law: Framework and specific proposals" (2006) 3 *European Company and Financial Law Review* 341, 343.

provision of Article 12 of the Directive hardly reinforces the single market, for it simply entrenches the diverse corporate cultures that existed in the EU prior to the Directive. The Court has said that, 'the Treaty, by establishing a common market and progressively approximating the economic policies of the Member States, seeks to unite national markets into a single market having the characteristics of a domestic market.'[64] Rather than limit the intrusion of the Court, the shift from mandatory to optional provisions in the Directive, creating tension between takeovers and capital movement, invites the intrusion of the Court to align the two.

The Court has defined the concept of a common market as involving 'the elimination of all obstacles to intra-Community trade in order to merge the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market.'[65] With the Treaty requiring the abolition of obstacles to free movement of capital in order to create a single market, it is difficult to see how the Court would not find objectionable Article 12 of the Directive that makes the abolition of those obstacles optional. Negative integration can be used to align takeovers with free movement of capital, as the Court is likely to find that a Member State that applies Article 12 of the Directive infringes Article 63 TFEU. This is because Article 12 has the effect of restricting takeovers and to that extent 'dissuade investors in other Member States from investing in the capital of those undertakings', rendering 'the free movement of capital illusory', and therefore constituting 'a restriction on movements of capital'.[66]

In finding whether a Member State is in breach of Article 63 TFEU, two models are usually applied: the 'non-discrimination model' and the 'no-restriction model.'[67] This is not ideal since the non-discrimination model is difficult to defend as it either violates the no-restriction model by justifying a restriction if it is not 'substantial' or adopts the approach sometimes taken by the Court in relation to other freedoms. The court has made it clear in a number of decisions that breach of Article 63 TFEU does not depend on discrimination.[68] Article 63 TFEU prohibits not only discriminatory or particularly restrictive treatment of nationals of other Member States, but every restriction of cross-border transfer of capital.[69] For this reason, the requirement of the free movement of capital is infringed if the measure applies equally but dissuades investors from other Member States.[70] Hence, it would appear that the Court applies the non-restrictive model in finding whether there is a breach of Article 63 TFEU.

Although Article 63 TFEU and Article 9 of the Directive use different terminologies, prohibiting 'restrictions' and 'obstacles' respectively, this does not challenge the harmony required between the two. The Court uses both terminologies interchangeably. For example, in *Commission v Netherlands*,[71] the court referred to both 'restrictions' and 'obstacles' to free movement of capital and referred to an 'obstacle to the movement of capital' in *Sandoz*.[72] In

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[64] Case 270/80 *Polydor v Harlequin* [1982] ECR 329 para 16.
[65] Case 15/81 *Gaston Schul Douane Expediteur BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal* [1982] ECR 1409 para 33.
[66] See Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.
[67] See C. Barnard, *The substantive law of the EU: The four freedoms*, 2nd edn (Oxford: Oxford University Press, 2007) 532-563.
[68] Cases C-367/98 *Commission v Portugl* [2002] ECR I-4731 para 44-45; C-174/04 *Commission v Italy* [2005] ECR I-4933 para 12.
[69] M. Andenas, T. Gutt and M. Pannier, "Free movement of capital and national company law" (2005) 16 *European Business Law Review* 757, 769.
[70] Cases C-250/94 *Sanz de Lera and Others* [1995] ECR I-4821 para 25; C-302/97 *Klaus Konle v Republik Oesterreich* [1999] ECR I-3099 para 44.
[71] Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-000 para 20.
[72] Case C-439/97 *Sandoz GmbH v Finanzlandesdirektion fur Wien, Niederosterreich und Burgenland* [1999] ECR I-7041 para 20.

such a case, any 'obstacle' to takeovers will amount to a 'restriction' contrary to Article 63 TFEU. Such restriction to movement of capital need not be substantial; it suffices that it 'dissuades investors in other Member States from investing', and it is irrelevant that the measure does 'not give rise to unequal treatment.'[73] Where a Member State has opted out of Article 9 of the Directive, 'if the management uses defensive mechanisms this could be either a direct barrier to the acquisition of shares but also a restriction of shareholder rights which make the investment into the company less attractive.'[74] It is irrelevant that the measure applies equally to domestic and to foreign investors. Provided the measures are liable to render free movement of capital illusory, which may make the investment into the company less attractive, it will constitute a breach of Article 63 TFEU.

It is not easy for a Member State to justify a breach of Article 63 TFEU. In *Commission v Portugal*,[75] the Court decided that a restriction to free movement of capital can be justified if (a) overriding requirements of general interest apply; or (b) express derogations in Article 65 TFEU (Ex Article 58) apply, and the measure accords with the principle of proportionality. Article 65 TFEU derogations essentially apply on the basis of taxation and public policy or security. These are difficult to invoke when a Member State wishes to restrict free movement of capital. The Court interprets these derogations very strictly.[76] As such, in derogations affecting takeovers, the ostensible ground for any such derogation would take the form of economic protection. The Court has, however, ruled that these derogations cannot be applied to serve purely economic ends.[77] In *Commission v Portugal* the court said that 'economic grounds can never serve as justification for obstacles prohibited by the Treaty'.[78] A Member State would find it difficult to successfully raise justification for breach of Article 63 TFEU.

The Takeover Directive is a product of over thirty years of political haggling. The resulting 'Thirteenth Directive' was a compromise with many options, choices and much discretion for the Member States.[79] The effects of disagreements and political compromises are reflected in Article 12, which was enshrined into the Directive. The question is whether the Court should take into account the long history of the Directive if called upon to decide on the implications of Article 12. It is argued here that the Court should not be bound to consider any underlying political compromises. The language of Article 63 TFEU and the line of consistent Court decisions are uncompromising. One can only speculate that, had Member States applying Article 12 of the Directive known that such an option would not limit the Court's intrusion, they might have voted differently in order to defeat the adoption of the Directive. It is argued here that the optional choice of lawmaking seen in Article 12 of the Directive does not limit the intrusion of the Court to further promote the single market concept. This is assessed in light of the Court's decisions in the 'golden share' cases,[80] which, together with other Court cases, are worth reviewing.

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[73] Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.

[74] M. Andenas, T. Gutt and M. Pannier, "Free movement of capital and national company law" (2005) 16 *European Business Law Review* 757, 778.

[75] Case C-367/98 *Commission v Portugal* [2002] ECR I-4731.

[76] see Case 36/75 *Rutili v Minister of the Interior* [1975] ECR 1219 para 26/27.

[77] Case 36/75 *Rutili v Minister of the Interior* [1975] ECR 1219 para 30.

[78] Case C-367/98 [2002] ECR I-4731 para 52.

[79] J. Armour and W.G. Ringe, "European Company Law 1999-2010: Renaissance and Crisis" (2011) ECGI Law Working Paper Number 175, paragraph 4.3.

[80] For context, a 'golden share' is a term used to denote a special share held by the State in a privatised company, which is usually held for the purpose of protecting the company from being subject to a takeover. A golden share is like a poison pill in regard to takeovers, for it gives the State power to restrict acquisition of shares in a company, making it difficult for hostile takeovers. It is to the extent of this restrictive power that the Court found golden shares objectionable as being contrary to both freedom of establishment and free movement of capital.

In 2000, in *Commission v Italy*,[81] the first golden shares case, the Court ruled that Italy was in breach of its Treaty obligation on free movement of capital by adopting special rights in the shares of companies in the energy and telecommunications sectors. It was no defence that the measures adopted by the Italian government had been pursuant to secondary EU law in the decree of the President of the Council of Ministers of 4 May 1999 (GURI 1999, No 109) and that these had been communicated to the Commission. The Commission had argued that the special shareholding powers allowed by the President of the Council of Ministers were liable to hinder or render less attractive the exercise of the fundamental freedoms guaranteed by the Treaty, unless they were justified, and the Commission considered that those special powers were incompatible with the Treaty. What this case demonstrates is that it is no defence for breach of Treaty obligation to refer to secondary EU law. Therefore, Member States applying Article 12 of the Directive would not find it a defence for breach of Article 63 TFEU.

In 2002, in three golden share cases in *Commission v Portugal*,[82] *Commission v France*,[83] and *Commission v Belgium*,[84] the Court found the Portuguese, French and Belgian golden share arrangements to be unlawful and contrary to Article 63 TFEU. In the Portuguese companies, the golden shareholding accorded the State power to limit participation by non-nationals and to establish a procedure for the grant of prior authorisation by the Minister of Finance once the interest of a person acquiring shares in a privatised company exceeded a ceiling of 10 per cent. In the French company (Société Nationale Elf-Aquitaine), the golden shareholding accorded the State power to approve in advance any acquisition of shares or rights that exceeded established limits on the holding of capital and to oppose decisions to transfer shares or use them as security.

The Court concluded that legislation which is liable to impede the acquisition of shares in the undertakings concerned, and dissuade investors in other Member States from investing in the capital of those undertakings, may render the free movement of capital illusory, and it thus constituted a restriction on movements of capital. In the case of Belgium, the Court found that, by maintaining in force the national provisions vesting in the Belgian State a golden share in Société Nationale de Transport par Canalisations, which carried special rights, including appointing two representatives of the Federal Government to the board of directors of the company who had power to annul any decision by the board of directors, the Belgian State was in breach of its Treaty obligation on free movement of capital. Conversely, a Member State that applies Article 12 of the Directive thereby retains obstacles or restrictions to takeover bids and to that extent dissuades investors in other Member States from investing in the capital of undertakings situated in that Member State. In so doing, the Member State would be in breach of its Treaty obligation on the free movement of capital.

In 2003 in two golden share cases, *Commission v Spain*[85] and *Commission v United Kingdom*,[86] the Court found that the golden share arrangements applicable to the undertakings in Spanish companies (Repsol, Telefónica, Argentaria, Tabacalera, Endesa) and a British company (British Airports Authority (BAA)) were contrary to the principle of the free movement of capital. In the Spanish companies, the golden share meant that the State had the power to restrict and approve certain decisions, including mergers or change of corporate objects or the disposal of certain assets or shareholdings in those companies. In the

[81] Case C-58/99 *Commission v Italy* [2000] ECR I-03811.
[82] Case 367/98 *Commission v Portugal* [2002] ECR I-4731.
[83] Case C483/99 *Commission v France* [2002] ECR I-4781.
[84] Case C-503/99 *Commission v Belgium* [2002] ECR I-04809.
[85] Case C-463/00 *Commission v Spain* [2003] ECR I-4581.
[86] Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641.

British company, BAA, the golden shares created power for the State to restrict and approve certain decisions, including the disposal of an airport and the acquisition of more than 15 per cent of the voting shares in a company.

In the Court's view, investments in the form of participations, constituted movements of capital under EU legislation. On that basis, the Court found that both the Spanish and the UK golden share rules entailed restrictions on the free movement of capital between Member States. Although Member States can justify restrictions in limited circumstances under the Treaty, the Court found that the restrictions failed the test of proportionality, i.e. the restrictions went beyond what was necessary in order to attain the objective they pursued. Member States applying Article 12 are unlikely to find justification for infringing Article 63 TFEU.

In 2005, in *Commission v Italy*,[87] although the case was not per se a golden share case, it concerned an Italian Decree-Law No 192/2001, the effect of which was contrary to Article 63 TFEU. The Decree-Law, insofar as it was concerned solely with public undertakings, was designed to exclude State influence but had a proviso for the automatic suspension of voting rights attaching to holdings in excess of 2% of the capital of undertakings operating in the electricity and gas sectors. This proviso, the Italian Government unsuccessfully argued, was to safeguard the supply of energy within Italian territory. The Court found that the suspension of voting rights meant that the category of public undertakings concerned was precluded from participating effectively in the management and control of Italian undertakings operating in the electricity and gas markets, which, in turn, had the effect of dissuading public undertakings established in other Member States from acquiring shares in Italian undertakings operating in the energy sector, contrary to Article 63 TFEU. This case demonstrates that the Court is likely to rule that application of Article 12 of the Directive has the effect of dissuading undertakings established in other Member States from acquiring shares in a Member State which has opted into Article 12 and thereby retained takeover obstacles.

In 2007 in *Commission v Germany*,[88] a case that is not a classic golden share case but one which has a restrictive State measure, the Court held that by maintaining in force certain provisions or State measures in the Volkswagen Law (VW Law), Germany had failed to fulfil its obligations under Article 56(1) EC (now Article 63(1) TFEU). The provisions of the VW Law gave the Federal State and the Land of Lower Saxony the ability to exercise a greater level of influence than would normally be linked to their investment. The Commission successfully argued that various disputed provisions of the VW Law were likely to deter direct investment: limiting the voting rights of every shareholder to 20% of Volkswagen's share capital; requiring a majority of over 80% of the shares represented for resolutions of the general assembly, allowing the Federal State and the Land of Lower Saxony each to appoint two representatives to the company's supervisory board. It concluded that all of these actions would be contrary to the general law so would constitute restrictions on the free movement of capital within the meaning of now Article 63 TFEU. The Court agreed with the Commission. This case therefore demonstrated that any State measure which included measures adopted pursuant to Article 12 of the Directive which might deter direct investment would constitute a restriction on the free movement of capital within the meaning of what is now Article 63 TFEU.

In 2010, in *Commission v Portugal*,[89] the Court ruled that by maintaining special rights in Portugal Telecom allocated in connection with the State's golden shares, the Portuguese Republic had failed to fulfil its obligations under Article 56 EC (now Article 63

[87] Case C-174/04 *Commission v Italy* [2005] ECR I-04933.
[88] Case C-112/05 *Commission v Germany* [2007] ECR I-08995.
[89] Case C-171/08 *Commission v Portugal* [2010] ECR I-06817.

TFEU). In this case, golden shares had been acquired legitimately under Portuguese national law under Article 15(3) of the Framework Law on Privatisations (Lei Quadro das Privatizaçoes) of 5 April 1990, which provided for the possibility of creating golden shares; nevertheless, national law was no defence to a breach of Article 63 TFEU. In reference to the Directive, it is argued here that any national law that applies Article 12 of the Directive in a manner resulting in that Member State failing to fulfil its obligation under Article 63 TFEU would not be a defence.

A review of the above cases clearly suggests that Article 12 of the Directive is very likely to 'dissuade investors' from investing in the capital of those companies.[90] To that extent, such optionality would be contrary to Article 63 TFEU by which Member States have the obligation to ensure that companies under their jurisdiction comply. As such, a Member State that has applied Article 12 of the Directive is very likely, in the light of the golden share cases, to be found infringing Article 63 TFEU. Article 12 of the Directive does not limit but rather invites the intrusion of the Court to align takeovers to free movement of capital.

Negative integration would have been more effective by the use of Article 263 TFEU but for the missed opportunity. The point being argued here is Article 12 of the Directive would have been subject to annulment if the matter had been brought to the Court. This would have been based on the principle that EU institutions cannot avoid judicial review of whether the measures adopted by them are in conformity with the basic constitutional charter, the Treaty.[91] All acts of institutions 'must be open to judicial review',[92] and a legal action must be available for 'all measures adopted by the institutions, whatever their nature or form, which are intended to have legal effect.'[93] Where actions for annulment are brought in time the Court has shown its willingness to annul secondary legislations in part or in entirety.[94]

As it is too late for action for annulment under Article 263 TFEU, the option now is for Article 12 of the Directive to be read in conformity with Article 63 TFEU, or to the extent that it does not conform, to be declared incompatible with Article 63 TFEU. The Commission could litigate for infringement of Article 63 TFEU. Perhaps in the current economic situation, there is no incentive for the Commission to litigate infringement of Article 63 TFEU on the basis of application of Article 12 of the Directive. In the drafting stages of the Directive, the Commission resisted making Article 9 optional but it now seems to accept the situation, concluding that 'it does not seem appropriate at this stage to propose to make the optional articles of the Directive mandatory.'[95] Nevertheless, it does not negate the legal analysis herein that the optional Article 12 of the Directive contravenes the mandatory Article 63 TFEU.

The alternative would be for the affected participants to bring an action before their national courts for infringement of Article 63 TFEU. Like any other form of TFEU freedoms,[96] free movement of capital is directly applicable.[97] In that case, private parties such

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[90] See Case C-250/94 *Sanz de Lara and Others* [1995] ECR I-4830 para 41; and Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para 45.

[91] Case 294/83 *Parti ecologiste 'les verts' v European Parliament* [1986] ECR 1339, para 23.

[92] Case T-411/06 *Sogelma v European Agency for Reconstruction* [2008] ECR II-2771, para 37; for general discussion see A. von Bogdandy and J. Bast (eds), *Principles of European Constitutional Law*, R'sed 2nd edn, (Oxford: Hart Publishing, 2009) 368.

[93] Case 22/70 *Commission v Council* [1971] ECR 263, para 42.

[94] For example, Case C-84/94 *United Kingdom v Council* [1996] ECR I-5755, and Case C- 376/ 98 Germany v European Parliament and Council [2000] ECR I-8419, para 89 and 101.

[95] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, paragraph 4.26.

[96] For instance, free movement of goods, see C-74/76 *Ianelli & Volpi/Meroni* [1977] ECR I-557 para 13; free movement of workers, see C-48/75 *Royer* [1976] ECR I-497 para 19/23; freedom of establishment, see C-2/74 *Reyners* [1974] ECR I-631 para 29/31; and free movement of services, see C-33/74 *Van Binsbergen* [1974] ECR I-1299.

as potential bidders of a blocked takeover affected by how Member States have applied Article 12 of the Directive, would not need to seek legal redress by virtue of the Directive but they would be able to invoke a breach of Article 63 TFEU directly. An action for breach of Article 63 TFEU before national courts might force a reference to the Court of Justice of the European Union. If the national courts refused to refer the matter to the Court of Justice of the European Union or ruled in a manner that still infringed Article 63 TFEU, such an outcome would make the State liable for infringement of EU law. Infringement of EU law by the national authorities (which includes national courts), might then be brought before the Court of Justice of the European Union by the Commission under Article 258 TFEU.[98]

**Interaction of takeovers and capital by compromise**

The historical difficulties leading up to the adoption of the Directive have continued to hamper harmonising takeovers with the free movement of capital. It is argued elsewhere that the difficulties were borne from the tension between the wider aim of achieving an integrated internal market for Europe and satisfying the unity of Member States with diverse corporate governance structures and cultures.[99] Ben Pettet,[100] commenting on these difficulties, suggested that there was probably a cultural antipathy in some countries to the idea of using the threat of a hostile bid as a spur to management, which might be why we commonly find their companies have elaborate and entrenched anti-takeover devices.[101] These anti-takeover devices have the potential to dissuade investors. The Commission observed that these defences make takeovers more difficult or costly and they consequently entrench management and render companies immune to unfriendly raiders.[102] The Directive has had no effect on the culture of takeover defences: a high number of mostly pre-bid defences are still used in Europe.[103] In their study into the impact of the Directive's optionality based on an analysis of the formal rules adopted pre- and post-transposition, Davies and colleagues found that there has been a significant shift away from bidder friendliness in the transposition process.[104] The effect of Article 12 is clear: entrenched diverse corporate governance cultures in Europe continue to hamper harmonising of takeovers with capital movement.

As positive integration seems unable to resolve the tension between the Directive and the Treaty, and perhaps with the need for judicial self-restraint in resolving the tension through strict negative integration, it is a question of whether appropriate safeguards could be implemented in applying takeover defences by virtue of Article 12 of the Directive. Arguably, subject to appropriate safeguards, Boards should be able to take defensive

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[97] See C-358/93 *Aldo Bordessa* [1995] I-0361 para 17.

[98] M. Taborowski, "Infringement proceedings and non-compliant national courts" (2012) 49 *Common Market Law Review* 1881, 1885; see Case C-396/03 *Magnus Killinger v Germany, Council and Commission* [2005] ECR I-4967, para 28; Case 14/83 *Sabine von Colson and Elisabeth Kamann v Land Nordrhein-Westfalen* [1984] ECR 1981, para 26.

[99] J. Mukwiri, *Takeovers and the European Legal Framework: A British Perspective* (Routledge-Cavendish, 2009) 8.

[100] B. Pettet, "Company and Capital Markets Law: Taking Stock of European Integration" (2004) 57 *Current Legal Problems* 393.

[101] B. Pettet, "Company and Capital Markets Law: Taking Stock of European Integration" (2004) 57 *Current Legal Problems* 393, 399.

[102] European Commission, "Report on the implementation of the Directive on Takeover Bids" (Brussels, 21 February 2007) SEC(2007) 268, para 2.1.1.

[103] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 11.

[104] P. Davies, E.P. Schuster and E. van de Walle de Ghelcke, "The Takeover Directive as a Protectionist Tool?" in U. Bernitz and W.G. Ringe (eds), *Company Law and Economic protectionism* (Oxford: Oxford University Press, 2010) 105, 155.

measures because as the officiating organisation they should know better than anyone else threatened by potential break-up and asset-stripping through hostile takeovers.[105] The difficulty is that directors' interests are often misaligned with that of the company and its stakeholders during takeovers. 'Often their own performance and plans are brought into question and their own jobs are in jeopardy. Their interest is in saving their jobs and reputation instead of maximising the value of the company for shareholders'.[106] If the directors reasonably believe it to be for the good of the company and its future business to resist a takeover, then they should convince the shareholders of that and only take action against unwanted bids with the consent of shareholders.[107] Article 9 effectively provides safeguards by placing the decision as to defensive measures in the hands of shareholders. Whilst there could be an economic benefit accruing to stakeholders in protecting them from asset strippers by allowing defensive measures via the Directive, such benefit does not resolve the tension between the Directive and the Treaty.

It is observed here that in light of the reluctance of Member States to opt into Article 9 so as to eliminate takeover obstacles, coupled with the reluctance of the Commission to propose to make the optional articles of the Directive mandatory,[108] it is unlikely that the harmonious interaction between takeovers and capital movement can be achieved by positive integration. In their review report, the Commission concluded that with 19 Member States opting into Article 9 the board neutrality rule was 'a relative success,'[109] but in the same review report, the Commission found that 13 out of those 19 Member States also apply the reciprocity rule.[110] These findings can hardly suggest 'a relative success', for the net number of Member States opting into and applying Article 9 is only six Member States. Given that the 13 Member States that also opted into Article 12(3) (reciprocity) included the six founding Members of the Community (Belgium, France, Germany, Italy, Luxembourg, and the Netherlands, it is suggested that the reluctance of the founding Members be taken as a signal that the Union is unwilling to reform Article 9 into a mandatory provision. With positive integration unlikely, given the reluctance of the six founding Members of the Community to seek harmonious interaction between takeovers and the free movement of capital by negative integration, such action might risk 'rocking the EU boat.' As the Directive was adopted by compromise, it seems only realistic to sustain it by compromise.

It has already been argued that it would be legitimate to appeal to the jurisprudence of the Court, in order to bridge the conflict between Article 63 TFEU and Article 12 of the Directive, by way of negative integration. The problem with negative integration is that it risks rocking the boat of the fragile sphere of the harmonisation of capital markets and company law. This is because such an approach, though legitimate, is likely to be seen as coercive and achieving by the 'back door' what failed to be achieved in the positive integration process. For this reason, a negative integration approach would be a very weak

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[105] J. Dean, "Directors' Duties in Response to Hostile Takeover bids" (2003) 14 *International Company and Commercial Law Review* 370, 377.

[106] J. Winter, "Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids" (Brussels 2002) 21.

[107] J. Mukwiri, *Takeovers and the European Legal Framework: A British Perspective* (Routledge-Cavendish, 2009) 57.

[108] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 26.

[109] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 19.

[110] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 7 – the report lists the 13 Member States applying a reciprocity rule as: Belgium, Denmark, France, Germany, Greece, Hungary, Italy, Luxembourg, the Netherlands, Poland, Portugal, Slovenia and Spain.

attempt at a solution. A more solid solution might be for the Commission to adopt an intentional partial approach to the procedure in Article 258 TFEU (Ex Article 226 TEC). The question is whether such a solution would be legitimate.

The first paragraph of Article 258 TFEU provides that, if the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. The second paragraph of Article 258 TFEU provides that if the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court. The partial approach to Article 258 TFEU or legitimate compromise would be a two-stage approach.

In the first stage, where there is evidence that a natural or legal person seeking to trade shares was being restricted contrary to their rights under Article 63 TFEU in Member States which have either opted out of Article 9 or opted into Article 9 and also opted to apply Article 12(3) (the reciprocity rule), the Commission should invoke the first paragraph of Article 258. The underlying argument here is that opting out of Article 9 does not suspend or create an exception to the application of the general principle laid down in Article 3(c) of the Directive,[111] to the effect that 'the Board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.' Therefore, opting out of Article 9 still leaves certain conduct caught by Article 3(c) prohibited by the Directive, which places the board in default of both Article 3(c) and Article 63 TFEU. On being alerted that a market participant has been restricted or dissuaded to invest by way of bidding for shares in those Member States, the Commission should ask the Member State to refrain from infringing Article 63 TFEU, and then give its reasoned opinion to the effect that the manner in which the Member State has implemented the Directive has led to the infringement of Article 63 TFEU.

On possible infringement of the free movement of capital, the Commission has continued to show zero tolerance for the use of golden shares. For example, in a press release of April 2012 the Commission issued a reasoned opinion under Article 258 asking Greece to refrain from the use of golden shares to comply with its Treaty obligations under Articles 49 and 63 TFEU.[112] Greece acquired golden shares in the Hellenic Telecommunication Organisation (OTE), whose golden shares granted the Greek government special rights, including the right to appoint half of the members on OTE governing bodies and a wide range of veto rights on corporate and business matters, all of which might dissuade investors from other Members States from increasing their investment in OTE. As previously discussed, golden shares have the effect of dissuading investors in other Member States from investing in a Member State with golden shares and applying Article 12 of the Directive would likewise have a dissuading effect, contrary to Article 63 TFEU, which would necessitate a reasoned opinion (as a matter of discretion for the Commission).

In the second stage, if the Member State concerned did not comply with the opinion given by the Commission within the period laid down by the Commission under the second paragraph of Article 258 TFEU, the Commission should consider whether to bring the matter before the Court and should exercise its discretion in favour of not litigating the matter.[113] The decision not to litigate, even where there is clear infringement of Article 63 TFEU,

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[111] A. Dashwood, M. Dougan, B. Rodger, E. Spaventa and D. Wyatt, *Wyatt and Dashwood's European Union Law*, 6th ed. (Oxford: Hart Publishing, 2011) 968.

[112] European Commission, "Commission requests Greece to comply with EU rules on free movement of capital and the right of establishment" (European Commission Press Release, Brussels, 26 April 2012).

[113] See P. Craig and G. de Burca, *EU Law: Text, Cases, and Materials*, 4th ed. (Oxford: Oxford University Press, 2008) 434; see also A. Evans, "The enforcement procedure of Article 169 EEC: Commission discretion" (1979) 4 *European Law Review* 442, 445.

would be within the practice and discretion of the Commission. The practice of the Commission is to settle disputes by negotiation; and litigation is simply a part, sometimes inevitable but nevertheless generally a minor part, of this process.[114] As to discretion, the Court has consistently held that the Commission is not bound to commence the proceedings provided for in Article 258 TFEU and that this discretion excludes the right for any party to require the Commission to litigate or adopt a specific position.[115]

So far, in order to refrain from pursuing a positive integration approach, the Commission has relied on the lack of economic evidence, suggesting that the manner the Directive has been implemented has had a negative impact. In their June 2012 review report, the Commission observed that it is difficult to calculate the impact of the Directive on the economy, mainly because there have been few takeover bids in the EU since the transposition of the Directive, due to the economic situation in the EU following the financial crisis.[116] It is partly due to this lack of economic evidence to justify changing the situation which made the Commission conclude that it was not appropriate to propose making the optional articles of the Directive mandatory.[117] As for negative integration, the lack of economic evidence may serve to delay but not to defeat the invoking of Article 258 TFEU. The fact that the Commission would commence its action after a lengthy period of time would not have the effect of regularising a continuing contravention.[118] In fact, whenever in future evidence becomes available that a Member State's application of Article 12 of the Directive has had a negative impact as in infringing Article 63 TFEU, the Commission may bring an action under Article 258 TFEU.

Alternatively, as another compromise, the Commission could resort to a series of permissive measures in the form of recommendations in an attempt to reverse the reality and effect of diverse corporate cultures in the EU; this could include requiring Member States who have opted out of Article 9 to require their companies to read such opt-out in the context of both Article 3(c) of the Directive and Article 63 TFEU. This takes us back to the discussion on whether takeovers should be regulated under capital markets law or company law. As noted above, whereas takeovers belong to securities regulation in most Member States, the EU deals with takeovers under company law.[119] In the regulation of takeovers, the corporate culture of most Member States would welcome a permissive rules approach akin to securities regulation, rather than a prescriptive rules approach akin to company law. Nevertheless, legal certainty and aligning takeovers to free movement of capital requires prescriptive rules. However, with such entrenched diverse corporate cultures in the EU, seeking to secure the economic exchange of capital with prescriptive rules as opposed to permissive rules ignores the free and liberal nature of capital markets. With most Member States maintaining takeover obstacles by Article 12 of the Directive, a series of permissive rules approach could gradually reverse the defensive cultures as corporate cultures converge to achieve a single market.

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[114] F. Snyder, "The effectiveness of European Community Law" (1993) 56 *Modern Law Review* 19, 30.

[115] See Case 247/87 *Star Fruit v Commission* [1989] ECR 291, para 11; Case C-87/89 *Sonita v Commission* [1990] ECR I-1981; Case T-201/96 *Smanor v Commission* [1997] ECR II-108.

[116] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 12.

[117] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 26.

[118] Case 7/71 *Commission v France* [1971] ECR 1003 (Judgment of the Court of 14 December 1971), para 6.

[119] E. Wymeersch, "About techniques of regulating companies in the EU" in G. Ferrarini (ed), *Reforming company and takeover law in Europe* (Oxford: Oxford University Press, 2004) 150.

It is worth summing up the difficulties in taking a strict legal approach in seeking to align takeovers to free movement of capital. Firstly, the difficulties partly lie in the Directive's aim of introducing into Member States the corporate cultures of other Member States.[120] Whilst the UK on which the Directive was modelled with its dispersed shareholding structures is accustomed to the idea of hostile takeovers, most economies of Europe have concentrated shareholding structures that are usually unfavourable to takeovers. Secondly, the perception has long existed that the prescriptive controversial provision, the board neutrality rule, which was mainly influenced by the UK, was designed to break down the laws of Germany, the Netherlands and other continental European countries which were hostile to takeovers.[121] Thirdly, national interests are still stronger than EU interests. For example, in its review of the implementation of the Directive, the Commission found that 'a large number of Member States has shown strong reluctance to lift takeover barriers'; by applying Article 12 of the Directive, the Commission observed that 'the number of Member States implementing the Directive in a seemingly protectionist way is unexpectedly large.'[122] Fourthly, there have been few takeover bids since the transposition of the Directive due to the economic situation in the EU following the financial crisis.[123] As a result, a more cautious approach should be taken in applying a strict legal approach to takeovers, given the fragile economic situation at a time when EU regulators are struggling to place business operations on a more secure basis. With all these odds, interaction between takeovers and capital movement may better be gained with a realistic compromise solution which applies a series of permissive rules to gradually reverse takeover obstacles across the EU.

## A way forward and concluding remarks

The way forward in resolving the tension between Article 12 of the Directive and Article 63 TFEU raises the question whether law reform is the appropriate answer. The core provisions of the Directive, if not subject to opt-out arrangements, would have improved conditions for takeovers in the internal market by preventing at least some self-serving defensive measures from company boards.[124] Due to the lack of economic evidence to justify changing the situation, the Commission concluded that it was not appropriate to propose to make the optional articles of the Directive mandatory.[125] In the words of Jaap Winter, 'a key challenge of regulation (…) is to distinguish which problems can be meaningfully addressed by new regulation and which problems cannot. A bigger challenge still is to act on this distinction and to have the courage not to regulate the latter problems but to seek different avenues of addressing them'.[126] With the lack of political willingness and the economic protectionism in some Member States, it is better to seek to enforce Article 63 TFEU than to reform takeover law. Seeking to enforce existing EU law would be less challenging than to turn to

[120] M. O'Neill, "When European integration meets corporate harmonisation" (2000) 21 *Company Lawyer* 173, 175.
[121] K.J. Hopt, "Takeover regulation in Europe – The battle for the 13th directive on takeovers" (2002) 15 *Australian Journal of Corporate Law* 1, 9.
[122] European Commission, "Report on the implementation of the Directive on Takeover Bids" (Brussels, 21 February 2007) SEC(2007) 268, para 3.
[123] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 12.
[124] A. Dashwood, M. Dougan, B. Rodger, E. Spaventa and D. Wyatt, *Wyatt and Dashwood's European Union Law*, 6th edn (Oxford: Hart Publishing, 2011), 695.
[125] European Commission, "Report on the application of Directive 2004/25/EC on takeover bids" (Brussels, 28 June 2012) COM(2012) 347 final, para 26.
[126] J. Winter, "The financial crisis: does good governance matter and how to achieve it?" (2011) DSF Policy Paper Number 14, p. 14, electronic copy available at: http://ssrn.com/abstract=1972057.

protectionist and unwilling Member States seeking a legal mandate for a takeover law reform.

In conclusion, this paper noted that the February 2007 and June 2012 Commission reports on the implementation of the Directive highlighted a number of problems in the context of aligning takeovers with the aims of a single market with a particular focus on enabling the free movement of capital throughout the EU. This paper critically examined how a number of choices, ranging from regulating takeovers by prescriptive or permissive rules by minimum or exhaustive measures to mandatory or optional rules, creates significant tension between takeovers and capital movement. In the context of aligning takeovers with capital movement rules, this paper made a number of observations. Firstly, the prescriptive rule in Article 9 is weakened by the permissive rule in Article 12, which in turn creates tension between takeovers and the free movement of capital. Secondly, the minimum measure in the Directive, allowing for a varied application of the core provisions, entrenches national interests above EU interests and creates tension between takeovers and the free movement of capital. Thirdly, optional rules in the Directive hardly reinforce the single market and leave Article 12 of the Directive at odds with mandatory provision of Article 63 TFEU.

Having concluded that positive integration seems to have failed to harmonise takeover rules to capital movement rules, this paper critically examined how the tension could be resolved by appealing to the jurisprudence of the Court. It discussed a number of Court decisions, including the so-called golden share cases, and concluded that Member States who have applied Article 12 of the Directive are likely to be found in breach of their obligation under Article 63 TFEU. Due to the lack of political willingness on the part of Member States to eliminate takeover obstacles and the uncertainty of the economic situation in the EU, this paper suggested a pragmatic solution that avoids a strict negative integration approach, namely for the Commission to use its discretion in applying Article 258 TFEU and issue a series of permissive rules in order to reverse gradually the culture of takeover obstacles across the EU.