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A Simple Theory of Takeover Regulation in the United States and Europe

Guido Ferrarini† & Geoffrey P. Miller††+

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Introduction

The law on takeovers, as it has developed in the European Union, differs in substance and spirit from the U.S. approach. What are those differences, and how can they be explained?[1] The thesis of this paper is that takeover regulation in both regions is shaped by two principal factors: (1) differences in the political power of targets and bidders at different geographic levels and (2) the respective political power of bidders and targets within a given geographic area. The observed pattern is consistent with this simple model: takeover regulation in both Europe and the United States becomes increasingly bidder-friendly with increasing geographic

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1. *See generally* Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171 (2006) (comparing U.S. and E.U. takeover law).

scope and, within jurisdictions, reflects the respective political interests of bidder and target firms.[2]

I. The Model

Consider a simple political system consisting of a large sovereign entity with power to set binding rules within its borders and a set of smaller entities, existing within the larger entity, that have sovereign authority to establish rules applicable within their borders not inconsistent with those set forth by the larger entity. Imagine that the political rules of the larger entity permit minority coalitions of smaller entities to block legislation. Imagine further that there exist firms with their principal places of business within the smaller entities. These firms are controlled by managers or shareholders who are also principally located in the smaller entities where the firms have their legal organization. All firms fall into one of two categories: potential bidders and potential targets. Bidders and targets have roughly equal political power. Bidders can attempt to acquire control over targets located anywhere within the larger entity and, because they are in the business of acquiring other firms, prefer rules that make takeovers easier. Targets, who might wish to remain independent, prefer rules that make takeovers harder. What sort of takeover rules can be expected in this set-up?

Consider first the rules applicable in the larger entity. These rules apply to all parties and transactions. In such a case, the interests of bidders and targets are both directly involved, and, since both have roughly equal resources, they will tend to offset one another. Legislators responding to lobbying pressures (or campaign contributions) will therefore tend to adopt rules that do not substantially favor either side, but that do serve as a means of protecting investors.[3] Thus, takeover regulation in the broader entity will be reasonably even-handed as between targets and bidders.

2. *See generally* Geoffrey P. Miller, *Takeovers: English and American*, 6 EUR. FIN. MGMT. 533 (2000) (discussing the theory on differences between U.S. and U.K. takeover law upon which this paper expands).

3. However, rules enacted for the ostensible purpose of protecting investors often have an impact on the cost and likelihood of takeovers. For example, rules requiring bidders to disclose substantial holdings may reduce the bidders' gains from acquiring a "toehold" in the target and, therefore, lessen their incentives to launch a bid. *See* Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 13 (1978) (arguing that a decision to tender involves research costs and that a failure to recognize a property right in this information will decrease the incentives to produce the same); Jonathan R. Macey & Jeffry M. Netter, *Regulation 13D and the Regulatory Process*, 65 WASH. U.L.Q. 131 (1987) (arguing that relevant disclosure rules appear to force inefficient wealth transfers from shareholders of bidding firms to shareholders of target firms). On the other hand, if shareholders' approval of takeover defenses is required, such defenses will be less likely and the number of takeovers will be potentially greater. We consider takeover regulation to be even-handed when its impact is minimized for both bidders and targets. We consider regulation to be target-friendly when its effect is to make hostile acquisitions relatively more expensive or to deter them altogether.

Now consider the political environment in smaller jurisdictions. Here the interests of *targets* remain strong—they prefer local rules that deter unwanted takeover bids. They know that when and if a hostile bid is made, it will be subject to the law of their local jurisdiction. Therefore, targets are likely to expend significant resources lobbying for local rules that increase the costs of unwanted takeover bids.

However, the interests of *bidders* do not result in the same level of campaign contributions at the local level. Bidders organized within the local jurisdiction have an incentive to lobby for bidder-friendly regulation, but the fact that only some potential targets exist within that jurisdiction dilutes their incentive. Many potential targets are in other smaller jurisdictions, and the bidder's lobbying within its local jurisdiction will not lead to a reduction of the costs of acquiring these foreign firms. This means that bidders organized within a given smaller jurisdiction have much less to lose if the entity adopts anti-takeover rules because such rules only foreclose part of their market. Bidders from other smaller jurisdictions do lose from protective legislation in the smaller entity, but they have little influence in the political process of the smaller entity and, therefore, little to gain by making contributions. The result is that rules in smaller entities can be expected to be more favorable to targets than are rules adopted by the larger entity.[4] Of course, the larger entity has the authority to enact preemptive regulations that displace rules adopted by the smaller entities.[5] But since minority coalitions of the smaller entities can block legislation at the level of the larger entity, and since smaller entities generally favor targets, such preemptive regulations will not be adopted. Instead the larger entity is likely to adopt neutral framework rules, such as those requiring publication of takeover bids or public supervision of the same, which can be adapted by the smaller entities to fit their own individual political situations.

So far, the model has predicted differences in takeover regulation between larger and smaller political jurisdictions. What about the differences between smaller jurisdictions? Here, we expect that the degree of protection afforded to target firms will be a function of the particular facts and circumstances in the smaller jurisdiction. If the ratio of targets to bidders varies across smaller entities, we would predict that smaller entities

4. For instance, the requirements for disclosure of substantial holdings will be more stringent—in the sense that the threshold for disclosure is lower or the delay for disclosure is shorter—or there will be more room for post-bid defenses. *See* Marco Pagano, Fausto Panunzi & Luigi Zingales, *Osservazioni sulla Riforma della Disciplina dell'OPA, degli Obblighi di Comunicazione del Possesso Azionario e dei Limiti agli Incroci Azionari*, 43 RIVISTA DELLE SOCIETÀ 152 (1998) (Italy) (arguing that if the bidder is forced to disclose its shareholding in the target too soon, its profit will be smaller and control contestability will be consequently reduced).

5. For example, rules permitting the adoption of multiple-voting shares or other control-enhancing devices by the targets. *See* Guido Ferrarini, *Share Ownership, Takeover Law and the Contestability of Corporate Control*, *available at* http://ssrn.com/abstract=265429 (arguing that a policy maker has to fix the threshold for shareholdings and the delay for disclosure by balancing the need for transparency on the one hand and that for corporate control contestability on the other).

with many potential targets and few bidders will adopt stronger antitakeover rules than will smaller entities with fewer targets and more bidders. Similarly, jurisdictions are likely to authorize a wider range of takeover defenses when target managers have a special reason to feel vulnerable to the threat of a hostile acquisition and fewer takeover defenses when target managers feel relatively protected against hostile bids.

II. The United States

We now consider whether the simple theoretical model presented above is consistent with the actual pattern of takeover regulation. We start with an analysis of U.S. rules.

A. Federal Law

In the case of the United States, the model suggests that regulations adopted at the national level, where both targets and bidders are reasonably equally represented, are likely to be neutral as between the two.[6] This prediction is consistent with the observed patterns of federal law: both the Williams Act and federal proxy rules adopt a neutral stance on the topic of contests for corporate control.[7]

1. *Tender Offers*

The federal Williams Act, enacted in 1968, established the basic ground rules for tender offers in the United States.[8] A key feature of the Williams Act is the policy of neutrality.[9] Congress attempted to create a level playing field between targets and bidders by attempting to empower investors to make decisions without compulsion and on the basis of full and complete information.[10]

The Williams Act contains several important provisions that implement this policy of creating a level playing field between bidder and target. First, any party who intends to seek five percent or more of a class of equity securities by means of a tender offer[11] must file a Schedule 14d-1

6. *See, e.g.*, Lucian A. Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 164 (2001) (suggesting that federal law could correct the pro-target bias of state law).

7. *See* William C. Tyson, *The Proper Relationship Between Federal and State Law in the Regulation of Tender Offers*, 66 NOTRE DAME L. REV. 241, 278-79 (1990).

8. *See* Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1968) (adding new §§ 13(d)-(e), 14(d)-(f) to the Securities Exchange Act of 1934, 15 U.S.C. § 78 [hereinafter 1934 Act]); Fleet Aerospace Corp. v. Holderman, 796 F.2d 135, 136 n.3 (6th Cir. 1986).

9. *See* Tyson, *supra* note 7, at 278.

10. *See* Edgar v. MITE Corp., 457 U.S. 624, 632 (1982) (stating that the Williams Act was intended to avoid creating an undue advantage for either management or the bidder).

11. "Tender offer" is not defined in the federal statute but has received definition through judicial gloss over the years. *See* EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 15:7 (2009).

statement with the Securities and Exchange Commission (SEC).[12] The Schedule 14d-1 statement must include information on the background of the bidder, the bidder's source of funds, plans for fundamental corporate change to the target company, the extent of the bidder's ownership in the target, past transactions with the target, antitrust problems, and other pertinent information.[13] The bidder must communicate information to shareholders as well as the SEC, and must also provide the target company with information about the bid.[14] The Williams Act imposes similar disclosure requirements under Schedule 13d on any purchaser who acquires five percent or more of a registered equity security, even prior to the launching of a tender offer.[15] Having provided the necessary information, the bidder may go forward with the bid, leaving the success or failure of the offer up to market forces.

As implemented by the SEC, the Williams Act contains certain other protections for shareholders of the target firm. For example, shareholders are permitted to withdraw their shares as long as the bid remains open.[16] The bidder must purchase all shares at the same price, even if it increases the offering price after a shareholder has tendered.[17] If the bid is for only some of the shares and more are tendered, the shares must be purchased on a pro rata basis.[18] The bidder cannot discriminate among shareholders by favoring some or excluding others.[19] False or misleading statements or omissions in connection with a tender offer are prohibited.[20] Although these provisions do limit the ability of bidders to apply pressure on target shareholders to tender into the bid, they in no way limit the ability of a bidder to succeed in a hostile acquisition if the offer is made at a fair price and on an even-handed basis.

Moreover, the Williams Act confers no explicit private right of action.[21] The courts, however, have recognized several such rights by implication.[22] Targets and bidders, as well as shareholders, have standing to seek injunctive relief to enforce both the statute and implementing regulations.[23] Private rights to sue for damages are somewhat more limited. Neither an unsuccessful bidder nor the target corporation has a private right of action for damages under the Act's antifraud provisions.[24] Other

12. *See* 1934 Act, *supra* note 8, § 78n(d)(1); 17 C.F.R. § 240.14d-1 (2008).
13. 1934 Act, *supra* note 8, § 78m(d).
14. *Id.* § 78n(d).
15. *Id.* § 78m(d) (2008); 17 C.F.R. § 240.13d-101 (2008).
16. 15 U.S.C. § 78n(d)(5); 17 C.F.R. § 240.14d-7(a) (2008).
17. 15 U.S.C. § 78n(d)(7); 17 C.F.R. § 240.14d-10(a)(2) (2006).
18. 15 U.S.C. § 78n(d)(6); 17 C.F.R. § 240.14d-8 (2005).
19. 17 CFR. § 240.14d-10(a)(1).
20. 15 U.S.C. § 78n(e).
21. *See* Brian E. Rosenzweig, *Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls*, 18 DUKE J. COMP. & INT'L L. 213, 227 (2007).
22. *See id.*
23. *See, e.g.*, Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981) (recognizing bidder's right to sue for injunctive relief); Weeks Dredging & Contracting, Inc. v. Am. Dredging Co., 451 F. Supp. 468 (E.D. Pa. 1978) (same).
24. *See* Piper v. Chris-Craft Indus., 430 U.S. 1 (1977).

investors do enjoy private rights of action for damages, both under the statute itself[25] and under the SEC regulations.[26] However, such rights are not available across the board;[27] the analysis depends on each specific statutory or regulatory provision.[28] Again, the policy of neutrality can be discerned in the area of private rights of action: some rights are conferred on both targets and bidders, but the regulations do not create an open season for lawsuits against bidding firms.

2. *Proxy Contests*

In addition to tender offers, proxy contests represent another means for acquiring control of a company. Although state rules govern the substantive law of proxies, the SEC—under the authority of the Securities Exchange Act of 1934—regulates proxy contests.[29] Here again, as in the case of the Williams Act, the policy of federal law is one of neutrality.[30] The SEC's Regulation 14A applies to all persons soliciting proxies, including, in the case of proxy contests, both the registrant (the target company) and the bidder.[31]

B. State Law

Our model of takeover regulation predicts that takeover rules will be more target-friendly at the state than at the federal level, since targets located in individual states have large, undiversified interests in rules protecting them from hostile acquisitions. As with federal law, the model's prediction is consistent with the observed pattern of state law.

State authority to act in this area is circumscribed both by the Williams Act, which courts have held to have broad preemptive force, and the Commerce Clause of the U.S. Constitution, which prohibits state actions that unduly burden interstate commerce.[32] In some cases, consistent with our theory, federal authorities have nullified state efforts to protect target

25. *See, e.g.*, Pryor v. U.S. Steel Corp., 794 F.2d 52 (2d Cir. 1986) (recognizing a private right of action under § 14(d)(6) that requires the bidder to purchase the target's shares on a pro rata basis); In Re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227 (W.D. Tex. 1979) (implying right of action under § 14(e) of the statute, the general anti-fraud provision).

26. For example, target shareholders enjoy private rights of action under Rule 14e-3, 17 C.F.R. § 240.14e-3, which prohibits insider trading in connection with tender offers. *See, e.g.*, O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179 (S.D.N.Y. 1981); *see also* All Holders Rule, 17 C.F.R. § 240.14d-10(a) (requiring equal treatment of shareholders in takeover bids); Polaroid Corp. v. Disney, 862 F.2d 987 (3d Cir. 1988).

27. *See, e.g.*, MARC I. STEINBERG, SECURITIES REGULATIONS: LIABILITIES AND REMEDIES §§ 9.02-.03 (2005) (detailing the sections of the SEC rules for which courts have and have not implied private rights of action).

28. *See, e.g.*, *id.*

29. *See, e.g.*, 18 AM. JUR. 2D *Corporations* §§ 902-13 (2009).

30. *See* Joseph E. Calio & Rafael X. Zahralddin, *The Securities and Exchange Commission's 1992 Proxy Amendments: Questions of Accountability*, 14 PACE L. REV. 459, 518 (1994).

31. 17 C.F.R. § 240.14a-2 (2005).

32. *See* Edgar v. MITE Corp., 457 U.S. 624, 630 (1982).

corporations. For example, in *Edgar v. MITE Corporation*,[33] the U.S. Supreme Court invalidated an Illinois statute on the grounds that the state did not have the power, under the U.S. Constitution, to authorize its secretary of state to block nationwide takeover bids for Illinois corporations. In another case, the Delaware Supreme Court upheld a company's attempt to defend itself against a hostile bid by means of an above-market tender for its own shares that excluded the bidder from the offer.[34] The SEC, however, effectively nullified this decision by enacting preemptive regulation under the Williams Act prohibiting discrimination in tender offers.[35]

In other cases, states have found ways to impose limitations on takeover bids and proxy contests while avoiding federal preemption.[36] For example, notwithstanding the extensive federal regulation of the proxy rules, states retain the power to determine whether the corporate treasury will pay the costs of a proxy solicitation.[37] Here, consistent with our theory, the pattern favors targets.[38] State rules generally permit the target's management to use corporate funds to resist takeovers but require the bidder to pay the proxy costs upfront, subject to potential reimbursement (with shareholder approval) in the event the contest is successful.[39]

States also use their power to regulate the internal affairs of corporations to favor targets over bidders.[40] State legislatures have drawn on this power to provide assistance to incumbent managers wishing to fend off unwanted takeover bids.[41] When the Supreme Court ruled that direct regulation of tender offers would not pass muster,[42] state legislatures became more creative in promulgating regulations.[43] Control-share statutes are one example: they apply to shares held by an acquirer that exceed certain threshold percentages of a company's total shares (such as twenty or

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33. *Id.*

34. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

35. *See* 17 C.F.R. § 240.14d-10(a)(1) (2006).

36. *See* Stephen Bainbridge, *State Takeover and Tender Offer Regulations Post-MITE: The Maryland, Ohio and Pennsylvania Attempts*, 90 DICK. L. REV. 731, 743-50 (1986); Arthur R. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After* CTS Corp., 29 WM. & MARY L. REV. 699, 778 (1988).

37. *See* Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 WIS. L. REV. 1071, 1078-79 (1992).

38. *See id.*

39. *See, e.g.*, Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291 (N.Y. 1955) (approving expenditures from corporate treasury by old board of directors as well as corporate reimbursement for expenditures by insurgents which were ratified by shareholder vote after successful proxy contest).

40. *See* Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, *supra* note 37, at 1073.

41. *See generally*, Bebchuk & Ferrell, *supra* note 6 (tracing the development of state antitakeover law).

42. *See* Edgar v. MITE Corp., 457 U.S. 624, 634 (1982).

43. *See* James E. Vallee, Student Article, *Beyond Reproach: Management Entrenchment Through the Texas Business Combination Law*, 30 TEX. TECH L. REV. 1283, 1307 (1999); *see also* David Porter, *Competing with Delaware: Recent Amendments to Ohio's Corporate Statutes*, 40 AKRON L. REV. 175, 185 (2007) (illustrating anti-takeover statutes promulgated in Ohio).

thirty-three percent).[44] When an acquirer exceeds that threshold, it loses voting rights in the shares it holds unless the other ("disinterested") shareholders affirmatively vote to restore the rights.[45] Business combination statutes function in a similar fashion, but do not restrict voting rights; they simply prohibit a bidder who exceeds the statutory thresholds from commencing a "business combination" with the target corporation for a specified number of years.[46] Some of these statutes also contain "fair price" clauses that effectively prevent freeze-out mergers, even at the conclusion of the moratorium period, unless a majority of the disinterested shareholders must approve the combination.[47] Pennsylvania has gone even further.[48] In addition to an onerous control-share provision, Pennsylvania's statute allows target companies to force bidders to repay profits on shares they purchased and sold during the specified period, thus precluding the bidder from making any merchant profits during the moratorium period.[49]

Target corporations have also effectively harnessed the internal affairs power to "home-make" takeover defenses structured as ordinary rules of corporate governance.[50] If blessed by the chartering state, these defenses are generally immune from legal challenge, either under federal law or under the law of states other than the chartering state.[51] A particularly effective antitakeover device that purports to represent an exercise of corporate internal affairs is the staggered board of directors—a board whose members serve for multiyear terms and who can be replaced (unless removed pursuant to the procedures in the charter or bylaws) only when their term expires.[52] The most common form of staggered board provides for the election of only one-third of the directors each year.[53] This means that a bidder generally will have to wait two years before acquiring control of a company even if it succeeds in acquiring an outright majority of a company's stock in a tender offer.[54] The bidder may, of course, seek to unseat a director before the expiration of his term, but this may prove diffi-

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44. *See, e.g.*, Vallee, *supra* note 43, at 1307 (noting that controlled shares are "acquired by outside interests in a series of related acquisitions that result in ownership above levels specified by the law.").

45. *See id.*

46. *See* Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 618 (2007).

47. *See, e.g.*, IDAHO CODE ANN. § 30-1705(3) (2009).

48. *See* 15 PA. CONS. STAT. §§ 1721, 2561, 2571, 2581 (2008).

49. *See id.* § 2571.

50. Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U.L. REV. 211, 230-31 (2007).

51. *See* Pinto, *supra* note 36, at 723-24.

52. *See* Rivka Weill, *Declassifying the Classified*, 31 DEL. J. CORP. L. 891, 895-96 (2006).

53. The limitation to three classes on the board is due to provisions of the Delaware Corporation Law, which prohibit more than three classes of directors, DEL. CODE ANN. tit. 8, § 141(d) (2005), as well as the listing requirements of the New York Stock Exchange, which do the same. NYSE, INC., LISTED COMPANY MANUAL § 304.00 (2005).

54. *See generally* Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 889 (2002) [hereinafter *Staggered Boards*].

cult: removal without cause generally requires a supermajority shareholder vote, and removal for cause requires proof of some misconduct, which may be lacking and may result in messy litigation.[55] Staggered boards have been a feature of Anglo-American corporations for hundreds of years, but their traditional purpose was to confer continuity in management by preventing wholesale board turnover.[56] The evidence suggests that staggered boards are now frequently used as an antitakeover device.[57]

Another management-created antitakeover device, which also derives its authority from internal affairs principles, is the poison pill.[58] These instruments, which were created by attorneys at a well-known corporate law firm, Wachtell, Lipton, Rosen & Katz, L.L.P., assume a variety of forms, but all serve the same general function.[59] Usually designated by a less opprobrious name, such as a "rights plan," a poison pill is distributed to shareholders of a potential target firm—ideally well in advance of any bidder appearing on the scene.[60] The plan purports to give shareholders rights to purchase the company's shares at a steep discount in the event of defined events in the corporation, such as any party acquiring more than a specified percentage of the company's stock without the consent of the target management.[61] Bidders, however, do not enjoy similar rights with respect to shares they have purchased.[62] Thus, when and if exercised, the poison pill has a powerful dilutive effect that makes unfriendly takeovers financially unacceptable.[63] In practice, pills erect "an impenetrable barrier to control acquisitions."[64] Although supporters promote poison pills as conferring a benefit on shareholders, critics argue that their real purpose is to deter hostile takeovers, thus depriving shareholders of the premium that they could expect for their shares if a hostile takeover were to succeed.[65]

In addition to the internal affairs power, states promote takeover defenses by allowing corporate managers to exercise broad business judg-

55. *See* David S. Freeman, *Shark Repellant Charter and Bylaw Provisions*, 16 J. CORP. L. 491, 500 n.40 (1991).

56. *See* ROBERT A. G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 226 (4th ed. 2008).

57. *Staggered Boards*, *supra* note 54, at 889 (finding that the percentage of staggered boards in publicly traded companies more than doubled between 1990 and 2001, increasing from 34% to over 70% in that period).

58. One of the authors represented shareholders in Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985), the leading Delaware Supreme Court case on poison pills, but he is too modest to suggest that the outcome—a unanimous rejection of the author's argument—had anything to do with his skills at oral advocacy.

59. *See* Wachtell, Lipton, Rosen & Katz, L.L.P., *The Share Purchase Rights Plan*, *reprinted in* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 10-18 (2d ed. Supp. 1999).

60. *See* John C. Coates IV, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271, 274-86 (2000).

61. *See id.*

62. *See* Jonathan R. Macey, *The Politicization of American Corporate Governance*, 1 VA. L. & BUS. REV. 10, 32 (2006).

63. *See id.*

64. *Staggered Boards*, *supra* note 54, at 905.

65. The literature on poison pills is enormous. *See generally* Coates, *supra* note 60 (summarizing literature on the poison pill).

ment to undertake transactions that have the effect of deterring unwanted takeovers. "Scorched earth" tactics, such as threats to sell off valuable assets that the bidder desires, were once used and approved under state law. These have fallen out of fashion—not because they were banned under state law but because they were more costly than other mechanisms that were equally effective.[66] One important device widely used today is the "embedded defense," a contract entered into between the target and a third party that would impose prohibitive costs on the bidder if the acquisition succeeds.[67] For example, a contract with a purchaser, supplier, or strategic partner might provide for the payment of a large financial penalty in the event of a change in control within the target firm.[68]

So far, we have described the menu of takeover regulations available across the states. As a practical matter, however, the most important state is Delaware, which is the corporate home to a majority of publicly traded firms.[69] One might suspect that Delaware, with its strong state interest in attracting corporate charters,[70] would be at the forefront of catering to the managers of companies who seek protection against unwanted bids.[71] This, however, is not the case. Delaware does protect targets, but it does not spread a protective wing over all defensive tactics. Such tactics must be "reasonable in relation to the threat posed."[72] Thus, under Delaware law, the target's board is not obligated to deal with a potential acquirer,[73] but if it does put the company "in play" it must conduct a fair auction.[74] Poison pills are generally permissible, but their use will be scrutinized and

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66. *See* Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 2007 COLUM. BUS. L. REV. 800, 828-29 (2007)

67. *See* Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 582 (2003); *see generally* Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from* Air Line Pilots Ass'n, International v. UAL Corp., 120 HARV. L. REV. 1239 (2007).

68. *See* Subramanian, *supra* note 67, at 1242.

69. *See* Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383 (2003).

70. Delaware obtains a substantial amount of tax revenues from out-of-state firms that charter in that state. *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 39 (1993).

71. *See* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 469 (1987); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 280-81 (1985); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 752 (1987).

72. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

73. *See, e.g.*, Moore Corp. Ltd. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545, 1555 (D. Del. 1995); Paramount Commc'ns, Inc., v. QVC Network, Inc., 637 A.2d 34, 43 n.13 (Del. 1994) ("[W]here a potential sale of control by a corporation is not the consequence of a board's action, this Court has recognized the prerogative of a board of directors to resist a third party's unsolicited acquisition proposal or offer."); Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1152 (Del. 1990) (noting that the court has "repeatedly stated that the refusal to entertain an offer may comport with a valid exercise of a board's business judgment.").

74. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see also* Ronald J. Gilson & Reinier Kraakman, *What Triggers* Revlon?, 25 WAKE FOREST L. REV. 37 (1990).

rejected if an obvious purpose is entrenchment.[75] The state's laws treat pills that insulate the target's management from market pressure in the face of a hostile bid with suspicion.[76] The Delaware business combination statute[77] is mild when compared with the laws of some other states:[78] It does not apply to one-time acquisitions of eighty-five percent or more of the target's stock, thus permitting tender offers conditioned on very high subscription rates.[79] It also contains an important "competitive bidding" exception for cases in which the board has approved another bid previously, thus limiting the target board's ability to sell the company without conducting a fair auction.[80]

How can we explain the pattern in Delaware? The answer, within the framework of the model presented, is that, because Delaware is home to a majority of the major American corporations, its field of political forces includes strong bidder interests. If Delaware adopts strong target protections, the result will be to place many potential targets out of reach of a hostile acquisition, not just a few. Bidders have more to lose from such legislation. At the same time, because so many large firms are incorporated in Delaware (and others may wish to incorporate there), many bidders will be able to exercise political influence in the state. Because relatively few potential target firms are located in Delaware, their political influence is correspondingly lower. We expect, therefore, that Delaware will adopt intermediate protections for target firms—exactly what is observed in practice.

III. Europe

We now turn to an analysis of the pattern of takeover regulation in the European Union (EU).

A. The European Union Directive

Our theory predicts that rules adopted at the EU level will be relatively neutral between the interests of bidders and targets, because the relative political power of bidder and target firms will tend to be relatively equal at this broader geographic level. This prediction is confirmed by the data.

75. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

76. *See* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998) (rejecting a poison pill plan that would fundamentally limit the new board's abilities to carry out their duties for six months—also known as a "dead hand" poison pill—as a violation of title 8, section 141(a) of the Delaware Code); Carmody v. Toll Bros., Inc. 723 A.2d 1180 (Del. Ch. 1998) (rejecting a similar dead hand poison pill as a violation of sections 141(a) and (d)).

77. DEL. CODE ANN. tit. 8, § 203 (2001).

78. *Compare* 15 PA. CONS. STAT. ANN. § 1101 (2008), *with* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795 (2002) (discussing antitakeover statutes in various states).

79. *See* DEL. CODE ANN. tit. 8, § 203.

80. *See id.*

The Takeover Directive, adopted in 2004, after agonizing years of controversy, provides a framework for EU member states to implement takeover rules.[81] In some respects the Directive emulates the U.S. Williams Act.[82] For example, it requires the following: that bidders announce their bids as soon as possible and inform the supervisory authorities,[83] that all holders of securities be treated equally in takeover bids,[84] that all shareholders be offered the highest offer price,[85] that bids remain open long enough to allow informed decisions by target shareholders,[86] and that appropriate disclosures are made so as to ensure the transparency and integrity of markets.[87] Furthermore, it recommends that supervisory authorities be empowered to obtain relevant information from bidders,[88]

In three key respects, however, the Directive goes beyond what the Williams Act deemed necessary to protect shareholders.[89] One of these aspects is the mandatory bid rule.[90] Following pre-existing law in most member states, the Directive instructs member states to require persons who have acquired control of a company to thereafter "make an offer to all the holders of that company's securities for all of their holdings at an equitable price."[91] The mandatory bid rule appears to have two principal purposes.[92] First, it purports to deny controlling shareholders the power to sell the private benefits of control to another party.[93] Second, the mandatory bid rule protects minority shareholders after the takeover by providing an escape hatch for persons who do not wish to be minority shareholders of a controlled company.[94] Although some critics might argue that the mandatory bid rule increases the price of takeovers rather than effectively protecting minority interests or that it impedes the redeployment of productive assets to more efficient uses, the strategy is popular in Europe and was adopted widely in member states even before the Directive.[95] This requirement parallels the Williams Act rules that all sharehold-

81. Council Directive 2004/25, 2004 O.J. (L 142) 12 (EC) [hereinafter Directive]; *see* Eddy Wymeersch, *The Takeover Bid Directive, Light and Darkness* (Financial Law Institute, Universiteit Gent, Working Paper 2008-01, 2008), *available at* http://ssrn.com/abstract=1086987 (providing an overview of the Directive).

82. In 1968, Congress added sections 13(d)-(e) and 14(d)-(f) to the 1934 Act, collectively known as the Williams Act. *See supra* Part II.A.1 (discussing the Williams Act).

83. Directive, *supra* note 81, pmbl., cl. 12, art. 6.

84. *Id.* art. 3(1)(a).

85. *Id.* art. 5(4).

86. *Id.* arts. 3(1)(b), 7.

87. *Id.* art. 8.

88. *Id.* pmbl., cl. 15.

89. In addition to these three, the Directive also goes beyond the Williams Act by requiring member states to allow successful bidders holding at least ninety percent of the securities to squeeze out minority shareholders for fair compensation and permitting states to increase this threshold to ninety-five percent). *Id.* art. 5.

90. *See* Wymeersch, *supra* note 81, at 5.

91. Directive, *supra* note 81, pmbl., cl. 9, art. 5(1).

92. *See id.*

93. *See id.* arts. 5(1)-(4).

94. *See id.* art. 5(1).

95. For criticism, *see* Luca Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?*, 1 EUR. CO. & FIN. L. REV. 440 (2004); Simone

ers should be treated equally and that all should receive the same price for tendered shares.[96] However, it exceeds U.S. law insofar as it requires the bidder to make an "any and all" offer if it acquires control.[97] Under U.S. law, the function of protecting minority shareholders against majority oppression is principally vested in state corporate law.[98] Thus, the Williams Act does not require bidders to offer for all the shares once they have acquired control.[99]

A second key difference between the rules in Europe and those in the United States is the Directive's endorsement of board neutrality during takeover contests.[100] Earlier drafts of the Directive essentially endorsed the position taken by U.S. corporate legal scholars Frank Easterbrook and Daniel Fischel that the target's board should remain passive in the face of a takeover bid and should not engage in any defensive strategies.[101] In particular, the Directive's passivity rule was modeled on the City Code on Takeovers and Mergers, which allows for post-bid defenses only upon authorization by the target's general meeting.[102] This rule goes beyond U.S. law, which, as we have seen, offers in some states an extraordinarily high degree of protection from unwanted takeovers.[103] The Directive is not so protective.[104] It requires target boards to act in the best interests of the company and prohibits them from taking actions that effectively would deny holders the opportunity to decide the merits of a bid.[105] It requires transparency for defensive tactics and arrangements[106] and emphasizes

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M. Sepe, *Private Sale of Corporate Control: Why the European Mandatory Bid Rule is Inefficient* (Siena Memos and Papers on Law and Economics, Working Paper No. 43, 2007), *available at* http://ssrn.com/abstract=1086321.

96. 15 U.S.C § 78n(d)(7) (2002).

97. *See* Directive, *supra* note 81, art. 5(4).

98. *See* Robert Todd Lang & Robert L. Messineo, *Recent Developments in Takeovers and Pending Proposals for Regulatory Changes*, 609 PLI/CORP 909, 950 (1988).

99. *See generally* 15 U.S.C. § 78 (2002).

100. Although these rules are sometimes described as requiring neutrality or passivity on the part of the board, this does not appear to be the case: the board can take a strong position against the takeover bid as long as it only engages in defensive tactics (other than seeking competing bids) as approved by a general meeting of the shareholders. *See* Ventoruzzo, *supra* note 1, at 199-201.

101. *See generally* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

102. *See* Charles M. Nathan, Michael R. Fischer & Samrat Ganguly, *An Overview of Takeover Regimes in the United Kingdom, France and Germany*, 1400 PLI/CORP 943, 1003 (2003).

103. *See* William Magnuson, *Takeover Regulation in the United States and Europe: An Institutional Approach*, 21 PACE INT'L L. REV. 205, 205 (2009).

104. *See* Vanessa Edwards, *The Directive on Takeover Bids–Not Worth the Paper It's Written On?*, 1 EUR. CO. & FIN. L. REV. 416, 439 (2004) (concluding that, despite its failures, the Directive unquestionably improves the position of minority shareholders in a target company).

105. Directive, *supra* note 81, art. 3(1)(c).

106. *See id.* pmbl., cl. 18 ("In order to reinforce the effectiveness of existing provisions concerning the freedom to deal in the securities of companies . . . and the freedom to exercise voting rights, it is essential that the defensive structures and mechanisms envisaged by such companies be transparent and that they be regularly presented in reports to general meetings of shareholders."), art. 10.

that member states "should take the necessary measures to afford any [bidder] the possibility of acquiring majority interests in other companies and of fully exercising control of them."[107] Most importantly, the Directive requires the target's board to obtain prior shareholder authorization before taking any action, other than seeking alternative bids, which may result in the frustration of the bid.[108] The Directive particularly disfavors defensive tactics that involve the issuance of shares that may result in a "lasting impediment" to the bidder's ability to acquire control over the target.[109]

The third key difference between U.S. law and the approach found in the Directive is the latter's use of "breakthrough" rules.[110] These invalidate a variety of corporate law strategies that might be used to impede or defeat takeover bids, such as poison pills or dual-class share structures conferring control rights on block-holders.[111] Thus, the Directive provides that restrictions on the transfer of securities will have no effect if used to resist takeover bids;[112] it nullifies limitations on voting rights adopted after the announcement of the bid;[113] and it requires that shares with multiple voting rights carry one vote.[114] The breakthrough rules also limit defensive tactics that apply after an offer has succeeded.[115] Bidders who acquire seventy-five percent of the shares are entitled to call a general meeting in which all shares carry one vote per share, the concept being that such a meeting will allow the bidder to break up remaining control positions.[116] These rules are controversial because they preempt prior contractual and legal arrangements, although their effect is mitigated, to some extent, by the requirement that "equitable compensation" must be paid to shareholders whose rights are broken through.[117]

107. *Id.* pmbl., cl. 19.

108. *Id.* art. 9(2).

109. *Id.* The requirement of shareholder approval is a potentially significant obstacle to defensive tactics, but its benefits in this respect may be fewer than might be imagined in the case of companies with highly concentrated share ownership. Because interested shareholders generally can vote in favor of their economic interests, and because the remainder of the shareholders are often rationally ignorant, the entrenched group might be able to prevail at the shareholders' meeting even when the tactic being proposed is not in the best interest of the public shareholders. In these contexts, it can be anticipated that defensive tactics will take the form of initiatives needing approval by only a majority vote rather than ones that typically require supermajority approval, such as the issuance of new shares.

110. *See* Magnuson, *supra* note 103, at 221-22.

111. *See* Directive, *supra* note 81, pmbl., cl. 19, art. 11 ("breakthrough" rules). For discussion of these important rules, see Guido Ferrarini, *One Share-One Vote: A European Rule?*, 3 EUR. CO. & FIN. L. REV. 147 (2006) [hereinafter *One Share-One Vote*].

112. *See, e.g.*, Magnuson, *supra* note 103, at 221-22.

113. *See, e.g.*, *id.*

114. *See, e.g.*, *id.*

115. *See* Directive, *supra* note 81, art. 11(4) (lifting restrictions on transfer once an offeror acquires seventy-five percent of a company's voting capital).

116. *See id.*

117. *See id.* art. 11(2) (stating that "contractual agreements" do not apply); Magnuson, *supra* note 103, at 221-22 (describing the breakthrough rule as "[o]ne of the more controversial . . . provisions of the directive"). The effect of the breakthrough rules is mitigated, to some extent, by the requirement that "equitable compensation" be paid

The board neutrality and breakthrough rules, if implemented, represent a strong endorsement of the value of a free and open market for corporate control. Even more than the Williams Act, they seek to create a level playing field where market forces, rather than political or legal power of incumbent managers, will determine the outcome of a takeover contest.[118] However, in a bow to countries that resisted strong limitations on defensive tactics, the Directive permits member states to opt out of both the breakthrough prohibitions on defensive tactics and the requirement of shareholder approval for defensive tactics, though individual companies can opt back in, and if they do, their member state may allow them to opt out again if their counterparty is not bound by the rules.[119] Further, the Directive contains a reciprocity feature, under which a member state may decide whether to relax or waive the prohibitions or restrictions of the breakthrough and board neutrality rules in the event of a takeover bid by a company that is not subject to such rules.[120] This complex structure of opt-out and opt-in rights obviously reduces the efficacy of the Directive at harmonizing takeover regulation at the EU level,[121] and, to some, effectively converts a system of mandatory rules into a series of "recommendations."[122]

Overall, the Takeover Directive can be understood as creating a relatively level playing field between bidders and targets. The provisions of the Directive regulating the details of bids—such as disclosure, timing and related matters—apply in an even-handed manner.[123] The board neutrality and breakthrough rules are also intended to create a level playing field between target and bidder, so that the offer's success or failure will depend on its intrinsic merit as judged by the testimony of the marketplace.[124] In some respects the Takeover Directive is even more protective of bidders than the United States' Williams Act. However, this may be explained by differing political dynamics in the two areas, including the fact that a minority of states may have greater power to block legislation in the United States due to the equal representation of states in the Senate, regardless of population, and the filibuster rule that requires a supermajority vote to defeat a determined minority block.

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to shareholders whose rights are broken through. *See* Directive, *supra* note 81, art. 11(5).

118. *See, e.g.*, Dmitry Tuchinsky, *The Takeover Directive and* Inspire Art*: Reevaluating the European Union's Market for Corporate Control in the New Millennium*, 51 N.Y.L. SCH. L. REV. 689, 691 (2007).

119. Directive, *supra* note 81, pmbl., cl. (21), art. 12(1), art. 12(3).

120. *Id.* art. 12(3).

121. *See generally* Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 EUR. BUS. ORG. L. REV. 553 (2005) (cautiously endorsing opt-out rules but critiquing reciprocity provisions).

122. *See* Ventoruzzo, *supra* note 1, at 211 ("The irony of this supposed harmonization is that, as to two of the three features, the supposed imposition of the new law by the European legislature is really a recommendation.").

123. *See* Directive, *supra* note 81, arts. 7-8.

124. *Id.*, arts. 9, 11.

Evenhandedness cannot be expected within the EU with respect to potential bids by parties not represented in the EU political process. We expect, therefore, that the rules adopted at the EU level would provide avenues for protection against hostile bids from outside the EU. As a practical matter, that means the United States. The Directive, consistent with theory, allows member states to protect their firms against takeovers from the United States by adopting reciprocity rules, which would remove the board neutrality and breakthrough rules when the bidding firm is chartered in the United States.[125]

The EU could, of course, have preempted the use of target-friendly rules at the member state level.[126] However, we posited in the model that a coalition of smaller entities could block legislation at the larger entity level. This is exactly what happened with the Takeover Directive, which originally would have imposed significant protections for bidders on member states, but which was blocked due to vehement opposition from a coalition of countries that wished to provide greater protections for potential targets doing business within their jurisdictions.[127] Opposition came from countries defending the use of multiple voting shares or double-voting "loyalty" shares as control enhancing mechanisms.[128] Other countries, in turn, rejected board neutrality as excessively weakening the competitive position of companies already subject to domestic breakthrough rules, such as those forbidding multiple voting shares and voting caps in Germany.[129] In the end, both European rules became optional for member states.[130] However, the Directive intentionally made it difficult for member states to avoid these rules by requiring that they affirmatively enact legislation to opt out of the

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125. *Id.*, art. 12(3).

126. Catherine E. Halliday-Roberts, *Building a Common Frontier or Deconstructing National Identity? An Analysis of the Effort to Centralize Control of Third Country Immigration in the European Union*, 9 ILSA J. INT'L & COMP. L. 501, 519 (2002).

127. *See* John W. Cioffi, The Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration 7 (The Berkeley Roundtable on the Int'l Econ., Sept. 28, 2001), *available at* http://brie.berkeley.edu/publications/John%20Cioffi's%20paper.pdf.

128. According to a recent study, multiple voting rights shares are the most common type of control enhancing mechanism used in Denmark (5 out of 20 large capitalization companies that were examined adopted them), Finland (8 of 20), the Netherlands (10 of 19), and Sweden (16 of 20). INSTITUTIONAL SHAREHOLDER SERVICES, SHEARMAN & STERLING, L.L.P., & EUROPEAN CORPORATE GOVERNANCE INSTITUTE, REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION 119, 121, 133, 137 (2007), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf [hereinafter PROPORTIONALITY PRINCIPLE]. Blockholder CEMs, such as double-voting shares, are the most common in France, with 23 occurrences in a 40-company sample (11 of 20 large caps adopted them). *Id.* at 44-45.

129. *See* Klaus Hopt, *La 13ème Directive sur les OPA-OPE et le Droit Allemand*, *in* ASPECTS ACTUELS DU DROIT DES AFFAIRES: MÉLANGES EN L'HONNEUR D'YVES GUYON 529 (Dalloz 2003) (Fr.); Rolf Skog, *The Takeover Directive - an Endless Saga?*, 13 EUR. BUS. L. REV. 301 (2002); Tyler Theobald, *Hostile Takeovers and Hostile Defenses: A Comparative Look at U.S. Board Deference and the European Effort at Harmonization*, 15 CURRENTS: INT'L TRADE L.J., Winter 2006, at 60, 71 (2006).

130. Directive, *supra* note 81, art. 12.

provisions, rather than allowing them to opt in if they wished to be subject to them.[131]

B. Implementation in Member States

So far we have outlined the provisions of the Takeover Directive, a policy adopted at the level of the European Union. That policy is not self-implementing; it must be embodied in legislation and regulation by the member states. Moreover, as noted above, member states have the power to nullify both the breakthrough and board neutrality rules, either categorically (by opting out of the rules) or on a case-by-case basis (if the bidder is not subject to similar rules).[132] Accordingly, much depends, in practical terms, on the implementation of the Directive in the member states. This issue is analogous, at the European level, to the pattern of state regulation of takeovers discussed above for the United States.

Our theory predicts that member state implementation of the Takeover Directive will be skewed in favor of targets because in any given member state the political power of potential targets will be significantly greater than the power of potential bidders. We also anticipate that, as among member states, the stringency of antitakeover protections will be a function of the ratio of target-to-bidder political power, which may vary from state to state. These predictions are consistent with the pattern of implementation among major member states.

1. *France*

The French approach to the Takeover Directive grew out of the Lepetit Report,[133] an official advisory committee study chartered by the government to recommend how France should implement the new rules.[134] The Lepetit Report recommended the board neutrality rule as a corporate governance measure close to what was already the law in France, subject, however, to reciprocity.[135] It endorsed reciprocity as a way to establish a level playing field between domestic and foreign companies.[136] The Report argued that companies subject to neutrality would be put at a disadvantage with respect to those not applying it, creating the risk that fewer companies would place their headquarters in France.[137] The Report recommended that France reject the breakthrough rule with respect to the time when the bid is pending, on the ground that its limitation of contractual freedom was not justified by the results achieved.[138] The Report instead floated the

131. *Id.*
132. *Id.*
133. JEAN-FRANÇOIS LEPETIT, RAPPORT DU GROUPE DE TRAVAIL SUR LA TRANSPOSITION DE LA DIRECTIVE CONCERNANT LES OFFRES PUBLIQUES D'ACQUISITION (2005) (Fr.). As to the previous provisions of French law on defensive measures, see ALAIN VIANDIER, OPA, OPE ET AUTRES OFFRES PUBLIQUES (2d ed. 1999).
134. LEPETIT, *supra* note 133, at 3.
135. *Id.* at 15.
136. *Id.*
137. *Id.* at 15-16.
138. *Id.* at 10-11.

idea of increasing the flexibility and transparency of shareholder agreements and recommended a breakthrough provision invalidating voting caps after a successful bid is completed, which was in line with the prior practice of the French financial markets regulator, the *Commission des Opérations de Bourse* or COB (now *Authorité de Marchés Financiers* or AMF).[139]

The French Parliament implemented the Takeover Directive at the end of March 2006, foreseeing a broad delegation of powers to the AMF.[140] The French Code de Commerce now includes a board neutrality obligation,[141] subject, however, to reciprocity.[142] Target companies are exempt from this obligation if either the bidder or the bidder's controlling entity are not subject to a similar obligation.[143] If several companies launch a bid, the French target company may invoke reciprocity if even one of them is not subject to board neutrality.[144] When reciprocity applies in the case of a takeover bid, however, any measure taken by the board must have been expressly authorized by the general meeting of shareholders no more than eighteen months before the launch of the offer in question.[145] This provision smoothes the impact of reciprocity and decreases the room for board entrenchment, keeping the shareholders involved in any determination concerning defensive measures.[146]

Furthermore, the new law entitles French companies to issue warrants for the preferred subscription of shares in the target (*bons de souscription d'actions* or BSAs), thus enhancing the possibility for these companies to resist takeover attempts.[147] BSAs are issued upon a resolution of the

139. *Id.*; *see also* AUTORITÉ DES MARCHÉS FINANCIERS, INTRODUCTION TO THE AMF AND OVERVIEW OF OPERATIONS IN 2004, *available at* http://www.amf-france.org/documents/general/6394_1.pdf (providing an overview of the AMF).

140. As a result, the AMF Regulation on takeovers was amended on September 18, 2006. *See* Decree of Sept. 18, 2006 approving amendments to the General Regulation of the AMF, Journal Officiel de la République Française [J.O.] [Official Gazette of France], September 28, 2006.

141. *See* C. COM. art. L233-32, para. 2 (stating that, as long a public offer is pending with respect to a company the shares of which are admitted to negotiations on a regulated market, the board of directors, the supervisory board with the exception of its power to appoint executives, the management board, the general manager, or one of the delegated general managers of the target must obtain the preliminary approval of the general assembly in order to adopt any measure the execution of which could frustrate the offer, save for the search of other offers). *See also id.*, para. 3 (stating that the general assembly must approve or confirm any decision of the above-mentioned persons if made before the offer period and if it has not been totally or partially executed, is not in the company's ordinary course of business, and could frustrate the offer).

142. *See id.* art. L233-33.

143. *See id.* art. L233-32.

144. *See id.* art. L233-33, para. 1.

145. *See id.* para. 2.

146. *See id.*

147. *See id.* art. L233-32, para. 2. According to Mr. Lepetit, the BSAs are amongst the means that can be used in the context of the reciprocity contemplated by the Takeover Directive. Bruno Segré & Christophe Tricaud, *La "Pilule Empoisonnée" de Breton Examinée par les Députés*, LA TRIBUNE (Fr.), March 6, 2006, at 23.

extraordinary general meeting[148] and are freely distributed to all shareholders at the time of the bid's closing.[149] A prior general meeting's delegation to the board for the issuance of BSAs is valid only if reciprocity applies, for example if the bidder is not subject to board neutrality (e.g., a U.S. bidder), provided that the resolution was made no more than eighteen months before.[150] Otherwise, board neutrality applies and a general meeting's resolution is required after the bid's launch.[151] BSAs expire after termination of the bid or competing offers. [152]

BSAs functionally are similar to poison pills in the United States: by according preferential treatment to existing shareholders, BSAs dilute the target's share capital and can be used as a negotiating tool with the bidder.[153] However, they are procedurally different from poison pills.[154] While the latter are adopted by the target's board of directors, BSAs cannot be issued without the target shareholders' authorization in a general meeting.[155]

French law also adopted the so-called "Danone Amendment," as a result of rumors that PepsiCo, the diversified U.S. food service company, was about to launch a takeover bid for Danone, the French yogurt maker.[156] Under this provision, the AMF can require potential bidders to disclose their plans to the AMF and the public.[157] Some commentators praised this provision for enhancing disclosure.[158] However, the AMF's power to ask for information about confidential plans of potential bidders can also abort these plans if they are premature and cannot stand the light of publicity. Moreover, AMF can bar a takeover bid if the bidder has

148. *See* C. COM. art. L233-32. However, the rules of ordinary general meetings apply as to the majorities required for the meeting's validity and voting. *See id.* art. L255-96.

149. *See id.* art. L233-32, para 2. BSAs are also assigned to the bidder in proportion to the shares already owned by the same. *See* Christophe Clerc, *Les Bons d'Offre au Coeur de la Transposition de la Directive OPA*, REVUE TRIMESTRIELLE DE DROIT FINANCIER 27 (2006), at 32.

150. *See id.* art. L233-32.

151. *See id.* para. 3.

152. *Id.* para. 2 (authorizing the target company to wait until the last day of the offer to make public its intention to issue the warrants).

153. Before the recent reform introducing BSAs, the AMF was opposed to any mechanism used by the target company unilaterally to increase the price of an offer, directly or indirectly. See AMF, Communiqué de Presse, April 23, 2004, *available at* http://www.amf-france.org/documents/general/5345_1.pdf, referred to by Christophe Clerc, *supra* note 149, at 27; Daniel Ohl, *Les Bons d'Offre: la Fin des OPA Hostiles?*, 5 BULLETIN JOLY BOURSE 527 (2006); and Pierre Henri Conac *Les Bons de Souscription d'Actions 'Plavix' et les Principes Généraux des Offres Publiques*, 2 REV. SOC. 321 (2005).

154. *See* Babatunde M. Animashaun, *Poison Pill: Corporate Antitakeover Defensive Plan and the Directors' Responsibilities in Responding to Takeover Bids*, 18 S.U. L. REV. 171, 194 (1991).

155. *See* Christophe Clerc, *supra* note 149 ; Pierre Henri Conac, *supra* note 153.

156. C. MONETAIRE ET FINANCIER art. L433-1, para. V; *see also* Youssef Djehane, *International Mergers & Acquisitions*, 40 INT'L LAW. 311, 31819 (2006).

157. AMF, RÈGLEMENT GÉNÉRAL DE L'AUTORITÉ DES MARCHÉS FINANCIERS, art. 223-32.

158. *See, e.g.*, Isabelle Urbain-Parleani, *The Implementation of the Thirteenth Directive 2004/25: Country Report on France*, in DIE UMSETZUNG DER ÜBERNAHMERICHTLINIE IN EUROPA 3, 18-19 (Theodor Baums & Andreas Cahn eds., 2006).

denied an attempt to acquire the target within the past six months.[159]

France opted out of the European breakthrough rule, while leaving companies free to opt in.[160] If a company opts back in to the breakthrough rules, it cannot avoid complying with these rules on reciprocity grounds, such as on the ground that the bidder is not subject to breakthrough rules in its home jurisdiction.[161] France did adopt a limited breakthrough rule as to voting caps—clauses of the charter limiting the voting rights to a stated percentage of the share capital, such as five per cent—which are allowed in principle provided that they refer to all shares other than preferential non-voting shares.[162] In the case of a takeover bid, voting caps are suspended from the date of the first general meeting after closure of the bid, and shareholders do not encounter limits to their voting rights provided that the bidder, either alone or in concert, owns a fraction of the target's capital higher than the threshold that AMF fixes.[163] Also, any share transfer restrictions in the articles of association of a listed company are subject to a limited breakthrough rule: they cannot be used to restrict the transfer of shares tendered to the bidder in a takeover bid.[164] However, other pre-bid defenses common in French corporate practice, such as double-voting shares and shareholders' agreements,[165] were left untouched in the Directive's implementation.[166] All this is consistent with the French Government protecting large corporations—so called "national champions"—under the theory, frequently invoked by politicians, of *patriotisme économique*.[167]

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159. AMF, *supra* note 157, art. 223-35.

160. *See* THOMAS SCHÜRRLE ET AL., THE EUROPEAN TAKEOVER DIRECTIVE: STATUS OF IMPLEMENTATION 6 (2006), *available at* http://www.debevoise.com/files/Publication/ac744779-09e1-448c-aa35-003adb117040/Presentation/PublicationAttachment/b18d9b78-ab24-4a08-ab8c-075baffa25c1/EuropeanTakeoverDirective.pdf.

161. *See id.*

162. C. COM. art. L225-125 (stating that the charter can limit the number of votes that each shareholder is entitled to exercise in a general meeting, provided that this limitation applies to all shares, with the exception of preferential non-voting shares).

163. *Id.*

164. *Id.* art. L233-34.

165. *See* PROPORTIONALITY PRINCIPLE, *supra* note 128, at 44 (stating that the most common control enhancing mechanisms (CMEs) in France consist of "blockholder CEMs, such as granting double voting rights to long-term registered shareholders, with 23 occurrences in a 40-company sample, or pyramids, which have been identified in seven companies"). Also, shareholder agreements are common in large companies and newly listed ones. *Id.* at 46.

166. Under French Law, double voting rights may only be attributed to shares, also known as "loyalty shares." *Id.* at 18. Loyalty shares must "have been registered in the name of a shareholder for a specific duration of time set in the company's bylaws (such duration may not be less than two years)." *Id.* These shares are not a specific class of shares, rather "the double-voting right is considered a reward for the long-term commitment of the shareholder." *Id.*

167. For example, recently the defense against a possible foreign takeover of *Suez*, a listed company with disperse shareholders, was brokered by the French Government sponsoring a merger with *Gaz de France*, another listed company controlled by the State. *See* Peggy Hollinger, *A French Energy Champion is Born*, FIN. TIMES, July 16, 2008 ("Launched by the French government in February 2006 to thwart a hostile bid for Suez

2. *Germany*

Germany implemented the European Directive in July 2006.[168] The relevant statute opted out of both the board neutrality and the breakthrough rules.[169] As a result, German companies that are listed are subject to the lighter regime of takeover defenses that were originally included in the German Law on Takeovers (*WpÜG*),[170] unless they decide to opt into the European regime.[171] Even if a company does opt into the board neutrality or breakthrough rules, reciprocity applies if there is a general meeting resolution to this effect.[172] Thus, such companies could still resist takeovers by means that would otherwise violate the rules if the bidder is not subject to these rules in its home jurisdiction.

The *WpÜG's* treatment of post-bid defenses reflects the two-tiered structure of German corporate governance: the managing board is allowed to take defensive measures only upon approval by the supervisory board.[173] Jeffrey Gordon has described this solution as a backlash following Vodafone's successful bid for Mannesmann.[174] Indeed, the German government, which had supported the first drafts of the European Takeover Directive, switched positions and opposed the final ones after Mannesmann's takeover.[175] The *WpÜG* regime of post-bid defenses was officially motivated by reference to the notion of a "transatlantic level playing

from Enel of Italy, the deal has drawn both domestic and foreign attacks over the state's role.").

168. Gesetz zur Umsetzung der Richtlinie 2004/25/EG des Europäischen Parlaments und des Rates vom 21. April 2004 betreffend Übernahmeangebote [Law Implementing European Union Takeover Directive], July 8, 2006, BGBl. I 2006 at 1426.

169. *See* SCHÜRRLE ET AL, *supra* note 160, at 4.

170. The German Law on Takeovers, *WpÜG*, was first adopted in 2001 to introduce a mandatory legal framework for the bid-making process. *See* Wertpapiererwerbs- und Übernahmegesetz [German Law for Takeovers] Dec. 20, 2001, BGBl. I,2001 at 3822 [hereinafter *WpÜG*].

171. The opt-in procedure (foreseen by § 33(1) of the *WpÜG* for the neutrality rule and § 33(2) for the breakthrough rule) requires an amendment of the articles of association under § 175 of the German Stock Corporation Act, *Aktiengesetz* (*AktG*), for which an approval of 75% of the share capital represented in the general meeting is required. *Id.* § 33(2); *Aktiengesetz* [*AktG*] [German Stock Corporation Act], Sept. 6, 1965, BGBl. I at 1089, last amended by Gesetz, July 31, 2009, BGBl. I 2009 at 2509 [hereinafter *AktG*].

172. *See WpÜG*, *supra* note 170, § 33(2) (requiring the general meeting's simple majority: the relevant authorization will expire after 18 months). The resolution shall be communicated to the supervisory authority of the Member State in which the company has its registered office and to all the supervisory authorities of Member States in which its securities are admitted to trading on regulated markets or where such admission has been requested. The authorization shall be published on the target company's web page. *See id.* § 33c(3).

173. *Id.* § 33(1)-(2).

174. Jeffrey N. Gordon, *An American Perspective on Anti-Takeover Laws in the EU: The German Example*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 542 (Guido Ferrarini, Klaus J. Hopt, Jaap Winter & Eddy Wymeersch eds., 2004); *see also* Martin Höpner & Gregory Jackson, *An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance* 27 (Max-Planck-Institut für Gesellschaftsforschung, Discussion Paper 01/4, 2001), *available at* http://www.mpifg.de/pu/mpifg_dp/dp01-4.pdf.

175. *See, e.g.*, CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS 80 (2008).

field,"[176] with the argument that the U.S. approach, which allows for a wide discretion of the board as to defensive measures without completely inhibiting takeovers, should also be valid for Europe.[177] However, other economic and social features of the German system contributed to the board neutrality rule's rejection, despite recent changes to German corporate law[178] going in the direction of an "outsider" system, which is characterized by dispersed ownership and an active market in corporate control.[179] German firms' fear of takeovers from foreign firms fired the push to preserve takeover defenses, even though "economic patriotism" does not always prevail in Germany.[180] Similarly, the principle of codetermination, which assigns to employees and their unions half of the supervisory board seats,[181] would have been undermined by the neutrality rule's empowering shareholders to authorize defensive measures. Thus, trade unions and incumbent managers shared an interest in opposing rules that made hostile takeovers easier to accomplish.

The German rejection of the European passivity rule stands, to some extent, in opposition to the relatively broad German acceptance of the one share-one vote approach that developed long before the Takeover Directive's implementation.[182] On the one hand, German Corporations Law has long since banned the use of multiple voting shares—shares conferring more than one voting right and, therefore, permitting a holder to control a corpo-

176. Gordon, *supra* note 174, at 545.

177. However, U.S. defensive measures are finally a means through which "the target board can negotiate a higher price for shareholders," whereas in the German context they represent a barrier for control change. *See id.* at 547.

178. *See* Eric Nowak, *Investor Protection and Capital Market Regulation in Germany, in* THE GERMAN FINANCIAL SYSTEM 425, 441 (Jan P. Krahnen & Reinhard H. Schmidt eds., 2004) (discussing German corporate law modernization).

179. *See id.*; Julian Franks & Colin Mayer, Ownership and Control of German Corporations, 14 REV. FINANC. STUD. 943 (2007); *see also* Tim Jenkinson & Alexander Ljungqvist, *The Role of Hostile Stakes in German Corporate Governance*, 7 J. CORP. FIN. 397 (2001) (concerning takeovers in particular).

180. Since the 1990s, control of German companies often was acquired by foreign firms. *See* Jenkinson, *supra* note 179, at 414. In the Mannesmann case, nationalism did not prevail. *See* Höpner & Jackson, *supra* note 174, at 35. Moreover, in 2005, a merger occurred between Italian Unicredit and German HypoVereins Bank to create a true European banking group. *See, e.g.*, *Unicredit Steals a March on the Competition*, THE BANKER, August 1, 2005. *But see* Klaus Hopt, *Obstacles to Corporate Restructuring: Observations from a European and German Perspective, in* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION, 373 (Michael Tison et al. eds, 2009) (arguing that the situation in Germany is no better than in other countries, as proven by the Risk Limitation Act of 2008, which stipulates *inter alia* new disclosure obligations for investors holding ten percent or more of the voting rights in a company and was influenced by similar provisions in the United States and France).

181. Among German scholars the view is still widely held that, under § 93(1) of the *AktG*, management should act not only in the shareholders' interest, but also in the "interest of the enterprise." *See* Oliver Rieckers & Gerald Spindler, *Corporate Governance: Legal Aspects, in* THE GERMAN FINANCIAL SYSTEM, *supra* note 178, at 350, 363. *But see* Reinhard H. Schmidt, *Corporate Governance in Germany: An Economic Perspective, in* THE GERMAN FINANCIAL SYSTEM, *supra* note 178, at 386, 393, 406 (providing a critical view).

182. *See AktG*, *supra* note 171, § 12.

ration with less than a majority of the share capital.[183] On the other hand, the Control and Transparency Act of 1998 forbade listed companies from using voting caps—clauses of a company's charter limiting the voting rights of shareholders, generally to a stated percentage of the share capital.[184] Consequently, takeovers like that of Mannesmann by Vodafone were made easier, as voting caps were voided by the new law.[185] However, listed companies can still include restrictions on voting rights either in shareholder agreements or in charters by assigning the right to appoint supervisory board members to individual shareholders or shares.[186] Also, share transfer restrictions are permitted under § 68(2) of the *AktG*, which allows companies to issue registered shares transferable only upon the corporation's approval.[187] In addition, listed companies tolerate and widely employ cross-shareholdings—reciprocal holdings of two or more corporations, creating strong ties between the same and often reinforced by cross-directorships[188]—making German transition to a dispersed ownership structure more difficult to the extent that they perpetrate controlling coalitions.[189]

3. *Italy*

Italy implemented the Takeover Directive in three steps, the first, under the Prodi government, making both the neutrality and breakthrough

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183. *Id.*

184. *See* Gesetz zur Kontrolle und Transparenz im Unternehmensbereich [*KonTrag*] [Control and Transparency Act] Apr. 27, 1998, BGBl. I at 786 (amending § 12 of the *AktG*); Ferrarini, *One Share-One Vote, supra* note (providing a comparative perspective).

185. *See, e.g.*, John W. Cioffi, *Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the United States and Germany*, 7 GERMAN L.J. 533, 553-55 (2006).

186. *See AktG, supra* note 171, § 101(2) (providing that shares attributing appointment rights must in their holders' name, while their transfer requires the company's approval). On the role of these shares in takeover defences, see Peter O. Mülbert, *Umsetzungsfragen der Übernahmerichtlinie-erheblicher Änderungsbedarf bei den heutigen Vorschriften des WpÜG*, 2004 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (F.R.G.) 636, 639 (2004).

187. These shares (*vinkulierte Namensaktien*) mainly are issued by insurance companies. The management board must approve their transfer, unless the articles of association empower either the supervisory board or the general meeting to the same effect. *See* Walter Bayer, *Comment to § 68*, *in* MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ 410 (Bruno Kropff & Johannes Semler eds., 2003). As to the impact of the breakthrough rule when adopted by German companies, see Stephan Harbarth, *Europäische Durchbrechungsregel im deutschen Übernahmerecht*, 2007 ZEITSCHRIFT FÜR UNTERNEHMENS- UN GESELLSCHAFTSRECHT 37 (2007) (F.R.G).

188. On cross-holdings, see *AktG, supra* note 171, § 19(1) (providing that two companies are "reciprocally participated" if each owns more than a quarter of the other). In the case of a cross-holding, a voting restriction applies to the company that last exceeded the 25% threshold. *Id.* § 328(1). If the cross-holding relates to a listed company, the relevant shares are not allowed to vote in the general meeting for the supervisory board election. *Id.* § 328(3). Cross-holdings were recently used as an antitakeover device by Commerzbank. Frank A. Schmid & Mark Wahrenburg, *Mergers and Acquisitions in Germany: Social Setting and Regulatory Framework*, *in* THE GERMAN FINANCIAL SYSTEM, *supra* note 178, at 261, 282.

189. *See* Cioffi, *supra* note 185, at 540-41.

rules mandatory for all listed companies;[190] the second, under the Berlusconi government, reversing in favor of pure optionality—wherein the rules only apply if the companies opt into their effect.[191] This reversal was officially motivated by the current financial crisis and the need to protect corporations from takeovers.[192] The third step, made recently by the same government, reintroduced board neutrality as a default rule, the application of which listed companies can exclude in their charter.[193]

The first statute adopted for the Directive's implementation embodied a strong norm of board neutrality.[194] Article 104 of the Consolidated Financial Services Act (CFSA) already prohibited managers from undertaking actions that might frustrate the bid, other than the mere search for other bids, unless duly authorized by a resolution of an ordinary or extraordinary shareholders' meeting.[195] This provision tracked the London City Code, save for a lack of clarity as to the point in time from which the neutrality rule should apply.[196] The revised Article 104 followed the Directive by specifying that the rule applied from the time that the takeover bid was communicated to the Italian Securities Commission, *Commissione Nazionale per le Società e la Bora* (CONSOB), to when the bid was completed or expired.[197]

The first statute also included the European breakthrough rule.[198] This was not a radical departure from the law already in force, which either prohibited or rigorously limited the use of pre-bid defenses like multiple voting shares,[199] voting caps,[200] non-voting shares,[201] and share-transfer

190. Cleary Gottlieb Steen & Hamilton, L.L.P., Implementation of the Takeover Directive in Italy 1-3 (2008), http://www.cgsh.com/news/newsdetail.aspx?news=224.

191. *See id.*

192. *See id.*

193. *See* Decree-Law No. 146, art. 1(3), Sept. 25, 2009, Gazz. Uff. No. 246, Oct. 10, 2009.

194. Attuazione della direttiva 2004/25/CE concernente le offerte pubbliche di acquisto [Implementation of the Directive 2004/25/EC on Takeover Bids], Decree-Law No. 229, Nov. 19, 2007, Gazz. Uff. No. 289, Dec. 13, 2007 (amending the Consolidated Financial Services Act, Decree-Law No. 58, Feb. 24, 1998, Gazz. Uff. No. 71, Mar. 26, 1998 [*hereinafter* CFSA]).

195. CFSA, *supra* note 194, art. 104(1).

196. *See infra* Part III.B.5 (discussing the London City Code). *See* Guido Ferrarini, *Implementing the European Takeover Directive in Italy: Requirements and Options*, *in* Die Umsetzung der Übernahmerichtlinie in Europa, *supra* note 158, at 101, 106 ("In [CONSOB]'s opinion, the relevant time is when the offer is first communicated to the market. However, in the case of *INA v. Generali*, both the *TAR Lazio* and the *Consiglio di Stato* (affirming the first instance judgment) held that the passivity rule only applied to the board of the target when an offer is pending, i.e., after a formal communication of the intention to launch a bid and delivery of the relevant 'offer document' had been made to [CONSOB] under Article 102(1). As some time could elapse between the date when the bid is made known to the public and the date when a formal communication is sent to [CONSOB], the target board may have sufficient time to adopt defensive measures before being subject to the neutrality rule. This solution is clearly unsatisfactory and could frustrate the neutrality rule.").

197. Cleary Gottlieb Steen & Hamilton, *supra* note 190, at 2.

198. CFSA, *supra* note 194, art. 104-a.

199. Multiple voting shares have been forbidden in Italy for more than sixty years. *See* Codice civile [C.c.] art. 2351(4) (Italy).

restrictions.[202] Moreover, a "mini-breakthrough rule" was also in force with respect to shareholder agreements, under which shareholders were entitled to back out of voting pacts, blocking agreements, and similar arrangements when a takeover bid for at least sixty percent of the votes were in place.[203] Withdrawal from the relevant agreements was rendered ineffective if the share transfer to the bidder does not take place, such as if the bid does not go through.[204] Parties to shareholder agreements exercised this right several times, allowing takeover bids to be completed successfully.[205]

Under new Article 104-*bis*, limitations on the transfer of securities during the takeover bid period, as envisaged in the articles of association, had no effect on the bidder.[206] Likewise, in cases where a shareholders' meeting was called under Article 10, limitations on voting rights envisaged in the articles or shareholders' agreement had no force or effect on the bidder.[207] If the bidder acquired seventy-five percent of the voting shares, limitations on voting rights did not apply at a shareholders' meeting following the close of the bid called to amend the articles or remove or replace directors.[208] The first statute also included reciprocity rules as permitted under the Directive; under section 104-3, the board neutrality and break-

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200. Voting caps are forbidden for listed companies, C.c. art. 2351(3), with the exception of formerly State-owned companies, for which voting caps are allowed by the 1994 Privatizations Law if the company's charter still includes such rights although it is now publicly traded. The Italian Government appears to believe that the relevant provisions of the Privatizations Law still have force as *lex specialis* with respect to the voting caps' prohibition included in the Civil Code.

201. The issuance of non-voting shares is permitted for stock corporations in general. *See* C.c. art. 2351(2). However, in the case of listed companies, non-voting shares must be issued as "savings shares" (*azioni di risparmio*) and are subject to the relevant CFSA provisions, including the requirement that they confer preferential rights to shareholders. Limited voting shares are also allowed, such as (a) shares with voting rights limited to the extraordinary general meeting (these shares usually confer preferential rights to their holders), (b) shares with voting rights limited to the appointment of directors, and (c) shares with voting rights subject to the occurrence of specific conditions, including the launch of a takeover bid (provided that the triggering of voting rights is subject to the shareholders' approval required for defensive measures). The sum of non-voting and limited voting shares must not exceed half of the legal capital.

202. Clauses requiring board approval of share transfers are generally permitted. *See* C.c. art. 2355-*bis*(2) (stating conditions for the validity of similar clauses). However, their non-inclusion in a company's charter is a condition for the listing of shares (which must be freely transferable) at the Italian Exchange. Moreover, third party approval of share transfers is permitted also for listed companies when required by law, as in the case of "golden shares" included in the charters of formerly State-owned companies.

203. *See* CFSA, *supra* note 194, art. 123(3).

204. *See id.*

205. *See id.*

206. *Id.* art. 104-*bis*(2).

207. *Id.*

208. *Id.* art. 104-*bis*(3). However, non-voting shares issued by listed companies as "saving shares" carry preferential rights, so that the "breakthrough rule" does not apply to them. *See* Directive, *supra* note 81, art. 11(6); CFSA, *supra* note 194, art. 104-*bis*(4) (implementing the directive). Also, limited voting shares are covered only to the extent that they did not confer preferential rights upon their holders (a case presently unknown in Italian practice).

through rules did not apply if the party promoting the takeover bid was not subject to the same or equivalent provisions.[209]

The second statute, which introduced measures aimed at coping with the current economic crisis,[210] took a very different approach. The second statute made both the neutrality and breakthrough rules optional.[211] As a result, these rules were no longer applicable to listed Italian companies, except for the rather remote possibility that individual companies opted into one of the rules.[212] This amendment came as a surprise to many observers because it effects a radical change not only with respect to the 2007 law first implementing the Directive, but also with regard to the board neutrality regime that had been in place for nearly ten years under the CFSA.[213] The official link between this reversal and the financial turmoil shows that the former may have been inspired by protectionism rather than by genuine corporate governance preferences, to the extent that low stock prices may have encouraged unwanted takeovers by foreign firms which Italian companies could more easily resist.[214]

The third statute, which recently modified the second one and goes into effect on July 1, 2010, reintroduced board neutrality as a default rule.[215] Companies intending to depart from this rule therefore will be able to modify their charter accordingly before the new law enters into force. The new regime does not affect the breakthrough rule because it is still subject to an opt-in by corporations and appears to be grounded in the reduced urgency for listed companies to be protected from takeovers once the stock markets have recovered part of their losses.[216]

4. *Spain*

Spain implemented the Takeover Directive through Law No. 6 of April 12, 2007.[217] Before the Directive's implementation, secondary legislation

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209. CFSA, *supra* note 194, art. 104-*ter*(1).

210. *See* Decree-Law No. 185, art. 13, Nov. 29, 2008, Supplemento Ordinario No. 263/L alla Gazz. Uff. No. 280, Nov. 29, 2008, converted into Decree-Law No. 2, Jan. 28, 2009, Supplemento Ordinario No. 14/L alla Gazz. Uff. No. 22, Jan. 1, 2009, which amended Articles 104, 104-*bis*, and 104-*ter* of the CFSA.

211. *Id.*

212. *Id.*

213. *Id.*

214. *But see* Luca Enriques, *A Dieci Anni dal Testo Unico della Finanza: il Ruolo delle Autorità di Vigilanza*, 8, http://www.consob.it/main/documenti/Pubblicazioni/Audizioni/intervento_enriques_20081029.pdf (Italy) (arguing that abolition of the board neutrality rule could remove a disincentive for entrepreneurs to open their companies to the stock market).

215. *See* Decree-Law No. 146, art. 1(3), Sept. 25, 2009, Gazz. Uff. No. 246, Oct. 10, 2009.

216. *See* Marco Ventoruzzo, *Un Nuovo Giro di Giostra per la Passivity Rule*, LA VOCE, Oct. 6, 2009, *available at* http://www.lavoce.info/articoli/pagina1001316-351.html (offering criticism).

217. Ley 6/2007 of April 12, 2007 (B.O.E. 2007, 7787). The new law deeply reformed Spanish takeover regulation, particularly by overhauling complex rules on mandatory bids, raising criticism of the Spanish system. *See* Benito Arruñada, *Crítica a la Regulación de OPAs*, 203 REVISTA DE DERECHO MERCANTIL 29 (1992); Juan Fernández-Armesto, *Las OPAs y el Mercado de Control Empresarial: Un Balance de Diez Años de*

provided the primary foundation for the regulation of takeovers in Spain.[218] Post-bid defenses were subject to a passivity rule forbidding defensive measures after the bid's authorization by the Spanish Securities Commission, the *Comisión Nacional del Mercado de Valores* (CNMV).[219] Previous law did not specifically address the consequences of post-bid shareholder authorization of takeover defenses, though some scholars interpreted the law as allowing for such authorization on the theory that the board was only forbidden to adopt defensive measures on its own initiative.[220] The new takeover provisions include the European board-neutrality rule requiring shareholders' approval of all post-bid defenses.[221]

Experiencia, 227 REVISTA DE DERECHO MERCANTIL 37 (1998); Ana Felícitas Muñoz Pérez, *Nueva Propuesta Comunitaria Sobre Régimen de OPAs y Reforma del Reglamento en Nuestro País*, 20 REVISTA DE DERECHO DE SOCIEDADES 417 (2003); Fernando Sánchez Calero, *Régimen Jurídico de las Ofertas Públicas de Adquisición (OPAs)*, *in* COMENTARIO SISTEMÁTICO DEL REAL DECRETO 1.197/1991 (1993); Fundación de Estudios Financieros, *Observatory on Reforms of the European Financial Market (2006)*, (Foundation Papers No. 17, 2006), *available at* http://www.ieaf.es/_img_admin/118823881017.1.pdf; *see generally* Alberto J. Tapia Hermida, *El Régimen de las Ofertas Públicas de Adquisición de Acciones (OPAs) en la Unión Europea y en España* (Universidad Complutense, Documentos de Trabajo del Departamento de Derecho Mercantil 2008/20, 2008), *available at* http://eprints.ucm.es/7900/1/A._Tapia.R%C3%A9gimen_OPAs.pdf.

218. *See* Art. 60 of the Ley del Mercado de Valores [Stock Market Law] (B.O.E. 1988, 18764) (delegating the regulation of takeover bids and post-bid defences to secondary legislation) .

219. *See* Art. 14 of Real Decreto 1197/1991 Sobre Régimen de las Ofertas Públicas de Adquisición de Valores (B.O.E. 1991, 19740) (requiring the target's board to abstain from any transaction that either is not executed in the ordinary course of business or may frustrate the offer. Three types of transactions were specifically forbidden: (1) issuing shares, bonds or other securities entitling to underwrite or purchase the former instruments, unless this is done purely to execute previous resolutions of the shareholders meeting; (2) trading in the target's shares with the aim of interfering with the offer; (3) selling or encumbering corporate assets in order to frustrate the offer or affect the same). Other actions were allowed to the board, such as the search for a white knight and the performance of transactions executed well in advance of a bid and without the intent to frustrate it. *See* Luis Fernández de la Gándara & Manuel Sánchez Álvarez, *Limitación de la Actuación del Òrgano de Administración de Sociedad Afectada por el Lanzamiento de una Oferta Pública de Adquisición*, 18 REVISTA DE DERECHO DE SOCIEDADES 231 (2002); José M. Garrido, *La Actuación de los Administradores de una Sociedad Frente a una OPA Hostil*, *in* 3 DERECHO DE SOCIEDADES. LIBRO HOMENAJE AL PROFESOR FERNANDO SÁNCHEZ CALERO 2719 (Ana Navarro Salinas ed., 2002).

220. *See* Santiago José González-Varas Ibáñez, *Controles Administrativos Sobre una OPA y Posibilidades de Defensa*, 22 REVISTA DE DERECHO BANCARIO Y BURSATÍL 251, 255 (2003); Javier García de Enterría Lorenzo Velázquez, *Los Recursos y Acciones Contra las OPAs Como Medida Defensiva*, 201 REVISTA DE DERECHO MERCANTIL 423, 437 (1991). Others argued that Spanish law carried a pure passivity rule requiring the target company to abstain from post-bid defences. *See* Gándara & Álvarez, *supra* note 219, at 232; Carlos L. Aparicio Roqueiro, *Regulación de las OPA: Teoría Económica, Regulación Europea y Ofertas sobre Empresas Españolas* 44 (Comisión Nacional del Mercado de Valores, 2007), *available at* http://www.cnmv.es/publicaciones/MON2007_20.pdf.

221. *See* Art. 60-*bis* of the Ley del Mercado de Valores 24/1988 of July 28, 1988 (B.O.E. 1988, 18764) as modified by Ley No. 6/2007 of April 12, 2007 (B.O.E. 2007, 7787). *See also* Fernando Gómez Pomar & Isabel Sáez Lacave, *La Eficacia del Deber de Pasividad de los Administradores Sociales en Presencia de una OPA: Mecanismos Privados Frente a Públicos*, 1 INDRET: REVISTA PARA EL ANÁLISIS DEL DERECHO 412 (2007), *available at* http://www.indret.com/pdf/412_es.pdf; Isabel Fernández Torres, *Luces y Sombras en la Reforma de OPAs: el Papel de la Junta General en Relación con las Medidas Defensivas*

However, this rule is subject to reciprocity, provided that a resolution has been taken to this effect by the shareholders' meeting under the rules concerning charter amendments not more than eighteen months before the bid.[222]

Spain has not implemented the European breakthrough rule, except for allowing individual companies to opt into its effect by charter amendment pursuant to a shareholders' meeting resolution.[223] Pre-bid defenses generally are allowed under Spanish law.[224] Voting caps are expressly permitted by the Stock Corporations Law and are widely used by listed companies, thirty percent of which include voting caps in their articles of association.[225] These caps are intended to make takeovers more difficult: a bid must be made conditional upon removal of the relevant charter's provision by the general meeting, for the bidder could not otherwise acquire control of the target.[226] However, multiple voting shares, which could also be used to enhance corporate control by blockholders, are forbidden.[227] Because the law wants to keep some proportionality between voting and non-voting shareholders, non-voting shares, which could similarly enhance the voting power of controlling shareholders, are rarely used and can only be issued within the limit of fifty percent of the share capital.[228] The defenses found in the charters of listed companies also include supermajority rules for shareholders' meetings.[229] Similar clauses can be included in a company's charter with the aim of raising the percentage of share capital that a bidder should acquire to gain control of the target.[230] Moreover, shareholder agreements have been entered into in twenty per-

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(Universidad Compultense, Documentos de Trabajo del Departamento de Derecho Mercantil, 2008/18, 2008), *available at* http://eprints.ucm.es/7755; Javier García de Entería Lorenzo Velázquez, *El Deber de Pasividad de los Administratores de la Sociedad Afectada por una OPA*, 2 REVISTA DE DERECHO DEL MERCADO DE VALORES 89 (2008).

222. *See* Art. 60-*bis* of the Ley del Mercado de Valores, *supra* note 221.

223. *See id.* (requiring a resolution of the shareholders' meeting under the rules applicable to charter's amendments).

224. *See* Gándara & Álvarez, *supra* note 219, at 235; Lorenzo Velázquez, *supra* note 221, at 439; Juan Sánchez-Calero Guilarte, *La Armonización Disgregante: La Directiva de OPAS y el Pricipio de Neutralización de Medidas Defensivas* 23 (Universidad Complutense, Documentos de Trabajo del Departamento de Derecho Mercantil, No. 2006/3, 2006), *available at* http://eprints.ucm.es/5624/1/sancalero.pdf.

225. *See* Fundación de Estudios Financieros, *Observatorio de Gobierno Corporativo de las Grandes Sociedades Cotizadas en el Mercado de Valores Español (IBEX-35) 2004* 40 (Papeles de la Fundación, No. 14, 2005), *available* at http://www.ieaf.es/_img_admin/118823853714.pdf [hereinafter *Observatorio de Gobierno Corporativo*].

226. *See* Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325, 344 (2003).

227. *Id.* at 327.

228. Arts. 50, 90-92 of the Ley de Sociedades Anónimas (B.O.E. 1989, 30361). Share transfer restrictions are generally permitted (save for the unconditional ones), but cannot be adopted by listed companies, the shares of which must be freely transferable. *Id.* Art. 63; Art. 27f of the Reglamento de las Bolsas Oficiales de Comercio (B.O.E. 1967, 10011).

229. *See Observatorio de Gobierno Corporativo*, *supra* note 224.

230. *See* Richard S. Ruback, *An Overview of Takeover Defenses*, *in* MERGERS AND ACQUISITIONS 49, 57-58 (Alan J. Auerbach ed., 1988), *available at* http://papers.nber.org/chapters/c5821.pdf?new_window=1.

cent of the Spanish listed companies, mainly for the purpose of enhancing the voting power of the relevant parties and blocking their shares with respect to potential bidders.[231] These agreements are valid under Spanish law provided they are adequately disclosed.[232] The rejection of the European breakthrough rule therefore leaves the Spanish barriers to takeovers substantially unaffected—a result that appears to reflect a relatively high degree of protectionism for target managers.[233]

5. *United Kingdom*

Takeovers in the United Kingdom traditionally have been subject to the City Code, which bidders and targets in the City of London followed voluntarily under the supervision of the Panel on Takeovers and Mergers, a private body responsible for the interpretation and revision of the Code.[234] The Takeover Directive is aimed at "coordinating the laws, regulations, administrative provisions, codes of practice and other arrangements of the Member States, *including arrangements established by organisations officially authorised to regulate the markets. . . .*"[235] This statement clearly was intended to authorize the City Code to continue in operation in the United Kingdom. Nonetheless, the Directive had to be transposed in the member states through "laws, regulations and administrative provisions"[236]—i.e., public regulation—which can be complemented by private codes and similar arrangements. Moreover, the authority or authorities competent to supervise takeover bids must be either "public authorities, associations or private bodies recognised by national law or by public authorities expressly empowered for that purpose by national law."[237] This provision is broad enough to cover the Panel on Takeovers and Mergers as a supervi-

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231. *See* PROPORTIONALITY PRINCIPLE, *supra* note 128, at 73.

232. Art. 7 of Ley de Sociedades Anónimas, *supra* note 228; Art. 112 of Ley del Mercado de Valores, *supra* note 221. Pyramidal groups are found in twenty-three percent of listed companies in Spain and cross-shareholdings exist for five percent of these companies. *See Observatorio de Gobierno Corporativo*, *supra* note 225.

233. For example, Endesa, Spain's largest electricity company, after becoming the target of a takeover bid from E.ON of Germany, was rescued by Acciona and Enel, the Italian utility, under a strategy clearly orchestrated by the Spanish Government. After coming to control jointly a total of forty-six percent of the target's capital, Acciona and Enel launched a takeover bid for Endesa. At the same time, they agreed with E.ON that, in exchange for withdrawing from the contest, the same would acquire from Endesa a portfolio of energy assets across Europe. *See How Not To Block a Takeover*, THE ECONOMIST, April 7, 2007, at 75. The bidders also agreed on their joint-governance of Endesa. The relevant conditions were made public and show the bidders' willingness to appease the Spanish Government, which was openly hostile to the E.ON's bid. *See* Mark Mulligan, *Acciona and Enel Launch Their Promised Bid for Endesa*, FIN. TIMES, April 12, 2007, at 25.

234. THE PANEL ON TAKEOVERS & MERGERS, THE TAKEOVER CODE A1 (9th ed. 2009) (U.K.), *available at* http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf.

235. *See* Directive, *supra* note 81, art. 1(1) (emphasis supplied).

236. *Id.* art. 21(1).

237. *Id* art. 4(1).

sory authority;[238] however, it also requires the Panel's activities to be placed within a legal framework.[239]

The United Kingdom implemented the Takeover Directive in several stages. First, in 2005, the Department of Trade and Industry published a Consultative Document including detailed proposals for the implementation of the Directive.[240] Based on this document, Parliament enacted the 2006 Companies Act as the basic implementing framework.[241] This statute, however, left the detailed rules to the City Code.[242] The City Code gives the power to promulgate these rules to the Panel on Takeovers and Mergers,[243] which will continue to give rulings on the interpretation, application, and effect of the Code.[244]

With regard to takeover defenses, the board neutrality rule already was at the heart of the City Code in rule 21—which no doubt influenced the formation of article 9 of the Directive.[245] The relevant implementing power was left to the Panel by the 2006 Companies Act,[246] and the Panel retained its original rule 21, except for amendments required by the different wording of the Directive's provision.[247] However, no reciprocity was allowed—the theory being that to do so would have undermined the principles underlying the board neutrality rule.[248]

The United Kingdom did not adopt the breakthrough rule.[249] On the one hand, no restrictions are foreseen under U.K. company law on the way

238. *See* John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1788 (2007).

239. *Id.*

240. *See* DEP'T OF TRADE & INDUST., COMPANY LAW IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS: A CONSULTATIVE DOCUMENT (2005) (U.K.) [hereinafter CONSULTATIVE DOCUMENT], *available at* http://www.berr.gov.uk/files/file10384.pdf.

241. The Takeovers Directive (Interim Implementation) Regulations were created to meet the implementation deadline. They were framed as interim regulations because the key provisions had to be incorporated as primary legislation within the Company Law Reform Bill. *See* The Takeovers Directive (Interim Implementation) Regulations, 2006, S.I. 2006/1183 (U.K.), *available at* http://www.opsi.gov.uk/si/si2006/20061183.htm

242. DEP'T TRADE & INDUS., EXPLANATORY MEMORANDUM TO THE COMPANIES ACT 2006 (COMMENCEMENT NO. 2, CONSEQUENTIAL AMENDMENTS, TRANSITIONAL PROVISIONS AND SAVINGS) ORDER 2007, 9-10 (U.K.), *available at* http://www.opsi.gov.uk/si/si2007/em/uksiem_20071093_en.pdf.

243. *See* Companies Act, 2006, c.46 § 943 (U.K.), *available at* http://www.opsi.gov.uk/ACTS/acts2006/pdf/ukpga_20060046_en.pdf (conferring to the Panel the power to implement several of the Directive's provisions. The Panel remains an unincorporated body, with scope to decide on its internal structures and operational framework, and continues to have rights and obligations under the common law.).

244. *Id.* § 945. Other sections provide for information to the Panel, *id.* §§ 947-948, regulatory co-operation, *id.* § 950, hearings and appeals, contravention of the rules and sanctions, *id.* §§ 952-956, and funding.

245. *See* CONSULTATIVE DOCUMENT, *supra* note 240, at 26-27.

246. *See* Companies Act, *supra* note 243, § 943.1.

247. On the relevant differences, see THE PANEL ON TAKEOVERS AND MERGERS, THE IMPLEMENTATION OF THE TAKEOVERS DIRECTIVE: PROPOSALS RELATING TO AMENDMENTS TO BE MADE TO THE TAKEOVER CODE (2005) (U.K.), *available at* http://www.thetakeoverpanel.org.uk/new/consultation/DATA//PCP%20200505.pdf.

248. *See* CONSULTATIVE DOCUMENT, *supra* note 240, at 28.

249. *See id.* at 27-28 (providing the rationale for rejecting the breakthrough rule).

companies can structure their share capital and control.[250] On the other, few listed companies are found in the United Kingdom with differential voting structures or restrictions on the transfer of shares or voting rights, mainly as a result of market forces.[251] In addition, a breakthrough regime might not have the desired effect of promoting more open takeover markets, as companies would simply move to other jurisdictions or try to circumvent the breakthrough mechanisms.[252] As required under the Directive, listed companies are, however, entitled to opt into the breakthrough rule.[253]

C. Our Model and the Directive's Implementation

Our model predicts that takeover regulation in member states will be more target-friendly than the regulation at the EU level. This prediction is confirmed in the implementing legislation just discussed. Each of the jurisdictions we examined opted out of the breakthrough rules, thus leaving open a wide range for the operation of privately crafted takeover defenses. The board neutrality rule was more popular, but, even here, two of the five countries—Italy and Germany—opted out of the Directive. Overall, the pattern strongly confirms the prediction of more friendly takeover rules at the member-state level.

Our model also predicts that differences among member states will reflect differences of the political power of targets and bidders: where bidders are more powerful, or targets are more threatened, we are likely to see a greater scope of defensive measures. Here, we also find evidence tending to confirm the prediction, although our conclusions are more tentative. We observe that protectionism tends to be relatively greater in jurisdictions where targets have more to fear from a takeover.

In Germany, the presence of substantial numbers of publicly traded firms places target firms at substantial risk—as illustrated by Vodaphone's successful bid for Mannesmann and by worries that Volkswagen might be a potential target.[254] At the same time, powerful labor interests, represented on German supervisory boards, can be expected to resist takeovers that may threaten jobs.[255] Their ability to do so might be diminished if they legally were required to adopt a posture of neutrality with respect to takeover bids.[256] Given these political conditions, we would predict that Germany would be one of the most protective of all member states. Such is, in fact, the case: Germany has adopted the strongest anti-takeover measures of any of the countries we studied, rejecting both the breakthrough and board neutrality rules of the Directive.[257]

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250. *See id.* at 27.
251. *See* PROPORTIONALITY PRINCIPLE, *supra* note 128, at 77-80.
252. *See* CONSULTATIVE DOCUMENT, *supra* note 240, at 27-28.
253. Companies Act, *supra* note 243, § 966-69.
254. *See* Tuchinsky, *supra* note 118, at 698-701.
255. *See* Höpner & Jackson, *supra* note 174, at 32-35.
256. *See id.* at 46-47.
257. *See supra* Part III.B.2.

France also hosts a substantial population of publicly traded firms that might be subject to hostile takeovers. France, however, does not maintain a system of co-determination like the German one.[258] Labor interests in France thus are not as strongly motivated to resist the board neutrality rules. This suggests that France would tend to be more receptive to the board neutrality rules than the breakthrough rules. This is in fact the case: France opted out of the breakthrough rules and authorized poison-pill-like defensive measures but did not opt out of board neutrality.[259] Incumbent managers in France may also take solace from the Danone Amendment, which allows the French financial regulator to place certain impediments in the path of takeover bids considered unfriendly to the interests of the French state.[260]

Italian firms do not have labor representatives in either boards of directors or supervisory boards.[261] Compared with France and Germany, moreover, Italian firms face a lower threat of takeovers due to the fact that so many Italian companies, even ones of substantial size, are family controlled.[262] Family blockholding is a very effective anti-takeover device.[263] We predict, therefore, that Italy will be more receptive than these other countries to the board neutrality and breakthrough rules. Until recently, this prediction was borne out.[264] Even before the Directive, Italian law had contained the equivalent of board neutrality standards and imposed substantial breakthrough provisions.[265] Because most potential targets had no reason to fear these rules, they did not mobilize sufficient opposition against them, and the interest of potential bidders was correspondingly larger.[266] The first Italian implementing statute carried out this pattern, adopting both the board neutrality and breakthrough provision of the

258. EIRIK G. FURUBOTN & RUDOLF RICHTER, INSTITUTIONS AND ECONOMIC THEORY: THE CONTRIBUTION OF THE NEW INSTITUTIONAL ECONOMICS 389 (2000).

259. *See supra* Part III.B.1.

260. *See id.*

261. The prevailing corporate governance structure in Italy consists of a board of directors and a board of statutory auditors. A few listed companies have either a two-tier or a one-tier structure, as allowed by the 2003 company law reform. *See* Guido Ferrarini, Paolo Giudici & Mario Stella Richter, *Company Law Reform in Italy: Real Progress?*, 69 RABELS ZEITSCHRIFT 658, 676 (2005).

262. One study reports that 65.8% of Italian listed companies have a blocking shareholder minority of at least 25%. Marco Becht & Colin Mayer, *Introduction*, *in* THE CONTROL OF CORPORATE EUROPE 1, 22 (Fabrizio Barca & Marco Becht eds., 2001).

263. *See* Martin Holmen & Eugene Nivorozhkin, *The Impact of Family Ownership and Dual Class Shares on Takeover Risk*, 17 APPLIED FIN. ECON. 785 (2007).

264. *See supra* Part III.B.3.

265. *Id.*

266. *See* Luca Enriques, *Modernizing Italy's Corporate Governance Institutions: Mission Accomplished?* 32 (University of Bologna, European Corporate Governance Institute, Law Working Paper No. 123/2009, 2009), *available at* http://ssrn.com/abstract=1400999 (arguing that recently almost no company existed in Italy that could really be taken over via a hostile bid); Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking Armour & Skeel's Thesis to Continental Europe* (Bocconi University, Legal Studies Research, Paper No. 2008-02, 2008), *available at* http://ssrn.com/abstract=1084429 (arguing that, in concentrated ownership systems, controlling shareholders might actually favor a board neutrality rule).

Directive.[267] The second Italian statute opted out of both;[268] however, we interpret this in part as a gesture by the Berlusconi government to respond to the burgeoning financial crisis as well as a favor to potential targets who are significant supporters of the present government. The third Italian statute, however, recently reintroduced board neutrality as a default rule, which substantially confirms our interpretation.

Spain, like Italy, has many family-owned firms which are substantially protected from hostile takeovers due to large block ownership.[269] We would predict, therefore, that Spain would adopt an intermediate level of takeover protection. This prediction appears to be borne out. Spain's implementing legislation adopts board neutrality but rejects the breakthrough rules.[270] Background law in Spain permits a substantial but not unlimited array of takeover defenses that would otherwise be subject to challenge under the breakthrough rules.[271] Spanish law thus provides significant protections to incumbent managers, going well beyond what would be permissible under the Directive in the absence of legislation opting out of the breakthrough rules, but still less protection than is available in Germany and France.

The United Kingdom presents a special case. Although U.K. target firms are vulnerable to takeovers because they are publicly traded and lack large family block ownership, the interests of potential bidders are also strong.[272] The United Kingdom has long been the financial center of Europe, and the British government has a powerful interest in maintaining that position. Thus it can be expected that U.K. law will cater, to a substantial extent, to the interests of big international and U.K.-based firms—firms that are more likely to be bidders than targets.[273] Where bidder interests are strongly represented, takeover protections can be expected to be relatively moderate. The City Code included a board passivity rule long before the Takeover Directive, while the need for breakthrough rules was

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267. *See supra* Part III.B.3.

268. *See id.*

269. Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365, 379 (2002).

270. *See supra* Part III.B.4.

271. *See id.*

272. *See* Faccio & Lang, *supra* note 269.

273. John Armour and David Skeel explained these developments mainly by reference to institutional investors, who became significant shareholders of listed companies much earlier than in the United States and influenced rule-making, i.e., "the formation of formal and informal norms that govern the operation of corporate enterprise." Armour & Skeel, *supra* note 238, at 1771. However, the same scholars also acknowledged that, by the time when the City Code was first adopted in 1968, most bids "were driven by consolidation, and managers were just as likely to be bidders as targets in this milieu." *Id.* at 1775-76. Sixty-nine percent of U.K. companies feature no CEM. PROPORTIONALITY PRINCIPLE, *supra* note 128, at 77. Therefore, the board neutrality rule, in addition to encountering the favor of institutional investors, was easily accepted by potential bidders/targets because of its evenhandedness. Armour & Skeel, *supra* note 238, at 1775-76.

not felt given the limited presence of control enhancing mechanisms in U.K. listed companies.[274]

Conclusion

This paper advances a simple theory of takeover regulation. The theory has two parts. First, we posit that the observed pattern of rules can be understood in part as a product of political forces operating at different geographical levels and under different conditions of target and bidder interests. The respective political powers of bidders and targets tend to be a function of the geographic size of the territory within which a takeover law operates: the larger the territory, the larger the power of bidders vis-à-vis targets (and vice versa). Thus, other things being equal, we expect to observe that takeover regulation will be increasingly target-friendly as the geographic scope of regulation narrows. This prediction is powerfully confirmed by the evidence: takeover regulation in both Europe and the United States is much more target-friendly at the smaller geographic level (U.S. states or EU member states).

Second, holding geographic scope constant, we posit that the tenor of takeover regulation will reflect the respective political interests of bidders and targets within a given geographic area. Restrictive takeover rules can be expected in jurisdictions where targets are strongly represented or feel vulnerable to hostile bids; more liberal rules are to be expected in jurisdictions where bidders are strongly present or targets are insulated from takeover threats for reasons other than the takeover regime. Again, this prediction appears borne out by the evidence. In particular, the theory helps explain why Delaware, in the United States, and the United Kingdom, in the EU, both administer regimes of takeover regulation that are relatively more friendly to bidder interests than are the rules applied by other states or countries.

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274. *See* Ferrarini, *supra* note 5, at 18.