

HOSTILE TAKEOVERS AND HOSTILE DEFENSES: A COMPARATIVE LOOK AT U.S. BOARD DEFERENCE AND THE EUROPEAN EFFORT AT HARMONIZATION

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ABSTRACT

The United States and the European Union have taken very different approaches in dealing with tender offers, especially in respect to the amount of power the board of directors has to block an unwanted takeover attempt. The United States has no single set of guiding principles regarding most of substantive corporate law and the field of tender offers is no different. The European Union, on the other hand, has very recently passed legislation that not only attempts to harmonize the corporate takeover laws of all its member states, but seeks to restrict the power of the board of directors. The European Union passed the 13th Directive on Takeovers after much debate and previous failure. Although the European Union required its member states to implement this legislation by May of 2006, only a handful of nations have actually met this goal, leaving the true effectiveness of this harmonization effort in doubt. This paper analyzes not only these different approaches of regulating corporate takeovers and the tender offer process, but also explores alternative theories of governance in order to better understand how we got to where we are and to best predict where we are headed in the future.

I. INTRODUCTION

Perspective defines corporate reality, at least it does when looking at the respective powers of the board of directors and shareholders in hostile tender offers. Europe and the United States view takeover law and hostile takeovers from entirely different perspectives, which has led to divergent laws and corporate powers. Corporate law in the U.S. is state law.¹ True to federalist principles and competitive roots, each state has its own set of corporate laws, enacted to draw corporations to incorporate in its state. In this battle for business, Delaware has emerged the current winner and is the focus of the majority of corporate law studies. Importantly, in this struggle for corporate business, the grand effect has been to increase the power of the corporate boards of directors, especially in the realm of defenses to hostile takeovers.²

The European Union, on the other hand, has brought sovereign nations together and focused on the harmonization of national laws.³ True to this effort to harmonize, the E.U. has focused on defining a single set of underlying principles to guide its members when writing takeover law in their own countries. It is not a battling system of laws, but a unified set of core values which the states

will use to legislate from. This system seeks not only to create a balanced playing field for shareholders, but it rejects the U.S. precedent of nearly unrestricted board power to defend against a hostile takeover. However, because the E.U.'s Takeover Directive is only in its infancy, it is yet to be seen whether or not its implementation will match its goals to reality.

A. THE TENDER OFFER AND THE DEFENSE: WHAT ARE WE TALKING ABOUT?

Essentially, a tender offer is an offer to the shareholders of a corporation to buy a specified number of shares (have the shareholders "tender" their shares) for a premium value.⁴ These offers are open for a specified period of time and usually require that a minimum number of shares be tendered for the purchase to go through. Although originating as a way for the corporation to buy back its stock, it has developed into a powerful corporate takeover tactic,⁵ which has led to a heated debate regarding the proper powers and roles of the board of directors and the shareholders in a transaction that will cause a change of control.

Tender offers, as discussed here, are hostile efforts to takeover a company. Boards of Directors have fought against these hostile

tender offers by effectuating a variety of defensive measures including selling off assets, making a counter bid for the hostile acquirer (Pac-Man Defense), and seeking out a more attractive acquirer (White Knight). We will focus here on the most effective and debated defensive weapon, the “shareholder rights plan”, also lovingly known as the “poison pill.”⁶

The poison pill refers to a variety of board measures, the most popular being the “flip-in” measure which gives the shareholders the ability to redeem an option to buy company stock at a very low price, or even at no cost, based upon a “triggering event.”⁷ It prevents takeovers by threatening to severely dilute the value of the stock (making it financially unviable for the purchaser) and by obligating the acquiror to use the acquired company funds to pay huge amounts of money to the shareholders instead of using that money to repay the takeover financing.⁸ These pills also allow the target board management to redeem the pill, or effectively negate the option, so that the transaction can go through, which in theory forces the acquirer to deal with the board instead of making a hostile bid.⁹ Most of the current litigation in this area concerns situations, if any, that require a board to redeem the poison pill to allow a takeover attempt.¹⁰ As of 2005, over 2,300 companies had adopted a poison pill.¹¹

The poison pill’s inventor, Martin Lipton, argues that he created these measures in order to protect corporations from abusive takeover practices and inadequate bids. He created these measures to increase the board’s bargaining position, to protect shareholder investment by preventing corporate raiders, and to increase the takeover premium.¹² However, Lipton’s nemesis, Ronald Gilson,

argues that Lipton’s invention does not serve its purposes and is instead an abuse of management power to the detriment of the shareholder.¹³

Further, boards have used staggered board arrangements in conjunction with Lipton’s poison pill, which adds even more bite to this defensive tactic. In theory, a hostile acquiror can overcome a poison pill by waging a proxy contest to oust the defending board and replace it with a board that will redeem the poison pill.¹⁴ In reality, however, the stag

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gered board entrenches existing management against such a tactic.¹⁵ A bidder would have to wait through multiple voting periods since only a small number of seats are contestable in any given period, which gives the management a veto right over a takeover through numerous election cycles.¹⁶ Evidencing the effectiveness of this defensive duo against acquisition is the fact that there are no reported cases of successful acquisitions where the board had a poison pill in place.¹⁷

B. THE FIGHT CARD: THE BATTLE OF INTERESTS AND THE CONFLICT OF LAWS¹⁸

In this debate over allocation of power, there is a clear line between those who feel the board of directors, consistent with its corporate governance role, should have almost unrestricted power to choose whether or not to defend against a hostile takeover,¹⁹ and those who feel the shareholders should

have the ultimate power to choose whether or not to tender their shares without board interference.²⁰ Since current law allows for broad use of defensive powers, it is the critics of these powers who bring this debate, and do so most fiercely in respect to an arguably “obvious and inherent conflict of interest.”²¹ Critics argue that although a tender offer allows a shareholder to sell his or her stock at a price above the current market value, it also can result in the forced removal of the current board of directors, who would like to remain in power.²² Further, the board can use its entrenched position to gain advantages, which it would not share with the shareholders.²³

In the U.S., states have given broad deference to the board of directors when it comes to who gets to decide the corporation’s fate in a hostile tender offer.²⁴ Critics of this power argue that this is not an accident, but the result of states seeking to maximize the number of corporations which charter and reincorporate within its borders.²⁵ Indeed, these critics cite the adoption of anti-takeover statutes in nearly every state to indicate the desire to provide protection to the incumbent management.²⁶ The theory goes, that managers want to keep their jobs and the benefits that come with it, which they can ensure by choosing a state that provides the most obstruction to hostile takeovers.²⁷

The internal affairs doctrine, which underlies U.S. corporate law, provides that corporations are governed by the laws of the state in which they are incorporated, even requiring other states to defer to the substantive law of the corporation’s jurisdiction.²⁸ This doctrine and the desire to draw more corporations into the state has arguably created a “race to the bottom,” the lessening

of shareholder rights and the elevating board powers in order to attract more corporate business into the state. Alternatively, some argue that this competition for corporate business has not and will not create a race to the bottom. Instead, competition will lead to a “race to the top,” where shareholders will choose not to invest in corporations incorporated under unfavorable laws, thereby inducing states to maximize laws benefiting shareholders.²⁹ Regardless of who wins this debate, the fact remains that current state laws in the U.S. defer to the board over the shareholders in deciding when to implement takeover defenses.

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The E.U., however, takes the alternate view and seeks to elevate the interests of the shareholders by forcing board neutrality in a manner consistent with the United Kingdom’s City Code, which actually inspired much of the E.U.’s 13th Directive on Takeovers (“the Directive”).³⁰ Article 9 of the Directive presents the clearest departure from U.S. takeover practices. It prevents the board of directors from enacting post-bid defensive measures and requires it to remain neutral and not act to frustrate the bid.³¹ The effectiveness of this effort to keep the board neutral and less like the U.S. model of strong board anti-takeover powers, however, relies on the degree of implementation of the Directive’s principles by the individual member states.³²

Contrary to the internal affairs doctrine

dominant in the U.S., the E.U. seeks harmonization and not competition of different jurisdictional laws, a goal mandated by the European Community Treaty and its policy of creating a common market.³³ The E.U. is currently seeking to draw its members away from the application of the European equivalent of the internal affairs doctrine, the Incorporation Theory. Proponents of the Directive fear that this theory would lead to a “European Delaware Syndrome” by creating competition among the member states to introduce more permissive corporate law.³⁴ The counter to this permissive theory is the Real Seat doctrine. This doctrine provides that the governing law of a corporation is the law of the country where it keeps its main office, or “real seat,” not simply where it chooses to incorporate.³⁵ This doctrine restricts the movement of corporations to find more permissive laws because although a corporation could still theoretically change the jurisdictional law that governs it, doing so is unlikely because of practicality and the substantial costs of moving its primary place of business.³⁶ Thus, the Real Seat theory arguably prevents the Delaware syndrome and a race to the bottom by keeping corporations in place and making it difficult to change locations for the purposes of operating under less restrictive laws.³⁷

II. THE UNITED STATES

A. CORPORATE LAW IS STATE LAW: DELAWARE REIGNS SUPREME

In the United States, corporate law is state law and Delaware leads the field.³⁸ Generally, in the U.S. the board of directors have vast authority to manage the affairs of the cor-

poration and to block hostile tender offers. Delaware is “the” place to incorporate based on its experienced judiciary, its commitment to meet the needs of its corporate customers and the indeterminacy of its law.³⁹ Indeterminacy makes Delaware law incompatible with rival state laws, even those similar to Delaware law, keeping the benefits of incorporating in Delaware away from outsiders.⁴⁰ Indeterminacy can increase the costs of doing business and thereby lessen the attractiveness of the laws. However, the experience and sophistication of the Delaware judiciary keeps these costs low, an advantage absent in states whose laws compare to Delaware’s but whose judiciary does not.⁴¹ Delaware recognizes this ability of its judiciary to keep the costs of indeterminacy low, which has led the state to further invest in it.⁴²

Lastly, Delaware’s incompatibility with other state laws makes it expensive for corporations to leave the state. Corporations stay in the state lest they have to deal with entirely different laws or at least a judiciary less capable of handling corporate issues.⁴³

Although state law currently controls the majority of corporate law, the federal government, true to form, has refused to completely cede regulatory control. The Federal government entered the arena in 1968 when it enacted the Williams Act to regulate the dramatic increase in the use of cash tender offers and to protect shareholders from what was a very secretive and abused process of corporate control change.⁴⁴ The Williams Act added sections 13(d)-(e) and 14(d)-(f) to the Securities and Exchange Act of 1934.⁴⁵ The most important of these regulations was the addition of disclosure requirements for the bidding entity as well as time and price limitations. For instance, sections 13(d) and

14(d) mandate disclosure of bidder identity and information to the target company, its shareholders and also requires the bidder to file the information with the SEC after it gains more than a five percent hold of the company stock.⁴⁶ These provisions, however, apply only to certain companies.⁴⁷ Further, the Act sought to give shareholders not only the best information possible, but the best price and adequate time to consider their options. Therefore, an acquirer must hold all tender offers open for at least 20 days, and if there is any subsequent change in the offer, the acquirer must hold the offer open for at least 10 days following the change.⁴⁸ Also, the Act has a “best price rule,” which states that if a bidder makes any subsequent increase in price, all tendering shareholders must get that price.⁴⁹ Although the federal government seeks to regulate part of the process, it is still state law which governs the substantive tactics⁵⁰ that have led to the heated debated regarding the respective powers of management and shareholders.

B. STATUTORY POWER TO THE BOARD: THE STATES WEIGH IN

Arguably, the most significant takeover development during the 1980's and 1990's was the development of state takeover laws aimed at providing protection to the local incumbent boards.⁵¹ Starting with Virginia in 1968, 37 states adopted takeover statutes to more thoroughly regulate the tender offer process than the William Act had.⁵² The state effort at regulating tender offers in this first generation of takeover statutes came to an abrupt halt with the Supreme Court's decision in *Edgar v. Mite Corp.*, which declared such regulation unconstitutional.⁵³ The state

statutes favored management and barred a tender offer anywhere in the U.S. unless the requirements of the state statute had been met, usually disclosure requirements similar to the Williams Act.⁵⁴ Because of the inherent favoritism towards management and the uncertainty as to how many state statutes might be applicable to any one merger, the SEC and private litigants attacked the constitutionality of these statutes.

In *Mite*, Mite Corporation, a Delaware Corporation, initiated a tender offer for a Chicago based company. Mite followed the disclosure guidelines of the Williams Act but did not follow the Illinois law, which required more specific disclosure and gave the secretary of state a veto power over unfair takeovers, arguing that the Williams Act preempted any such state regulation.⁵⁵ The Court's problem with the Illinois law was that instead of just regulating the commerce within its own borders, the law had “nationwide reach,” which required compliance and gave Illinois the ability to control an offer made to a shareholder regardless of which state the shareholder lived in.⁵⁶ The Court held this type of state regulatory statute unconstitutional as a direct burden on interstate commerce and frustrating the intent of the Williams Act.⁵⁷

Following this decision, state legislatures went to work again and enacted the next generation of takeover statutes: control share acquisition statutes, fair price statutes, cash-out statutes, and business combination statutes.⁵⁸

Control share acquisition statutes prohibit an acquirer of a certain percentage of stock from voting those shares unless a majority of disinterested shareholders grant the acquirer voting rights.⁵⁹ These have the effect of

imposing significant barriers to a potential acquiror because it may end up purchasing an expensive block of shares that it is unable to make any use of.⁶⁰

Fair price statutes address a two-tiered offer, which arguable coerces shareholders into tendering their stock in the fear that if they hold out and the bid is successful, the acquiror will offer a very low price for their shares in the second-tier.⁶¹ The statutes generally require the bidder pay a fair price for any non-tendered shares to ensure the price in the second-tier is as fair as if it was in the first tier.⁶² Further, if the fair price requirements are not met, statutes like that of Maryland subjected the bidder to the requirement of getting 80% shareholder approval and two-thirds disinterested shareholder approval for any second tier merger.⁶³ These statutes helped to stem the coercive effect, but did not adequately address “abusive partial bids.”⁶⁴

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Cash-out statutes, like fair-price statutes, require that an acquiror who has obtained a controlling interest in a company, upon request by a non-tendering shareholder, buy the outstanding stock at a fair price. This forces the acquirer to buy the stock outstanding after the tender offer at the price offered during the tender offer.⁶⁵

Business combination statutes impose a moratorium on specified transactions between the target and a shareholder with a certain amount of stock unless the board

of directors approves the stock acquisition or the transaction prior to the shareholder obtaining a certain percentage of the company stock.⁶⁶ These statutes are supposed to help prevent coercive two-tiered takeovers and “bust up” or dismantling takeovers, by preventing action by the acquiror after a successful bid.⁶⁷

It seemed as though these statutes were doomed to the same fate as the first generation statutes, which the Supreme Court declared unconstitutional in *Mite*.⁶⁸ In *CTS Corp. v. Dynamics Corp. of America*, however, the Supreme Court upheld the constitutionality of these statutes.⁶⁹ In *CTS*, the court looked at this new generation of state statutes in a challenge to Indiana’s control share acquisition law.⁷⁰ Distinguishing *Mite* on the basis of its nationwide blocking power, the court held that Indiana’s law did not frustrate the William’s Act because these statutes sought to place the shareholders on equal footing with the bidder. The mere delay they caused in an acquisition was insufficient grounds to find that Williams Act preempted the state law or that the state law frustrated the purposes of the Act.⁷¹

The holding in *CTS* freed states up to enact more stringent anti-takeover legislation. The next generation of statutes, the third generation, gave rise to the poison pill, constituency statutes, and director indemnification statutes, which give the board more protection when defending against a takeover.⁷² Hotly debated, this third generation of takeover statutes gives the board of directors an unprecedented arsenal of power and protection. Constituency statutes, for instance, diverge from the traditional fiduciary duties of directors to shareholders and allow the board of directors to consider other

constituencies when deciding whether or not to “[unleash] anti-takeover weaponry.”⁷³ Instead of acting to maximize the welfare of the shareholder, the statutes allow the board to reject the best offer for the shareholders in favor of an alternative constituent such as a creditor or neighborhood.⁷⁴

The board undoubtedly has substantial power under these statutory schemes, especially as defined by the Delaware courts.

C. POWER TO THE BOARD, DELAWARE STYLE

The source of the board’s power comes from state statutes in line with Delaware’s statute, which makes the board of directors the sole decision making authority regarding corporate business and also the legal deference paid to those decisions by courts

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under the business judgment rule.⁷⁵ The business judgment rule, grounded on the belief that the directors are better equipped to make business decisions, is a reputable presumption that they acted in good faith, on an informed basis, and with an honest belief that it was in the best interest of the corporation.⁷⁶ Courts respect this presumption absent a showing that the board abused their discretion in making a decision by being ill-informed or self-interested.⁷⁷

The Delaware courts have applied this deference to the realm of hostile takeovers and the board’s ability to use defensive tactics.

The deference given to the boards in the takeover situation, however, is not as absolute as the pure business judgment rule. Courts have found it proper to regulate management actions where there is an inherent conflict of interest.⁷⁸ Thus, Delaware courts have applied an enhanced business judgment rule to contests of corporate control where the board would be tempted to decide an issue in favor of its own interests rather than those of the shareholders.⁷⁹ Further, the Delaware courts have defined a line and a limit of deference between defensive actions to protect the company and defensive actions in situations where the company is clearly for sale or its break-up is inevitable.⁸⁰

This enhanced business judgment rule came out of the Delaware Supreme Court decision in *Unocal Corp. v. Mesa Petroleum (“Unocal”)*.⁸¹ Mesa was a minority shareholder in Unocal and initiated a hostile tender offer to buy Unocal stock, which the Unocal board felt was insufficient.⁸² In response, the Unocal board issued an offer to buy back its stock at a price above Mesa’s offer and excluded Mesa from this offer.⁸³ The board’s reasoning for this exclusion was that if it in fact bought back Mesa’s shares it would essentially be financing Mesa’s inadequate tender offer.⁸⁴ The board also argued Mesa had a reputation of being a “greenmailer” and that its financing, which was inadequate, would cause shareholders to tender in fear that Mesa would offer holdouts significantly less after a successful takeover.⁸⁵

The *Unocal* court affirmed the broad powers that §141(a) granted to the board of directors and expanded these powers to so as to allow the board to protect the corporate entity and shareholders from a reasonably perceived threat.⁸⁶ Because of the threat of

self-interest in the takeover context, however, the court felt that decisions on defensive tactics had to be scrutinized under an enhanced business judgment rule. This rule requires the board to show that through good faith and reasonable investigation 1) they reasonably perceived a threat to the corporate entity by another person's acquisition of ownership and 2) their response was proportional to the perceived threat.⁸⁷ The process for determining whether the business judgment rule applies has been labeled the "Unocal test." The court found the Unocal board to have met this enhanced scrutiny because of the nature and price of Mesa's offer and its reputation for greenmailing.⁸⁸

Essentially, the ability of the board to meet its burden under the Unocal test is the "whole ballgame."⁸⁹ The test creates a case-by-case analysis where if the board of directors carries its burden, the business judgment rule will apply to shield its decision from judicial intervention.⁹⁰ But, if the board fails to meet its burden the court applies a much stricter and almost impossible intrinsic fairness test.⁹¹

In the same year as *Unocal*, the Delaware Supreme Court decided *Moran v. Household Int'l, Inc.*⁹² Household adopted a "poison pill" as a preventative measure against any possible futures takeovers, which allowed shareholders the right, in the event of a successful takeover, to purchase \$200 worth of stock from the acquirer for \$100.⁹³ The current board had the authority to redeem the rights at a very low price.⁹⁴ The court held that Delaware Corporations Code §157 allowed a board of directors to deploy a "poison pill" *without shareholder approval* in order to prevent a hostile tender offer⁹⁵ (emphasis added). Further, if faced with a

hostile tender offer and a request to redeem the rights, the company's decision to deny the request could not be arbitrary, but instead had to be the result of a legitimate and non-conflicted exercise of board power subject to court scrutiny under *Unocal*.⁹⁶

The process for determining whether the business judgement rule applies has been labeled the "Unocal test."

In *Revlon*, the Delaware Court invalidated the defensive action of the Revlon board and made clear that although broad, the board of director's authority was not absolute. There, Pantry Pride initiated a tender offer for Revlon stock, which the Revlon board considered too low.⁹⁷ In response to the initial low tender offer and the subsequent increased Pantry Pride tender offer bid premiums, Revlon knew that its sale was inevitable and sought out a "white knight," Forstmann. Eventually, Revlon granted Forstmann lock-up options⁹⁸ in Revlon assets, which effectively ended bidding even though the Pantry Pride bid was higher.⁹⁹ The Court held that this type of situation was different from *Unocal*.¹⁰⁰ Once a company is clearly for sale, the board has a duty to play auctioneer and to secure the highest price possible for the common stock.¹⁰¹ Ignoring the duty to the shareholders to maximize the sale price in favor of a deal which protected the directors from liability to note holders breached the board's duty of loyalty.¹⁰² *Revlon* reaffirmed Unocal's requirements of a reasonable response to a reasonably perceived threat, but more importantly stated that the board's duty is altered to that of an auctioneer once change of control or sale becomes

inevitable.¹⁰³

The Court clarified this standard in *Paramount Communications v. Time, Inc.*¹⁰⁴ The court identified two scenarios which invoked the *Revlon* auctioneer duty: when the board actively initiates a bidding to sell itself or break-up the company, and also where the board abandons the company's long term strategy in favor of a break-up of the company.¹⁰⁵ Paramount made a tender offer to Time, which Time labeled as inadequate based upon the likely merger between Time and Warner, which would dramatically increase the value of the company.¹⁰⁶ The board, concerned that shareholders would tender, restructured the merger of Warner as a tender offer and prevented the shareholders from accepting the Paramount offer.¹⁰⁷ The Court held that Time's action did not invoke either of the *Revlon* situations because there was no evidence that the reworked merger with Warner represented either a decision to sell Time or an effort to break-up Time.¹⁰⁸ The Court found that the defensive response was reasonable to the perceived threat and that such action didn't prevent Paramount from subsequently bidding on the combined Time-Warner.¹⁰⁹

The previous cases lead us to the modern day framework enunciated in *Paramount v. QVC*.¹¹⁰ Paramount agreed to merge with Viacom, amended its poison pill to permit the merger, and granted Viacom stock lock-ups and a no-shop promise.¹¹¹ QVC then made a tender offer bid, which Viacom countered, and which QVC subsequently countered. Paramount refused to alter its preference for Viacom, calling QVC's offer illusory.¹¹² The court restated the *Revlon* rule and its auctioneer requirements when the company initiates a bidding process, when

its break-up is inevitable. But, the court noted that Revlon is not limited to just these two scenarios.¹¹³ The court found that this case fell into the first category because the Paramount board had essentially entered into a bidding process and thus had a duty to modify its bid with Viacom and negotiate with QVC in order to get the highest price for the shareholders.¹¹⁴ The court stated that the board had a duty to protect its Shareholders in a change of control because when a buy-out or change of control occurs the shareholders become minority shareholders and lose any meaningful voting influence.¹¹⁵

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Through the preceding cases and *Unitrin*,¹¹⁶ the Delaware courts have validated the vast board power to defend against takeovers, and have subjected this power to very few limitations, such as the bidding or break-up process of *Revlon* or *QVC*.

D. RECENT BAD BEHAVIOR: THE FEDERAL HAMMER AND ITS EFFECT ON THE FUTURE OF COURT DEFERENCE TO THE BOARD

In June 2002, Congress passed the Sarbanes-Oxley Act, in response to management scandals such as Enron and WorldCom, in order to create and enforce more stringent management accountability. In doing so, Congress may have indeed affected the amount of deference the Delaware courts are now willing to give to management.¹¹⁷ In a late 2003 article, an author noted that in

every case dealt with by the Delaware courts regarding directorial powers and duties after Congress passed the Sarbanes-Oxley in 2002, the courts ruled against management and in favor of shareholder power.¹¹⁸ Another significant occurrence was the expansion of the *Blasius* doctrine into the *Unocal* realm of corporate control and defenses.¹¹⁹

In *Blasius*, the Delaware court addressed a case where the Atlas board, in response to a possible future proxy fight with Blasius, expanded the size of its board and filled the vacancies in order to thwart Blasius, not from taking complete control, but from gaining enough board seats to implement what the Atlas board felt were bad policies.¹²⁰ The court acted to protect shareholder voting rights and held that a high standard of scrutiny applies when board actions have the primary purpose of impairing the shareholding franchise and that the board has the burden to show a compelling justification for its conduct.¹²¹ Thus, a court can find a violation of board duties even where the board acted reasonably and in good faith; these requirements being the same requirements under *Unocal* that invoke deference under the business judgment rule.¹²² This is significant because no board has ever met the burden under *Blasius*.¹²³

In 2003, the *Blasius* review toppled the board powers and deference in *Liquid Audio* decision.¹²⁴ The Delaware Supreme Court expanded the impassible compelling justification test, applying it to the realm of defensive measures enacted by the board to prevent a change of control by interfering with the shareholder's ability to elect directors.¹²⁵ This decision was pro-shareholder move and marks the willingness and ability of the courts to ignore the business judg-

ment rule and apply their own judgment, arguably to the detriment of corporations and corporate law.¹²⁶

Scholars argue that this move against board deference is directly related to Congress enacting the Sarbanes-Oxley.¹²⁷ Delaware courts have historically reacted to and changed its policies when threatened with federal preemption into corporate issues and it is argued that this current move is Delaware's response to Sarbanes-Oxley and to avoid further Congressional meddling.¹²⁸ This trend may lead away from *Unocal*, its business judgment deference, and the policy that absent abuse, management is the more skilled corporate decision maker, and may lead to substantive scrutiny of board defensive actions taken in hostile takeovers.¹²⁹

E. THE POWER STRUGGLE AND THE GREAT DEBATE: SHAREHOLDERS V. THE BOARD

Is all this power a good thing? As stated previously, state law favors incumbent management in the takeover context providing them with a vast array of tools to fend off potential acquirors. Proponents of these defensive measures cite the necessary deference to board business decisions and apply that rationale to the ability to protect shareholders from insufficient bids, to encourage higher premiums, to protect the shareholders from a distorted choice of tendering their shares, and to implement long-term company goals.¹³⁰

There are, however, many scholars who argue that the legislatures and courts have gone too far and have given too much deference to the board of directors especially in the defenses arena where there is such an apparent

conflict of interest between the board's desire to stay in power and the shareholders desire to maximize their investment.¹³¹ Further, they argue that tender offers are an essential and healthy component in maintaining optimal corporate governance.¹³²

I. EFFICIENT MARKET THEORY

Opponents of the defenses, such as Professor Gilson, argue that the unencumbered tender offer serves a crucial role in the modern corporate structure. The tender offer serves as a market check on the performance of management. By replacing poor management to increase corporate performance, the tender offer leads to more optimal and proficient management and thereby lends support to giving the board deference in other areas.¹³³ Essentially, the threat of a takeover propels the board to act efficiently and in the best interests of the company and shareholders. Defensive tactics negate this market check by allowing even the inefficient board the power to entrench itself, thus negating any incentive to act more efficiently.¹³⁴ Why work harder if you cannot get fired? Professor Bebchuk concurs with Gilson stating that a board veto over a tender offer diminishes the disciplinary force that a takeover threat can exert on incumbents,¹³⁵ resulting in poorer management performance, lower profit margins, less return on equity, slower sales growth, and an overall reduction in value.¹³⁶

Opponents also cite the inconsistency and hypocrisy they find in the board's fight to keep their defensive tactics. They argue that the boards cannot play both sides of the regulation argument, espousing the use of the free market as a check on their bad

behavior, but then advocating a regulated market in order to veto hostile takeovers.¹³⁷

Supporters of the defenses, however, disagree with the validity of the market theory,¹³⁸ stating that there simply is no evidence that takeovers actually perform any type of corrective role and that research and real life experience have undermined that argument.¹³⁹ In fact, they argue that the poison pill has neither reduced takeover activity nor reduced any shareholder returns, citing that since 1985 Delaware merger and acquisition activity has actually increased.¹⁴⁰

Further, this group draws support for its argument from history, claiming that defensive devices, in particular the poison pill, are necessary tools. In the mid 1980's corporations were falling to corporate raiders armed with junk-bonds and singing the efficient market theory battle cry.¹⁴¹ Recognizing a threat to corporate welfare and its inability to function in an environment where there is a permanent "For Sale" sign,¹⁴² Martin Lipton created the pill to allow a target board the ability to control its own destiny and make an informed decision to remain independent.¹⁴³ Further, its intent and its result is not an absolute block to corporate takeovers, but rather it seeks to promote takeovers through the proxy/board replacement process or a tender offer approved by an informed board.¹⁴⁴ Essentially, the pill gives the board sufficient time (more than the 20 days the Williams Act gives) to carefully consider the bid and make the informed decision, but does not provide absolute insulation.¹⁴⁵

As mentioned previously, however, opponents claim that Lipton's reliance on the proxy as an effective means of corporate change of control may in fact be a moot point when a board couples the poison pill

with a staggered board.¹⁴⁶ If the only way to prevent the poison pill from killing a tender offer is to gain control of the board through a proxy contest and redeem the pill, the staggered board can prevent this for enough time to make the takeover idea unappealing to a prospective bidder.¹⁴⁷ The interesting point to note is that the staggered board, although arguably a defensive tactic by hindering the ability of an acquiror to take control of the board, is more a defense of the poison pill itself.¹⁴⁸

Supporters of the defenses, however, disagree with the validity of the market theory...

Supporters of defenses, however, state that the proxy contest is actually easier and more successful for a party seeking to buy the stock from the shareholders at a premium. The likelihood of success increases because its election platform is much more appealing.¹⁴⁹ Instead of the solicitor asking for votes because it will manage the company better, it asks for the votes so that it can buy the stock at a premium over market price.¹⁵⁰ Yet, it still remains the case that the staggered board requires not one, but at least two proxy contests in order to overcome the poison pill.¹⁵¹ So, even though in theory there is still the possibility of a successful contest, no bidder has ever actually succeeded in doing so.¹⁵²

Supporters also argue that the corporation does not exist solely for the benefit of the shareholder's short-term gains and that it would be dangerous to force corporations into acting as if they did.¹⁵³ Delaware has rejected the efficient market theory for this very reason.¹⁵⁴ The danger of doing so is

evident when one looks at the market occurrences over the last two decades. First, any company under-valued in the 1980's would have been bought out for a slight premium, which would have led those companies and their shareholders to miss out on the long-term 1000% increase in stock market value since then.¹⁵⁵ More alarming would be a reoccurrence of the tech-stock bubble of 1999-2000, where a company forced to look only at short-term gain may have been

Shareholders agree that managers should exercise control over regular business decisions, but should not exercise that same control over tender offers...

pressured into allowing a takeover by an extremely overvalued and doomed company.¹⁵⁶ It is these dangers which supporters seek to prevent by allowing companies to consider long-term goals and to protect shareholders from an illusory short-term gain. The Delaware courts have protected corporations from these forces by holding that the board "is not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."¹⁵⁷

As a corollary to this argument board supporters claim shareholders should leave the board alone to manage the company. For the same reasons that the business judgment rule operates in other arenas, it should operate in the takeover context because management is best suited to evaluate the takeover bid for both its present value and its correlation to the company's predicted future value.¹⁵⁸ The value of the corporate form is not the ability

to raise money, but the ability to effectively manage a myriad of complex issues and players with an efficient hierarchical structure.¹⁵⁹ "Investor involvement in corporate decision making threatens to disrupt the very mechanism that makes the public corporation practicable; namely, the centralization of essentially non-reviewable decision making authority in the board of directors."¹⁶⁰

The counterpoint to this argument leads us into the next area of debate. Shareholders agree that managers should exercise control over regular business decisions, but should not exercise that same control over tender offers because self-interest impairs their judgment.¹⁶¹

II. CONFLICT OF INTEREST

Opponents of defenses cite the inherent conflict of interest, claiming that managers are not loyal agents, acting instead to benefit their own interest in the face of conflicting shareholder interests.¹⁶² For example, managers may act to save their jobs,¹⁶³ reject bids benefiting shareholders in order to make a deal with a favored acquirer,¹⁶⁴ or use the threat of a veto (held in its poison pill) to extract payments, or so-called golden parachutes, that would benefit management but would have no benefit, if not cause detriment, to the shareholders.¹⁶⁵

As for the shareholders, management's entrenchment behind its use of defensive tactics arguably decreases the shareholder welfare.¹⁶⁶ Tender offers give the shareholders the opportunity to sell their stock at a premium above the current and arguably true value of the stock.¹⁶⁷ If the board uses its defensive measures, the shareholder loses out on this opportunity.¹⁶⁸

Further, this lost opportunity may indeed create a vicious cycle of market inefficiency as cited by Bebchuk and Gilson. Defensive measures that raise the costs of a tender offer discourage prospective future bidders for other targets, limiting the number of bidders and thereby weakening the utility of the market as a check on management performance.¹⁶⁹

Takeover defense supporters refute these assertions in light of the judicial standards of review and the effect defensive tactics have on offers. First, supporters claim that boards cannot arbitrarily reject tender offers because the *Unocal/Unitrin* standard requires that the board have acted reasonably and on an informed basis.¹⁷⁰ Also, supporters claim that defensive tactics, especially the poison pill, act to deter inadequate bids and increase the premiums offered to shareholders.¹⁷¹ By giving the board the defensive powers to screen and veto a bid, the unsolicited bidder is forced to negotiate so that the board will be vested with the power to extract a higher price than initially offered.¹⁷² Moreover, these supporters argue that shareholder rights are contractual, and that "shareholders do not possess a contractual right to receive takeover bids... [Instead], the shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics."¹⁷³

Although there certainly are judicial standards of review, which require the board to act in an informed and reasonable manner, the opponents of the takeover defenses argue that such measures are insufficient to address real life dynamics of board power.¹⁷⁴ In *Moran*, the court stated that the right to use a poison pill was not absolute, leaving

room open for situations when the board may be required by its fiduciary duties to redeem the pill and allow the takeover.¹⁷⁵ Also, some state courts including Delaware and New York have struck down attempts by the boards to protect the pill by either making them non-redeemable (dead-hand provisions), redeemable only by the current target board (no-hand provisions), or making it redeemable only after a certain time has passed (slow-hand provisions).¹⁷⁶ But these holdings seem to be a moot point in light of the fact that the Delaware courts have not ordered the redemption of a pill since the mid 1980s.¹⁷⁷ This data leaves the opponents of defensive powers questioning the teeth that these review standards actually have,¹⁷⁸ and board power supporters praising corporations for not abusing their discretion to implement defenses.¹⁷⁹

III. DISTORTED CHOICE

Perhaps the only area where there is consensus between the two warring sides is on the danger of distorted choice in responding to a tender offer. The anti-defense side even concedes (without conceding that the power should actually be given) that protection from the distorted choice may be a valid reason to give defensive power to the board.¹⁸⁰ However, the two sides disagree as to how to best handle the danger.

The distorted choice occurs when a shareholder is forced to decide whether or not to tender shares. The theory posits that a shareholder will tender her shares, even though the takeover is not in her best interest, because she fears that if the takeover is successful the post-takeover value of her untendered shares will be significantly less than the bid price.¹⁸¹

This pressure to tender is detrimental to the shareholder and the corporation because tendering out of fear instead of tendering to replace poor or inefficient management is a waste of corporate assets and is contrary to the idea that takeovers are desirable only when they create efficiency gains.¹⁸² The anti-takeover camp argues that board defensive tactics lead to social waste by preventing efficient takeovers, while also failing to prevent the distorted choice.¹⁸³

One solution to this problem is a essentially a two question tender offer: Does the shareholder want the tender offer to be successful; and in the event that it is successful does the shareholder want to tender his or her shares.¹⁸⁴ This solution acts to end the distorted choice by eliminating the pressure to tender shares blindly and in fear that the shareholder may suffer monetarily if the takeover goes through.¹⁸⁵ In practice, the tender offer would only go through if a majority of shareholders felt the transaction was beneficial; and if that is the case, then even the dissenters will have their shares bought at the premium value.¹⁸⁶ Conversely, if the vote on the takeover question fails, those who wanted to tender may still get to have their shares bought by the potential acquiror.¹⁸⁷

Supporters of the defenses dislike this alternative for a number of reasons. They claim the shareholders simply lack the power to make a separate vote denying or approving a tender offer.¹⁸⁸ The board has the duty and right to make the final decision in all but a very few areas of corporate governance, and shareholders lack authority to strip the board of its control or even review its decisions.¹⁸⁹

A toned down criticism argues that the proper defense against distorted choice lies

in the poison pill and proxy battle.¹⁹⁰ Having the shareholder referendum on the tender offer puts that old "For Sale" sign back on the corporation assuring any potential bidder a vote on the offer and leaving the target board

The distorted choice occurs when a shareholder is forced to decide whether or not to tender shares.

powerless to do anything else but declare the corporation up for auction.¹⁹¹ Even if the tender offer fails, the board will expend major amounts of company resources to protect the business.¹⁹² In the end, the supporters argue that the poison pill is the best method of protecting the company and the shareholders.¹⁹³

F. THE UNITED STATES: DIRECTORS WIN, BUT THE DEBATE CONTINUES

As it stands, the board of directors under U.S. state law has enormous power to make business decisions, whether those are everyday decisions or decisions on takeovers. The heated debate focuses on the balance of power between the board and the shareholders and the board's duty to act in the best interest of the shareholders. Although there are those who feel that events like Enron have brought the tide back toward shareholder power, such a move at this point seems uncertain. What is certain, however, is that no matter how the tide moves, the debate will continue.

III. THE EUROPEAN UNION

After almost 30 years of planning, 15 years of debate, and one failed attempt to enact takeover legislation, in late 2003 the E.U. finally approved a takeover directive.¹⁹⁴ Although this effort has been in the works for some time, this debate does not have the history in the E.U. that it does in the U.S. Hostile takeovers have historically been so infrequent as to be a non-issue in the E.U.¹⁹⁵ It was not until the same time period that the U.S. began debating the new found poison pill did the E.U. member states begin discussing and implementing national law to deal with the increasing number of hostile takeovers, most of that law mirroring the U.K. City Code and its pro-shareholder choice/director neutrality model.¹⁹⁶ Interestingly, when the E.U. recognized the need for some sort of multinational takeover regulation, the same divisive and on-going debate occurring in the U.S. (encouraging takeovers versus allowing defensive tactics) hindered its efforts.¹⁹⁷

Hostile takeovers are rare in the E.U.,¹⁹⁸ however, the harmonization of takeover laws is seen as key to fulfilling the idea of a common market among the member states¹⁹⁹ and ultimately to challenge U.S. economic and political dominance.²⁰⁰ The underlying objective is to release companies into the market of corporate control, essentially subscribing to the efficient market theory, with the expectation that the free market will discipline management and lead to optimal performance and economic growth.²⁰¹ The European Takeover Directive is now in its final stages of implementation. However, because of the opt-out provisions, which made the Directive politically viable and

important provisions optional, it remains to be seen whether or not the Directive will provide the cohesive system it was designed to promote or if its harmonizing goals will instead remain a fiction among the diverse web of national law.

A. THE FRAMEWORK APPROACH AND THE E.U.'S OWN "FEDERALIST" ISSUES

The E.U.'s efforts at enacting takeover legislation focuses on creating a general set of principles and basic requirements and not over-encompassing and detailed legislation. This approach is an effort to respect the national laws and sovereignty of each member, requiring that they individually enact the detailed law to effectuate the principles and guidelines.²⁰² Thus, the harmonization,

Most notably, the Directive seeks to prohibit unauthorized use of the poison pill and other defensive measures...

which the E.U. seeks, is not an effort at total legislative uniformity,²⁰³ but instead a theoretical and principled uniformity to drive individual national law.

In this regard, the E.U. has a similar structure to the U.S. internal affairs doctrine because corporate law, and takeover law specifically, is the law of the country in which the company incorporates.²⁰⁴ Although not completely unifying, the Directive goes much further in its attempt to harmonize substantive law than the Williams Act does, which remains primarily procedural.²⁰⁵ Most notably, the Directive seeks to prohibit unauthorized use of the poison pill and other defensive measures, whereas in the U.S., restrictions

or allowances on this front remain entirely subject to state law.²⁰⁶

B. THE ROAD TO HARMONIZATION – FAILED ATTEMPTS

In 2001, the European Parliament rejected a proposed multinational takeover Directive, the 13th Directive on Takeovers.²⁰⁷ Discussed below are the proposal's history, its elements, and ultimately its rejection.

The real push towards multinational takeover regulation began in 1985 upon publication of the "White Paper" by the European Commission, which emphasized the need for cross-border collaboration in order to achieve the goal of a common market.²⁰⁸ Alongside this academic push, Italian Carlo de Benedetti's attempt to gain control of a very large Belgian holding company, Société Générale de Belgique, provided a real life catalyst for legislation.²⁰⁹ This takeover attempt was a fierce battle which employed a plethora of defensive tactics and revealed the need for a European regulation to fill an obvious cross-border takeover void.²¹⁰

Ten years later and after many drafts, the European Council trumpeted the proposed Directive as essential to making Europe the leading world economy.²¹¹ With such high expectations, the impact of the vote to reject the takeover Directive was "tragic...and a major set-back to the goal of reaching an integrated capital market."²¹² The failure came as a shock partly because the proposed Directive was only a framework and not mandatory law, giving leeway to national prerogatives in its implementation, and partly because the Directive was based on the U.K. City Code provisions, which were already being enforced by many member states.²¹³

The aim of this failed Directive was to set minimum guidelines for the conduct of takeover bids, minimum levels of shareholders safeguards, and to create a minimal level of harmonization between the laws of the many nations.²¹⁴ Underlying this effort, however, was the Directive's fatal rule, board neutrality.²¹⁵ This rule arguably encouraged hostile takeovers by requiring that the board of the target company remain neutral in the face of a tender offer and not act to defeat the offer with defensive tactics unless the shareholders gave specific authority to do so.²¹⁶ This provision prevents the use of U.S. style defenses like the popular poison pill and allows defenses only after specific approval during the bid period itself.²¹⁷

The fallout from the neutrality rule ended the debate on provisions such as equal shareholder protection and mandatory bid rules, which arguably would have benefited the European market and corporate governance, and focused the debate exclusively on whether or not takeovers should be encouraged or discouraged.²¹⁸

The focus on this element of the Directive resulted in its failure and negated the economic and other benefits it would have brought. The Directive would have increased much needed European restructuring by opening up the corporate takeover market, allowing the break-up of conglomerates in favor of concentration and specialization.²¹⁹ By offering better investment and shareholder protection, it would have also made the E.U. markets more attractive, thereby bringing in more foreign investment and venture capital to help the needy technology sector.²²⁰ Currently, the absence of such shareholder protection makes the E.U. markets less desirable than the U.K. or U.S. markets.²²¹

The debate over the Directive, however, was not unimportant. Like the U.S., the E.U. politicians questioned the true effectiveness of the market as a check on corporate efficiency.²²² There was great concern that allowing takeovers would bring the perceived less advantageous elements of the U.S. system

Like the U.S., the E.U. politicians questioned the true effectiveness of the market as a check on corporate efficiency.

across the Atlantic, most notably, the attention on short-term profits over long-term strategy, the corporate cut-backs, and the ever increasing income discrepancy between management and employees.²²³ Also, after witnessing the financial prosperity in the U.S. during the dot.com boom, Europe tried feverishly to join in by enacting the policies that were causing such enormous economic growth.²²⁴ Towards the late stages of the failed Directive, however, the dot.com boom came crashing down. This crash led many European leaders to question the effectiveness of giving the shareholders more power in corporate governance and attacked the efficient market idea which had pushed corporations to focus on short-term gains over long term strategy.²²⁵

Germany takes the blame for the ultimate failure of the Directive because of its last minute withdrawal of approval, which centered on its fear of increased takeovers.²²⁶ The negotiations and the proposed Directive failed because of the German rejection of the E.U.'s desire to follow the UK's model of board neutrality.²²⁷ In the wake of the fiercely fought takeover of Germany's Mannesmann by the UK's Vodafone, even with

numerous compromises in its favor on other regulations, the German government was simply not going to sign onto any legislation which forced neutrality on the board of directors.²²⁸

Germany opposed what it perceived to be unfair takeover advantages imbedded in the national laws of other countries that the Directive would not sufficiently limit.²²⁹ Its argument was essentially that there are unique risks associated with cross border acquisitions because of the possibility that an outside acquiror will act in favor of its home country at the expense of the target country and the employees or other stakeholders there.²³⁰ A solution to end this type of "entrepreneurial nationalism" is a system where all companies are equally vulnerable to takeovers.²³¹ On equal ground, a foreign acquirer's bias to its home country in its operations may lead to lower performance and deteriorating public support in the host country, which then creates the opportunity for a new entity to acquire the company.²³² A flaw in the proposed Directive was its lack of effective parameters regarding elements of national corporate structure, such as state retention of special voting rights called "golden shares," which restricts the transfer of corporate control and are equally dangerous in causing the above nationalistic risks.²³³ In practice, these governments hold add another layer of takeover protection by making foreign companies unappealing to a hostile bidder looking for control.²³⁴ The problem for many nations in the E.U. is that not all member states have this added layer of takeover control and protection.²³⁵

In the years leading up to the proposed Directive, Germany opened itself up to the market for corporate control on a scale

much grander than that of its E.U. partners had done, and thus had more to fear stemming from the “entrepreneurial nationalism” than its neighbors.²³⁶ Germany’s late stage withdrawal of support tied the vote, caused the measure to fail and provoked widespread animosity.²³⁷

Enacted in 2001, Section 33 of the German Securities and Acquisitions Act directly rejects the E.U. neutrality principle...

Although the Directive failed, the E.U. commissioners favoring a cohesive takeover system immediately went back to work. They convened the “Winter Group” to research and propose a politically viable and effective takeover regulation, which resulted in a revised and ultimately adopted 13th Directive.²³⁸

C. GERMANY FILLS THE VOID: DELAWARE WOULD BE PROUD

Historically, Germany signed onto the UK thinking on issues of director neutrality in tender offers, but it changed its mind, and while working to defeat the E.U. proposed takeover Directive, it also began working on its own national law to give German boards of directors the powers they needed to defend against hostile takeovers.²³⁹ Enacted in 2001, Section 33 of the German Securities and Acquisitions Act directly rejects the E.U. neutrality principle in favor of giving the boards the power to defend against hostile takeovers.²⁴⁰ But, this mandate does not allow the U.S. board’s weapon of choice, the poison pill.²⁴¹ Critics argue that the lack of a poison pill may be detrimental to German

companies because it may leave the boards with no choice but to use the permitted value-reducing measures, such as selling significant assets, which can ultimately lead to the “destruction of the firm in order to save it.”²⁴²

Section 33(1) allows management to implement limited defensive measures with the approval of the supervisory board and without first getting shareholder approval, such as the sale of essential assets or use of authorized capital.²⁴³ As stated above these are potentially destructive and irreversible tactics, yet they do not require shareholder approval.

Section 33(2) provides the board an alternate source of authority, the shareholders. This section allows the shareholders to grant the board the authority to implement defensive measures prior to any known tender offer, with such authorization being renewable every 18 months.²⁴⁴

These two grants of power are separate and the shareholder approval allowance under §33(2) does not restrict the power of the supervisory board to authorize defensive measures consistent with §33(1).²⁴⁵ In reality, the board is not likely to seek shareholder approval in fear that the shareholders may deny this authority, which would then leave the board in a more precarious position as to what defensive measures it could and could not legally implement.²⁴⁶

Critics argue that Germany, in enacting this legislation, has participated in a U.S. style race to the bottom, largely propelled by labor union fears regarding the perceived negative effects of hostile takeovers on co-determination.²⁴⁷ Although written to give the shareholders a say in the implementation of defensive tactics, the German takeover

law, by granting the supervisory board its own discretionary power, arguably gave the board the deferential power equivalent to that in the U.S. minus the shareholder protection that U.S. courts offer²⁴⁸ by way of *Unocal* and other fiduciary standards.

This discretion of the supervisory role can essentially be even more profound when viewed in the context of the make-up of the German two-tiered board structure. As stated previously, the labor unions lobbied for the defensive powers as a way to protect the workers of German corporations. Under German law, most corporate supervisory boards are comprised of one-half labor representatives, leaving only half of the board directly representing the shareholders.²⁴⁹ Thus, if the labor representatives oppose a tender offer to protect the worker’s rights, even at the detriment of the shareholders and a large premium, they only need one shareholder representative to agree with them in order to authorize management to take a defensive action.²⁵⁰

Thus, in the absence of E.U. regulation and in response to their own fears, which ended the viability of the initial 13th Directive, Germany enacted laws completely counter to the principles espoused in the failed Directive and more inline with U.S. style board defensive powers. These developments were seen as potentially damaging in a number of ways not only to Germany, but to the E.U. as a whole.

First, the German laws restrict the openness of the market for corporate control, which scholars see as crucial to modernizing E.U. corporations, ultimately leading to greater E.U. competitiveness in global economics and politics.²⁵¹

Second, by giving such broad defensive

powers to the board, but at the same time disallowing the poison pill, the boards might adopt more self-destructive measures, resulting in a takeover system having more detrimental effects than the U.S. system.²⁵² For all the criticism of the poison pill, it allows a company to staunchly defend against a takeover without destroying the corporation in the process.²⁵³ Without the pill, corporate boards may resort to the sale of assets or other alternatives and irreversibly harmful errors.²⁵⁴ Also, the German board structure places a greater emphasis on the stakeholder, allowing the board to ignore shareholder interests without too much fear of removal.²⁵⁵ In the U.S., even with takeover discretion, the board is arguably still receptive to shareholder interests, especially the large institutional shareholders.²⁵⁶ A U.S. board that ignores these interests and parties may face removal in a proxy fight.²⁵⁷ In Germany, this result, though possible, is highly unlikely.²⁵⁸

In the end, some scholars believed that the 13th Directive's failure and the German legislative response meant the end of the effort to enact unifying takeover legislation. Hopeful voices, however, stated their belief that the animosity towards the German withdrawal and its national legislation would possibly provide the political momentum needed to pass new takeover legislation. These individuals argued that the German unilateral protectionist act would show other nations the dangers of not having an E.U. regulation and would thus lessen Germany's credibility in trying to garner support to defeat a new E.U. takeover effort.²⁵⁹ To this end, Germany's withdraw of support was seen as a positive catalyst to makeover the weaknesses in the 13th Directive and pass a redrafted E.U. Takeover Directive.²⁶⁰

D. THE CURRENT LEGISLATION – THE GOOD, THE BAD, AND THE OPT-OUT PROVISION

In the wake of the defeated legislation and Germany's own takeover code, the E.U. was unwilling to abandon its efforts to enact takeover legislation. A group of corporate law experts (a.k.a. the Winter group) was convened to study the unresolved issues surrounding the 13th Directive's failure; the group ultimately endorsed the major provisions of the failed Directive, in particular Article 9's board neutrality requirement, and gave the 13th Directive new life.²⁶¹ The E.U. passed this revised 13th Directive ("the Directive") into law on April 21, 2004 and the E.U. member nations were required to implement it by May of 2006.²⁶² In doing so, the E.U. went above and beyond the federal regulations of the U.S. and into the realm of substantive regulation.

The Directive covers a wide range of issues, many of which mirror the Williams Act. For example, mandatory bid periods, best price rules and disclosure requirements are all part of the new Directive.²⁶³ The key provisions are covered below: mandatory bids, board neutrality, the breakthrough rule, and the opt-out provision.

I. MANDATORY BIDS, FAIR PRICE, AND MINORITY SHAREHOLDER PROTECTION: ARTICLE 5

Article 5 requires that where any party (or cooperative group) attains a specified percentage of shares in a company, the member state must require that party make a fair bid to all shareholders, as a means of protecting the minority shareholders.²⁶⁴ An equitable

price is the highest price paid by the acquiror for stock during a time period chosen by the member state, but which must be within 9-12 months prior to the required bid.²⁶⁵

Importantly, the E.U. has delegated the responsibility of setting the triggering share percentage to the individual member states.²⁶⁶ This allocation of control to the individual national legislatures is the result of compromises to allow the individual nation to set percentages that will work with their own corporate system.²⁶⁷ Although deviating from harmonization, the different triggering percentages can still cause the same result, based upon whether the individual member

Importantly, the E.U. has delegated the responsibility of setting the triggering share percentage to the individual member states.

state has a concentrated corporate control system or a diffused control system, the latter not requiring the acquirer to purchase such a high percentage of stock in order to gain control of a company.²⁶⁸ The opposite is true in a concentrated system where the company is owned and controlled by a shareholder who holds the vast majority of outstanding stock.²⁶⁹

The individual nations also regulate the fair price. Article 5 requires that the price be the highest paid during the transactions to gain control of the company.²⁷⁰ Thus, if the acquiror raises his bid for some shares, all shareholders must get that same price for their shares. The individual nations regulate this by setting the time period for determining the highest price offered, and in extreme circumstances can adjust the price in line to

conform with principles of equality, such as when something has interfered with valid market prices.²⁷¹

The mandatory bid rule does have its ups and downs. First, the rule provides a gain to minority shareholders because they will get the same premium for their stock as was given in the control-gaining transaction.²⁷² Further, the rule forces the acquiror to bear the cost of any negative effect on the price of the stock caused by the acquiror obtaining the triggering percentage.²⁷³ Although the theory is that a bidder will not make a bid unless it is efficient to do so, the internalization of costs as well as the forced bid requirement, deters bidders from offering higher premiums or even trying to gain control in the first place, and thus can result in lost market efficiency.²⁷⁴

Article 9 is the most apparent split between U.S. and E.U. takeover law because it prohibits the defensive mechanisms so beloved by U.S. boards of directors.

This principle of equal price is akin to the “best price rule” under the U.S. Williams Act, which requires that the acquiror pay all tendering shareholders the highest price paid for the shares during the tender offer.²⁷⁵ Article 5, like the Williams Act, protects minority shareholders because if the offeror raises his bid, all shareholders, even those that had already tendered get the higher price. Although, the scenario under the Directive is different because its fair price rule relates to a mandatory bid procedure, the underlying principle is still the same, the equal protection of shareholders.

Although the E.U. fair pricing requirement has a counterpart under U.S. law, there is no counterpart for the mandatory bid, which proponents argue would be irrelevant in the U.S. anyway since it simply acts as a defensive mechanism by raising the costs of a tender offer.²⁷⁶ In its best form, the protection and power it would offer to an incumbent board would not come close to the powers already enjoyed by U.S. boards.²⁷⁷

II. BOARD NEUTRALITY IN TAKEOVERS: ARTICLE 9

Article 9 is the most apparent split between U.S. and E.U. takeover law because it prohibits the defensive mechanisms so beloved by U.S. boards of directors. As we have seen in the discussion of U.S. takeover law, the states give the board of directors the power to implement defensive tactics at their discretion in almost all circumstances, subjecting them only to limited review by the courts.²⁷⁸ The E.U., on the other hand, embracing the efficient market theory and mirroring the UK City Code, gives the shareholders the power to decide whether or not to implement defensive tactics against takeovers.²⁷⁹ Even though Article 9 caused the German withdrawal of support and the failure of the proposed 13th Directive, the E.U. drafters retained this provision.

Article 9 requires that member states enact rules prohibiting the use of defensive actions to frustrate tender offers from the time the bid is announced until the result of the bid is announced or the bid time lapses. During this period, the board must obtain shareholder approval before it can take any action (other than seeking alternative bids), which may result in the frustration of the bid.²⁸⁰ Here, the member states have the ability to

extend the period of board neutrality back before the time when the bid was announced to the time when the board becomes aware the bid is imminent.²⁸¹

This requirement of neutrality rejects not only the U.S. model for granting the board the power to act defensively, but also rejects the German model of preauthorization. First, contrary to the U.S. and the developed case law of *Unocal* and *Moran*, the E.U. boards are bound under this Article to let the shareholders decide the fate of the takeover. The board cannot take defensive action unless the shareholders give the board specific authorization to do so.²⁸² It also rejects use of the poison pill.²⁸³ In the U.S., under most state law (including Delaware), the board can enact defenses even in the face of shareholder disapproval as long as that decision meets the business judgment requirements of *Unocal*.²⁸⁴ Second, contrary to the German law, which allows an 18 month renewable authorization period given prior to any impending takeover effort, Article 9 requires specific shareholder authorization given during the relevant time period in order for the board to act.²⁸⁵ The policy underlying this requirement is that the shareholders should be making the decision to grant authority based upon the relevant information and not simply giving blind authorization. The language of section 3 makes this intention of informed authorization very clear.²⁸⁶ Decisions made before the beginning of an offer, which are not yet fully implemented at the time the an offer is made, require shareholder approval to continue if they have the ability to upset the bid attempt and are not otherwise part of the normal course of company business.²⁸⁷

Even though many U.S. scholars would jump at the chance to enact Article 9 neu-

trality legislation in the U.S., it is important to note that the idea of board neutrality has different consequences in Europe than it would in the U.S. In Europe, because corporate ownership is concentrated in a few shareholders or a shareholder holding enormous blocks of shares, the conflict is between controlling and majority shareholders, not management versus shareholders like the U.S.²⁸⁸ Essentially, putting control of the defense tactics in the hands of the shareholders in many corporations in Europe would be pointless because that corporation is managed by a shareholder who potentially owns a majority of the stock and can do with the defense tactics as they please. Further, unlike in the U.S., where management is checked by a fiduciary duty to shareholders, there is no equivalent duty for the controlling shareholder to protect the minority shareholders.²⁸⁹ The protection available to minority shareholders in Europe is the unification of minority shareholders to overpower a controlling shareholder, and also publicity in the sense that the controlling shareholder must publicly announce the use of defensive measures, which will inevitably draw market attention to ensure legitimate use of the defensive tactics.²⁹⁰

III. THE BREAKTHROUGH RULE: ARTICLE 11

The Breakthrough Rule addresses a different kind of defense mechanism, namely those actions by the corporation to imbed its management, such as: shareholder agreements limiting the right to transfer shares, shares with multiple voting rights, and supermajority requirements to approve post takeover transactions.²⁹¹ Essentially, a corporation can defend itself by enacting rules

regarding whose shares can be transferred to whom and the number of votes the certain shares carry. Effectively combating the threats Germany saw in these tactics when it rejected the failed 13th Directive, the intent of this Article was to limit the ability of management to entrench itself and to equalize the handling of these tactics, which vary from country to country, to provide equal treatment across Europe.²⁹² The U.S. has no equivalent to this Article, and in fact, the U.S. state anti-takeover laws are in direct conflict with this Article by allowing U.S. companies to enact poison pills.²⁹³

Article 11 renders any restrictions (contractual or in the articles of incorporation) on share transfers or voting rights ineffective once a bid has been made public.²⁹⁴ These provisions act on two levels.²⁹⁵ First, once a bid is made public, voting rights or transfer limitations, such as an agreement to offer shares to other shareholders before offering them to a third party, are null and void for the period of the bid.²⁹⁶ Second, if the bidder gets more than a 75% controlling stake through the bid, the incumbents or controlling shareholders lose any special voting rights or requirements, and the bidder can call a shareholders meeting to revise bylaws and elect a new board.²⁹⁷

This Article exempts Golden Shares and all special rights afforded by member states to companies as long as they are not overly restrictive on the transfer or movement of investment.²⁹⁸ Even though the Directive allows these rights, their validity remains uncertain. The European Court of Justice has cast doubt on their validity and usefulness and requires the nation wishing to use them to show a “precisely tailored scheme” to protect a national interest.²⁹⁹

IV. OPT-OUT PROVISIONS AND RECIPROCITY:

ARTICLE 12

Article 12 is not only the newest addition to the takeover Directive, it is the most interesting provision of the E.U.’s effort to regulate takeovers and attempt to harmonize the laws of the many member nations. In

Essentially, Article 12 allows for three scenarios.

2002, the Commission introduced Articles 9 and 11, which caused heated debate and threatened the new Directive with the same fate as the previous failed 13th Directive.³⁰⁰ Late in 2003, however, the nations agreed to the “Portuguese Compromise,” allowing the enactment of the Directive, but also deteriorated its harmonizing potential.³⁰¹ Article 12 made the Article 9 restrictions on defensive tactics and Article 11 breakthrough rules optional.³⁰²

Essentially, Article 12 allows for three scenarios.³⁰³ First, member states can refuse to adopt the board neutrality and breakthrough provisions, but then must allow companies with its borders to individually opt-in to Articles 9 and 11.³⁰⁴ This situation is much like the one Lucian Bebchuk has pushed for in the U.S. Bebchuk proposes an alternative shareholder-friendly Federal system whereby shareholders would be entitled to a voice in defense tactics and have elective rights to opt into that system, much like the E.U. companies are allowed to opt into the Directive even if their government does not.³⁰⁵

The next two scenarios surround the idea of reciprocity, which perhaps acts as a check against uninhibited protectionism and diver-

sity of law. Article 12, section 3 sets forth this reciprocity rule, which states that member states can exempt target companies who apply the defensive measure rules and/or the breakthrough rules from the requirements of those rules when they are faced with a bidder who does not apply the rules.³⁰⁶ The company, however, must receive permission for this exemption from the member state and cannot engage in reciprocity on its own volition.³⁰⁷ Under the second scenario, the state would adopt Article 9, Article 11, or both, but exempt companies from following the requirements of those Articles when faced with a foreign bidder who is not subject to those same requirements because its home jurisdiction did not opt-in.³⁰⁸ This leaves the member state with the last two scenarios. It can opt into the requirements, and allow for reciprocity, or it can opt-in to the requirements and not allow reciprocity.³⁰⁹ Though, because of international agreements like the GATS, it remains a question whether or not member nations can enforce the reciprocity clause against nonmember nations like the U.S.³¹⁰

The existence of this opt-out provision has caused many to call the Directive a failure in its attempt to affect any serious takeover harmonization. European Commissioner Frits Bolkestein criticized the Portuguese Compromise as “taking the heart out of the Directive” and nullifying the E.U.’s hopes of becoming the top world economy.³¹¹ Indeed some have argued that this provision is likely to increase national protectionism and end the possibility of harmonization.³¹² However, the positive voices say that such pessimism is unwarranted because it overlooks the positive elements of the Directive, such as the establishment of a common frame-

work from which to legislate.³¹³ Further, this Directive forces the nations to confront and address these issues and to signal a national stance on the critical issue of defensive measures, which itself can help build a more harmonized multinational corporate control system.³¹⁴

E. IMPLEMENTATION: HOW IT WILL PLAY OUT ACROSS EUROPE?

So, in the end, the Directive has left Europe with a largely optional system of takeover regulations, which the member states were required to implement by May 2006. The question now is how will the nations implement the Directive and what effect will the implementation actually have? It will certainly take a significant amount of time to see the practical effects of any national legislation, especially since only five of the twenty-five nations actually met the implementation deadline.³¹⁵ Below is the current stance of a few key nations. From these current stances, it seems as though the legislation will indeed vary, especially in relation to the optional provisions and reciprocity.

I. THE UK

The UK has already stated that it will be “business as usual,” seeing how most of the Directive itself was drawn from their takeover system.³¹⁶ The UK will opt-in to Article 9, which is already law under the City Code, but will most likely opt-out of Article 11 and leave open the opportunity for companies to opt-in because it conflicts with market practice of allowing irrevocable shareholder agreements not to transfer shares or accept rival offers.³¹⁷ Further,

the UK will not be allowing reciprocity for Article 9 or 11.³¹⁸ In terms of Article 5, the mandatory bid rule, the UK will set its trigger at 30% of the voting rights and extend the time period to determine the fair price to twelve months.³¹⁹

ii. France

France, like the UK, will most likely implement Article 9, sections 2 and 3, which would create more limited use of takeover methods than current French law allows.³²⁰ Currently, absolute defenses are prohibited and so is any defense violating the “social interest.”³²¹ However, under Article 9, many of the accepted defenses will be void. In terms of section 3, France has already changed some of its laws in order to conform.³²² Previously in France, a target board had the authority to continue implementation of decisions during a takeover bid, which may frustrate the bid, without further shareholder approval.³²³ However, France recently suspended this authority during bid periods, except when, as in line with section 3, it is in the ordinary course of business.³²⁴ France, unlike the UK is also likely to allow reciprocity for Article 9.³²⁵

France will opt out of Article 11, except for the breakthrough transfer restrictions in the by-laws during an offer and voting rights caps in the by-laws at the first shareholder meeting after a successful bid, which were already part of French law.³²⁶ It is however unclear if France will apply reciprocity to this Article.

In respect to Article 5, France is likely to set the mandatory bid trigger at 1/3 of the share capital or voting rights, and the equitable price time range will be twelve months.³²⁷

III. GERMANY

Germany is unlikely to change much regarding its current takeover law. It will opt-out of Article 9, allowing corporations to opt-in to on their own, which almost none are actually expected to do.³²⁸

It will also opt out of Article 11.³²⁹ Many of the restrictions of Article 11 would have no effect in Germany anyway because much of what the Article covers is already prohibited. Germany's only real concern would have been its golden shares in Volkswagen AG, which it managed to protect from the regulation because of Article 11's exclusion of state owned shares.³³⁰

Germany will allow reciprocity under Article 9 and 11, and like the UK, has set the trigger for mandatory bid at 30% of voting rights, but has set the time period for the fair price at 6 months.³³¹

IV. CONCLUSION

The U.S. and the E.U. have very different approaches to tender offers, not only in the substantive regulations regarding the power dynamic between shareholders and the board of directors, but in their overall policy goals and legislative structure. The U.S. system developed out of a competitive federalist system, with the states running the show and the Federal government only regulating the procedural elements. The E.U. on the other hand entered the regulation arena with the goal of harmonizing the substantive laws of many nations. Although, that effort did not necessarily produce a fully harmonized system, it did result in a harmonized core framework from which to legislate from

and build on.

There is a constant debate in the U.S. regarding our current system of board deference in respect to defensive measures. The current status of the laws allows boards of directors to implement these defensive measures subject almost solely to the check of their own business judgment. The E.U., however, was not willing to accept this approach. Its guidelines push for a neutral board and shareholder choice in whether to accept a tender offer or allow the board to enact defensive measures. Many in the U.S. would champion this guideline as model for the U.S. system to rebuild on, and perhaps that idea is not such a bad one. Perhaps, it is time in the U.S. to look towards a more shareholder focused approach to tender offers and to allow the shareholders an unobstructed, undistorted vote on the tender offer. However, there are also those in the U.S. and E.U. alike, especially in Germany, who view the neutral system as a real and serious danger to corporate existence. This threat too cannot be ignored.

In the end, although the U.S. and E.U. have two completely different structures, the need to work together still exists. As the May implementation deadline has come and gone, it remains to be seen how the E.U. Directive will play out. Regardless of what nations implement which provisions, the debate regarding tender offers and who gets the ultimate power to decide the defensive issue will continue to rage on both here at home and abroad.

END NOTES

1. CHRISTIN M. FORSTINGER, TAKEOVER LAW IN THE EU AND THE USA: A COMPARATIVE ANALYSIS 17 (Kluwer Law International 2002).
2. See Harry G. Hutchinson, *Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm*, 36 LOY. U. CHI. L.J. 1111, 1149 (2005). See also Lucian Bebchuk & Allen Farrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111, 132 (2001).
3. See FORSTINGER, *supra* note 1, at 48.
4. *The Developing Meaning of "Tender Offer" Under the Securities and Exchange Act of 1934*, 86 HARV. L. REV. 1250, 1251-52 (1973).
5. *Id.*
6. Bebchuk & Farrell, *supra* note 2, at 118; see also Edward D. Herlihy, *Takeover Law and Practice 2005, in CONTESTS FOR CORPORATE CONTROL 2006 – CURRENT OFFENSIVE & DEFENSIVE STRATEGIES IN M&A TRANSACTIONS* 341, 397 (Practising Law Institute 2006).
7. Julian Velasco, *Just Do It: An Antidote to the Poison Pill*, 52 EMORY L.J. 849, 856-868 (2003) (showing that the triggering event would be the hostile acquisition of a certain percentage of common stock).
8. See Herlihy, *supra* note 6, at 398.
9. *Id.*
10. *Id.* at 399.
11. *Id.* at 397.
12. Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002) [hereinafter Lipton, *Pills, Polls, and Professors Redux*]; see also Martin Lipton & Paul K. Rowe, *Pills, Polls, and Professors: A Reply to Ronald Gilson*, 27 DEL. J. CORP. L. 1, 10 (2002).
13. Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 845-860 (1981).
14. Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 627 (2003).
15. *Id.*
16. Bebchuk & Farrell, *supra* note 2, at 121.
17. *Id.*
18. This section focuses on the theories and arguments of the critics of board deference in applying defenses to takeovers. This is not an argument that these theories are correct. I present this first because they are the attacks against what is existing law. There are compelling counters to these arguments, which I present later in the paper.
19. Leo Herzel et al., *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980).
20. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).
21. See Gilson, *supra* note 13, at 819-20.
22. *Id.*
23. See Bebchuk & Farrell, *supra* note 2, at 121. Examples of these benefits would be like those in *Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc.*, 506 A.2d 173 (1986) such as "Golden Parachutes," which are bonuses, jobs, and other benefits conferred on the defending board by the acquiror in exchange for their cooperation and redemption of any poison pill.
24. *Id.* at 132-33.
25. *Id.*
26. *Id.* at 129.
27. *Id.*
28. See FORSTINGER, *supra* note 1, at 22.
29. Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909 (1998).
30. *The City Code on Takeovers and Mergers, in THE TAKEOVER CODE (The Panel on Takeovers and Mergers 2006) (1985)*. General Principle VI and Rule 38 of the City Code on Takeovers and Mergers state that during an offer or before an imminent offer the management cannot take measures to frustrate that offer. See also FORSTINGER, *supra* note 1, at 121.
31. *Commission Proposal for Directive of the European Parliament and of the Council on Takeover Bids*, arts. 3 §1(c), 11, at 11, 16, COM(2002) 534 final (Oct. 2, 2002) [hereinafter *EU Takeover Directive*]. The City Code Section of the United Kingdom also has the same requirement on board neutrality for tender offers.
32. *Id.* art.12, at 16.
33. See FORSTINGER, *supra* note 1, at 25-30.
34. *Id.* at 36-38.
35. *Id.* at 38-40.
36. *Id.*
37. *Id.*
38. See Kamar, *supra* note 29, at 1909 (stating that Delaware has attracted over half of the large, publicly traded corporations).
39. *Id.* at 1909-13.
40. *Id.*
41. *Id.* at 1927.
42. *Id.* at 1928.
43. *Id.*
44. See FORSTINGER, *supra* note 1, at 77.
45. 15 U.S.C. § 78m (2002); see also FORSTINGER, *supra* note 1, at 79.
46. 15 U.S.C. §§ 78m (d)-(e), 78n (d)-(e).
47. 17 C.F.R. §§ 240.12g-1, 240.12h-3 (1994) (applying only to target corporations which are 1) listed on a national stock exchange, or 2) where the corporation has assets in excess of \$10 million and has 500 or more shareholders of that class of security).
48. *Id.* § 240.14e-2.
49. *Id.* § 240.14d-10.
50. See FORSTINGER, *supra* note 1, at 76.
51. John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Towards Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1431 (1991).
52. See FORSTINGER, *supra* note 1, at 87.
53. *Edgar v. Mite Corp.*, 457 U.S. 624 (1982).
54. See FORSTINGER, *supra* note 1, at 88; see also Matheson & Olson, *supra* note 51, at 1439.
55. *Edgar*, 457 U.S. at 626-30.
56. *Id.* at 643.
57. *Id.* at 640.
58. See FORSTINGER, *supra* note 1, at 89.
59. See Matheson & Olson, *supra* note 51, at 1442.
60. *Id.* at 1444.
61. *Id.* at 1445.
62. *Id.*
63. *Id.*
64. *Id.* at 1446.
65. See FORSTINGER, *supra* note 1, at 90.
66. See Matheson & Olson, *supra* note 51, at 1440-1441.
67. *Id.*
68. See FORSTINGER, *supra* note 1, at 90.
69. *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987).
70. *Id.*
71. *Id.* at 80-87.
72. See FORSTINGER, *supra* note 1, at 92-94.
73. See Matheson & Olson, *supra* note 51, at 1449 (citing the Minnesota Corporate Statute as an example). See MINN.STAT. § 302A.251, subd. 5 (1989) ("In discharging the duties of the position of director, a director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.").
74. See Matheson & Olson, *supra* note 51, at 1449.
75. Del. Gen. Corp. L. §141(a) (1998); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del., 1984).
76. *Aronson*, 473 A.2d at 812.
77. *Id.*
78. See Gilson, *supra* note 13, at 823-25.
79. See Hutchinson, *supra* note 2, at 1145.
80. *Compare Revlon v. MacAndrews and Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) with *Paramount Comm'ns v. Time, Inc.*, 571 A.2d 1140 (Del.1989).
81. *Unocal Corp. v. Mesa Petroleum*, 493 A.2d 946 (Del. 1985).
82. *Id.* at 949-54.
83. *Id.*
84. *Id.*
85. *Id.* See also *id.* at 956 n.13 (mentioning that Mesa had a reputation of being a greenmailer, a different form of blackmail, where a party purposely makes an insufficient offer in order to coax the target company to buy back the potential acquirer's stock at a premium to prevent them from taking control of the company with the undervalued tender offer).
86. *Id.* at 954.
87. *Id.* at 955.
88. *Id.* at 946.
89. See Hutchinson, *supra* note 2, at 1146.
90. *Id.*
91. *Id.*
92. *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).
93. *Id.* at 1349.
94. *Id.*
95. *Id.* at 1357. See also Del. Gen. Corp. L. §157(a), (b) (providing essentially that the board of directors can create and issue stock rights or options that allow the holders of those rights or options to acquire shares of the corporation at a time and price of the boards choosing. The board decisions regarding these options or rights are respected unless there is a showing of actual fraud).
96. *Moran*, 500 A.2d at 1354.
97. *Revlon*, 506 A.2d at 176-80.
98. A lock-up option is an option to buy key assets of a target company, which that target company gives to a "white knight" (or preferred purchaser) in order to deter a hostile bid. See 19 AM. JUR. 2D *Corporations* § 2184 (2004).
99. *Revlon*, 506 A.2d at 176-80.
100. *Id.*
101. *Id.* at 182
102. *Id.*
103. See Hutchinson, *supra* note 2, at

- 1150-51.
- 104.*Time*, 571 A.2d 1140.
- 105.*Id.* at 1150.
- 106.*Id.* at 1151-50.
- 107.*Id.*
- 108.*Id.* at 1151.
- 109.*Id.* at 1155.
- 110.*Paramount Comm'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (1994).
- 111.*Id.*
- 112.*Id.*
- 113.*Id.* at 46-48.
- 114.*Id.* at 47.
- 115.*Id.* at 48-51.
- 116.*Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361 (Del. 1995) (reiterating that the broad board power and standard of review as laid out in *Unocal*).
- 117.*See* Subramanian, *supra* note 14, at 681-82; *see also* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Corporate Delaware Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1495-1499 (2005) (explaining how scandals such as Enron and WorldCom and ultimately the Sarbanes-Oxley Act lead the Delaware Courts to push towards "best corporate practices").
- 118.*See* Subramanian, *supra* note 14, at 681-82 n.224 (citing the following cases: *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003); *Omni Care, Inc. v. NCS HealthCare, Inc.*, 822 A.2d 397 (Del. 2002) (unpublished table decision); *Levero Alternative Fund Ltd. v. Reader's Digest Ass'n*, 803 A.2d 428 (Del. 2002) (unpublished table decision); *Saito v. McKesson HBCO, Inc.*, 806 A.2d 113 (Del. 2002); and *Telxon Corp. v. Meyerson*, 802 A.2d 257 (Del. 2002); *see also In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003) (denying a motion to dismiss a complaint against the board of directors for breach of fiduciary duty in approving an employment agreement for Michael Ovitz)). It is important to note that *In re Walt Disney* was eventually decided in 2005 in an unpublished decision in favor of the board of directors. *See* the unpublished opinion at 2005 WL 2056651.
- 119.*See* Hutchinson, *supra* note 2, at 1185-86.
- 120.*Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).
- 121.*Id.* at 660-62.
- 122.*See* Hutchinson, *supra* note 2, at 1178-82.
- 123.*Id.* at 1180.
- 124.*MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003).
- 125.*Id.* at 1131.
- 126.*Id.* at 1198-200.
- 127.*See* Subramanian, *supra* note 14, at 682.
- 128.*Id.*
- 129.*Id.*
- 130.*See infra* notes 133-192.
- 131.*Id.*
- 132.*Id.*
- 133.*See* Gilson, *supra* note 13, at 848.
- 134.*Id.*
- 135.Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PA. L. REV. 713, 719-721 (2003) [hereinafter *Why Firms Adopt Antitakeover Arrangements*].
- 136.*Id.*; *see* Bebchuk, *supra* note 20.
- 137.*See* Gilson, *supra* note 13, at 862.
- 138.*See* Lipton & Rowe, *supra* note 12.
- 139.*Id.* at 21-22.
- 140.*Id.*
- 141.*See* Lipton, *Pills, Polls, and Professors Redux*, *supra* note 12, at 1040.
- 142.*Id.* at 1041.
- 143.*Id.* at 1039.
- 144.*Id.* at 1040.
- 145.*Id.* at 1047.
- 146.*See* discussion in *supra* notes 13-18.
- 147.*Id.*
- 148.*Id.*; *see also* 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, 904-907 (2002).
- 149.Paul H. Edelman & Randall S. Thomas, *Corporate Voting and the Takeover Debate*, 58 VAND. L. REV. 453, 476 (2005).
- 150.*Id.*
- 151.*Id.* at 461.
- 152.*See* Bebchuk & Farrell, *supra* note 2, at 121.
- 153.*See* Lipton, *Pills, Polls, and Professors Redux*, *supra* note 12, at 1041.
- 154.*See* Lipton & Rowe, *supra* note 12, at 20 (arguing that Delaware never signed on to the efficient market theory and in 1985 explicitly decided not to adopt the theory). *See also* Lipton, *Pills, Polls, and Professors Redux*, *supra* note 12, at 1045-1047 (citing four 1985 cases for support: *Smith v. Van Gorkom*, 488 A.2d 858, 875-76 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55, 957 (Del. 1985); *MacAndrews & Forbes Holdings, Inc. v. Revlon Inc.*, 501 A.2d 1239, 1248 (Del. Ch. 1985); and *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354 (Del. 1985)).
- 155.*See* Lipton & Rowe, *supra* note 12, at 26.
- 156.*Id.* at 27.
- 157.*Time*, 571 A.2d at 1154.
- 158.Jennifer Arlen & Eric Talley, *Unregulable Defenses and The Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 590-593 (2003).
- 159.Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 807 (2002) [hereinafter *Director Primacy in Corporate Takeovers: Preliminary Reflections*].
- 160.*Id.*
- 161.*See* Gilson, *supra* note 13, at 845-48.
- 162.Lucian Bebchuk, *Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1743 (1985) [hereinafter *Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*].
- 163.*See* Gilson, *supra* note 13, at 845-48.
- 164.*Id.*
- 165.*Id.*
- 166.*See Why Firms Adopt Antitakeover Arrangements*, *supra* note 135.
- 167.Velasco, *supra* note 7, at 908; *see also* Lipton, *Pills, Polls, and Professors Redux*, *supra* note 12, at 1049-50.
- 168.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, 1175 (1981).
- 169.*Id.* at 1176-77.
- 170.*See* Lipton & Rowe, *supra* note 12, at 33.
- 171.*See* Herlihy, *supra* note 6, at 395-396.
- 172.*Id.* at 398.
- 173.*See Director Primacy in Corporate Takeovers: Preliminary Reflections*, *supra* note 159, at 811-12.
- 174.Bebchuk, Coates & Subramanian, *supra* note 148.
- 175.*Id.* at 905.
- 176.*Id.*
- 177.*Id.* at 906.
- 178.*Id.*
- 179.*See* Lipton & Rowe, *supra* note 12, at 17.
- 180.Lucian Arye Bebchuk, *The Case Against the Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 981 (2002) [hereinafter *The Case Against the Board Veto in Corporate Takeovers*]; *see also Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 162, at 1742-43.
- 181.*The Case Against the Board Veto in Corporate Takeovers*, *supra* note 180, at 981.
- 182.*See Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*, *supra* note 162, at 1700-02, 1765.
- 183.*Id.* at 1743-44.
- 184.*See The Case Against the Board Veto in Corporate Takeovers*, *supra* note 180, at 982.
- 185.*Id.*
- 186.*Id.* *See also* Lucian Arye Bebchuk, *The Pressure to Tender: An Analysis and Proposed Remedy*, 12 DEL. J. CORP. L. 911, 931-936 (1987).
- 187.*Id.* at 932.
- 188.Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 569 (2003).
- 189.*Id.*
- 190.*See* Lipton, *Pills, Polls, and Professors Redux*, *supra* note 12, at 1059-60.
- 191.*Id.*
- 192.*Id.*
- 193.*Id.*
- 194.Erik Berglöf & Mike Burkart, *European Takeover Regulation*, 18 ECONOMIC POLICY 173, 189-91 (Apr. 2003), available at <http://ssrn.com/abstract=405660>.
- 195.*Id.* at 186.
- 196.*Id.*
- 197.André Nilsen, *The EU Takeover Directive and the Competitiveness of the European Industry*, OXFORD COUNCIL OF GOOD GOVERNANCE: ECONOMY ANALYSIS, NOV. 2004, at 1, available at <http://www.oxfordgovernance.org/index.php/305/0>.
- 198.Christian Kirchner and Richard W. Painter, *A European Modified Business Judgment Rule for Takeover Law*, 2 EUROPEAN BUS. ORG. L. REV. 353 (2000), available at <http://ssrn.com/abstract=247214>.
- 199.*EU Takeover Code Thrown Out*, BBC NEWS, July 4, 2001, available at <http://news.bbc.co.uk/1/hi/business/1422107.stm>.
- 200.Marco Ventoruzzo, *The Thirteenth Directive and the Contrasts Between European and US Takeover Regulation: Different Regulatory Means, Not so Different Political and Economic Ends*, BOCCONI UNIVERSITY LEGAL STUDIES RESEARCH PAPER, at 2, available at <http://ssrn.com/abstract=819764>
- 201.*See* Nilson, *supra* note 197, at 5.
- 202.*See* FORSTINGER, *supra* note 1, at 103.
- 203.*Id.*
- 204.*Id.* at 96.
- 205.*Id.* at 108.
- 206.*Id.*
- 207.*Id.* at 101.
- 208.*Id.* at 100.
- 209.*See* Berglöf & Burkart, *supra* note 194, at 189.
- 210.*Id.*
- 211.*See* FORSTINGER, *supra* note 1, at 101.
- 212.*See EU Takeover Code Thrown Out*, *supra* note 199 (quoting European Commissioner Frits Bolkestein).
- 213.*See* Berglöf & Burkart, *supra* note 194, at 189-90.
- 214.*See* FORSTINGER, *supra* note 1, at 102.
- 215.John W. Cioffi, *The Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration*, BERKELEY ROUNDTABLE ON THE INTERNATIONAL ECONOMY, Sept. 28, 2001, at 3-4, available at <http://brie.berkeley.edu/publications/John%20Cioffi%20paper.pdf>.
- 216.*EU Takeover Directive*, *supra* note 31, art. 9: Member States shall ensure that rules are in force requiring that: (a) after receiving the information concerning the bid and until the

- result of the bid is made public, the board of the offeree company should abstain from any action which may result in the frustration of the offer, and notably from the issuing of shares which may result in a lasting impediment to the offeror to obtain control over the offeree company, unless it has the prior authorization of the general meeting of the shareholders given for this purpose;
- (b) the board of the offeree company shall draw up and make public a document setting out its opinion on the bid together with the reasons on which it is based.
- 217.*Id.*; *See also* Berglöf & Burkart, *supra* note 194.
- 218.*See* Nilson, *supra* note 197, at 4.
- 219.*Id.*
- 220.*Id.*
- 221.*Id.*
- 222.*Id.* at 7.
- 223.*See* FORSTINGER, *supra* note 1, at 105.
- 224.*Id.*
- 225.*Id.*
- 226.*See* EU Takeover Code Thrown Out, *supra* note 199.
- 227.*Germany Threatens Takeover Code*, BBC NEWS, May 2, 2001, available at <http://news.bbc.co.uk/1/business/1309160.stm>.
- 228.*Id.*
- 229.Theodor Baums & Kenneth Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 66 (2005).
- 230.Jeffrey N. Gordon, *An American Perspective on the New German Anti-takeover Law*, ECGI - LAW WORKING PAPER NO. 02/2002; COLUMBIA LAW AND ECONOMICS WORKING PAPER NO. 209, v. Feb. 2002, at 3, available at <http://ssrn.com/abstract=336420>.
- 231.*Id.*
- 232.*Id.*
- 233.*Id.*
- 234.Christian Kirchner & Richard W. Painter, *Takeover Defenses Under Delaware Law, the Proposed 13th EU Directive and the New German Takeover Law: Comparisons and Recommendations for Reform*, 50 AM. J. COMP. L. 451, 461 (2002) [hereinafter *Takeover Defenses Under Delaware Law*].
- 235.*Id.*
- 236.*See* Gordon, *supra* note 230.
- 237.*See* EU Takeover Code Thrown Out, *supra* note 199.
- 238.*See* Berglöf & Burkart, *supra* note 194, at 190.
- 239.*See* Baums & Scott, *supra* note 229, at 66-67.
- 240.*See* Gordon, *supra* note 230, at 3.
- 241.*Id.* at 5-6.
- 242.*Id.*
- 243.Wertpapiererwerbs- und Übernahmegesetz [German Securities and Acquisitions Act], Dec. 20, 2001, BGBl. I S. at 3822, §33(1) (F.R.G.), available at <http://www.iuscomp.org/gla/statutes/WpUG.htm>.
- 244.*Id.* §33(2).
- 245.*See Takeover Defenses Under Delaware Law*, note 234, at 466.
- 246.*See* Gordon, *supra* note 230, at 6 n.13.
- 247.*See Takeover Defenses Under Delaware Law*, note 234, at 467.
- 248.*Id.* at 468.
- 249.*Id.*
- 250.*Id.*
- 251.*See* Gordon, *supra* note 230, at 8.
- 252.*Id.* at 5.
- 253.*Id.*
- 254.*Id.*
- 255.*Id.*
- 256.*Id.*
- 257.*Id.* at 6.
- 258.*Id.*
- 259.*See Takeover Defenses Under Delaware Law*, note 234, at 471-72.
- 260.*See* Gordon, *supra* note 230, at 8.
- 261.*See* Ventruruzzo, *supra* note 200, at 55.
- 262.*Id.*
- 263.*Compare* EU Takeover Directive, *supra* note 31, arts. 5-8, at 13-14 with Securities and Exchange Act of 1934 §§ 13(d)-(e), 14(d)-(f), 15 U.S.C. §78a et seq. (1934).
- 264.EU Takeover Directive, *supra* note 31, art.5, § 1, at 13.
- 265.*Id.* art. 5, § 4, at 13.
- 266.*Id.* art. 5, § 1, at 13; *see also* Ventruruzzo, *supra* note 200, at 57.
- 267.*See* Ventruruzzo, *supra* note 200, at 57-58.
- 268.*Id.*
- 269.*See id.* at 59.
- 270.*See* EU Takeover Directive, *supra* note 31, art. 5, § 4, at 13.
- 271.*See id.* *See also* Ventruruzzo, *supra* note 200, at 59.
- 272.*See* Berglöf & Burkart, *supra* note 194, at 196.
- 273.*Id.*
- 274.*Id.*
- 275.17 C.F.R. § 240.14d-10 (1994).
- 276.*See* Ventruruzzo, *supra* note 200, at 68-70.
- 277.*Id.*
- 278.*See* discussion on pp. 11-17.
- 279.*See* EU Takeover Directive, *supra* note 31, art. 9, at 14-15.
- 280.*Id.* art. 9, § 2, at 14-15.
- 281.*Id.*
- 282.*Id.*
- 283.EU Takeover Directive Falls Short of Expectations, EUROPEAN VENTURE CAPITAL JOURNAL, Mar. 24, 2005, available at <http://www.private-equityweek.com/evcj/protected/mthlyfeatures/1110465969665.html>.
- 284.*See* the above discussion on the Unocal standard and its progeny on pp. 11-17.
- 285.*Id.*; *see also* Ventruruzzo, *supra* note 200, at 61.
- 286.*See also* Ventruruzzo, *supra* note 200, at 61.
- 287.*See* EU Takeover Directive, *supra* note 31, art 9, § 3, at 14-15.
- 288.*See* Ventruruzzo, *supra* note 200, at 71.
- 289.*Id.*
- 290.*Id.*
- 291.*Id.* at 62.
- 292.*Id.*
- 293.*See id.* at 65.
- 294.*See* EU Takeover Directive, *supra* note 31, art 11, at 16.
- 295.Silja Maul & Athanasios Koulouridas, *The Takeover Bids Directive*, 5 GERMAN LAW JOURNAL 355, 357 (2004), available at http://www.german-lawjournal.com/pdf/Vol05No04/PDF_Vol_05_No_04_355-366_Private_Maul_Koulouridas.pdf.
- 296.*See* Ventruruzzo, *supra* note 200, at 64.
- 297.*Id.*
- 298.*See* EU Takeover Directive, *supra* note 31, art. 11, §6.
- 299.*See* Gordon, *supra* note 230, at 5 n.10 (citing Commission v. France, C-483/99 (June 4, 2002); Commission v. Portugal, C-367/98 (June 4, 2002); Commission v. Belgium, C-503/99 (June 4, 2002)).
- 300.Scott V. Simpson et al., *The Future Direction of Takeover Regulation in Europe, in* Understanding Complex Financial Institutions 759, 761-62 (Practising Law Institute 2006).
- 301.*Id.*
- 302.*See* EU Takeover Directive, *supra* note 31, art 11, at 16.
- 303.*See* Ventruruzzo, *supra* note 200, at 66.
- 304.*Id.*
- 305.*See* Bebhuk & Farrell, *supra* note 2.
- 306.*See* EU Takeover Directive, *supra* note 31, art 11, § 3, at 16.
- 307.*Id.*
- 308.*See* Ventruruzzo, *supra* note 200, at 66.
- 309.*Id.*
- 310.*See* Maul & Koulouridas, *supra* note 295, at 358.
- 311.*The EU's Takeover Plan*, WASHINGTON TIMES, Nov. 26, 2003, available at <http://www.washtimes.com/op-ed-20031125-082611-8252r.htm>; *see also* EU Takeover Code Thrown Out, *supra* note 199.
- 312.THE TAKEOVER DIRECTIVE (Freshfields Bruckhaus Deringer July 2005), available at <http://www.freshfields.com/practice/corporate/publications/pdfs/12218.pdf>.
- 313.*See* Ventruruzzo, *supra* note 200, at 67.
- 314.*Id.*
- 315.Tobias Buck, *Setback for EU Takeover Directive*, FINANCIAL TIMES, May 23, 2006, available at <http://www.ft.com/cm/s/acc84c16-ea11-11da-a33b-0000779e2340.html> (mentioning that only the UK, France, Denmark, Hungary, and Luxembourg met the May 20, 2006 deadline).
- 316.*See* Simpson et al., *supra* note 300, at 764-66.
- 317.*Id.*
- 318.IMPLEMENTING THE TAKEOVER DIRECTIVE (Freshfields Bruckhaus Deringer February 2006) available at <http://www.freshfields.com/publications/pdfs/2006/TakeoverDirective.pdf>.
- 319.*Id.*
- 320.*See* Simpson et al., *supra* note 300, at 765-67.
- 321.*Id.*
- 322.*Id.*
- 323.*Id.*
- 324.*Id.*
- 325.*See* IMPLEMENTING THE TAKEOVER DIRECTIVE, *supra* note 318.
- 326.*Id.*
- 327.*Id.*
- 328.*See* Simpson et al., *supra* note 300, at 768-69.
- 329.*See* IMPLEMENTING THE TAKEOVER DIRECTIVE, *supra* note 318.
- 330.*Id.*
- 331.*Id.*