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**HARMONIZATION OF TAKEOVERS IN THE INTERNAL
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ABSTRACT

This DPhil thesis analyses the Takeover Bid Directive in the light of EU Law and examines the extent to which this Directive facilitates the exercise of the fundamental freedom of establishment and the free movement of capital in the internal market. Since the Directive is based on the EC Treaty chapter on freedom of establishment (Articles 43 and 44(2)(g) EC Treaty), it should in principle contribute to cross frontier corporate mobility in the internal market through takeover bids; this was the aim of the Commission in its various proposals. Takeover bids and the EC Treaty provisions on freedom of establishment are closely related. The Directive forms part of the EU company law harmonization programme whose weaknesses and limits are also explored. However, the Takeover Bid Directive is an EU company law instrument with strong links to EU capital market law. The initial aims of the EU legislature were to establish an internal market for companies and to achieve market integration in the field of EU company law. However, the Takeover Bid Directive is a compromise and watered down version of a proposal which the Commission envisaged would lead to a more effective pan-European takeover regime than that which actually proved possible. The need for compromise was the result of the very different legal and policy approaches of the Member States in the field of takeover regulation. Some provisions of the Directive are obligatory for all Member States. These provisions include the mandatory bid rule, the squeeze-out right, and the sell-out right. All these obligatory provisions of the Directive are in their present form open to criticism. The two key provisions of the Directive have been made optional for Member States. These are the non-frustration rule, requiring the board to obtain the prior authorization of the general meeting of shareholders before taking any action which could result in the frustration of the bid; and the breakthrough rule, requiring that any restrictions on the transfer of securities or voting rights provided for in the articles of association of the offeree company or in contractual agreements between the offeree company and the holders of its securities or in contractual agreements between holders of the offeree company's securities shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid. Nevertheless, Member States, which opt out, are obliged to allow individual companies to opt in. Moreover, a reciprocity rule was also adopted, which allows Member States to permit those companies, which apply these provisions, to opt out again if they are the target of a bidder, which does not itself apply the same takeover provisions. Additionally, the non-frustration and the breakthrough rule are not fully comprehensive and even when a company applies them, it might still be able to evade their application since some corporate and financial structures remain outside the Directive's scope. Finally, this thesis discusses the extent to which obstacles to cross border takeovers addressed by the Directive, or indeed left intact by the Directive, are to be regarded as restrictions on the right of establishment *stricto sensu*, or simply as obstacles in practice to making a successful takeover bid. More specifically, it scrutinizes the horizontal direct effect of the EC fundamental freedoms and seeks to analyze the extent to which conduct of the board and articles in the corporate constitution might be said to constitute restrictions on the freedom of establishment and on the free movement of capital.

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CHAPTER 1

THE FUNDAMENTAL FREEDOM OF ESTABLISHMENT OF COMPANIES

1.1 Introduction

This chapter will analyze the various characteristics of the fundamental freedom of establishment of companies. In this analysis, some elements of the freedom of establishment case law on natural persons will be invoked but only to the extent these elements fit into the special nature of legal persons such as companies; arbitrary generalizations will be avoided. This general approach will assist in understanding some obscure parts of the exercise of this fundamental freedom by companies and in drawing a more complete analysis.

1.2 The right of establishment: a right of natural and legal persons.

The EC treaty sets out the four fundamental freedoms of the European Communities: free movement of goods, workers, establishment and the provision of services, and capital. The fundamental freedoms contribute to the development and the evolution of the internal market.¹ The EC Treaty relates to economic activities that are physically carried out by natural persons, either as such or organized in the form of a legal person or persons.² The applicable fiscal regime, rules for the limitation of liability and organizational, commercial or even promotional purposes play an important role in the choice to conduct business as a natural or legal person. The distinction between natural persons and legal persons relates to form, not to substance, and the economic operator should be free to select the form in which to conduct his economic activities.³ This

¹ The concept of internal market will be explained below.

² I.G.F. Cath 'Free Movement of Legal Persons' in H.G. Schermers and others (eds), *Free Movement of Persons in Europe, Legal Problems and Experience* (Martinus Nijhoff Publishers, London 1991) 450.

³ I.G.F. Cath (n 2) 450. Case C-1/93 *Halliburton Services BV v Staatssecretaris van Financiën*. [1994] ECR I-1137 paras 16-23.

freedom of choice is crucial for market integration and for the most efficient allocation of economic resources; in addition to that, it boosts entrepreneurship and economic initiatives because businessmen are free to choose and realize their business plans. Intra-community economic activities can be carried out either by cross-border movement of goods and/or services or by cross-border movement of the supplier or receiver of such goods and/or services.⁴ In the first case the emphasis is put upon the movement of the goods and/or services; in the second case the emphasis is on the movement of the supplier or receiver thereof.⁵ From the perspective of rights guaranteed and treatment received under the EC treaty, the form selected should make no difference.⁶ The distinctions in the EC Treaty between the fundamental freedoms should be seen as the result of the organization of the subject matter in the EC Treaty rather than of any significant difference in substantive treatment.⁷ Except when specifically provided for otherwise under the EC Treaty (or its interpretation by the ECJ), there should be no national exceptions or ‘reserved areas’ that cannot be affected by the above fundamental freedoms on cross-border movement of economic activities, unless the subject matter is completely harmonized by Community measures which leave no discretion to the Member States.⁸

According to Article 43 EC Treaty, freedom of establishment includes the right for nationals of a Member State, ‘to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms’ in the territory of another Member State ‘under the conditions laid down for its own nationals by the

⁴ I.G.F. Cath (n 2) 450.

⁵ I.G.F. Cath (n 2) 450.

⁶ I.G.F. Cath (n 2) 450.

⁷ I.G.F. Cath (n 2) 451.

⁸ I.G.F. Cath (n 2) 451.

law of the country where such establishment is effected' (primary establishment).⁹ It also includes the right, for nationals of any Member State who are already established in any Member State, to set up agencies, branches or subsidiaries in another Member State (secondary establishment).¹⁰ According to Article 48 EC Treaty, companies or firms, as defined in that provision, are to be treated in the same way as natural persons who are nationals of Member States.¹¹ Although Article 48 EC Treaty requires companies to be treated in the same way as nationals for the purposes of the Treaty provisions on freedom of establishment, this is not strictly possible, given the differences between natural and legal persons.¹² It may be easier, for example, to recognize what is a primary as opposed to a secondary establishment in the case of the registered office of a company and one of its subsidiaries or branches, than it is in the case of a professional who has two places of practice in different Member States.¹³ Article 44 (2)(g) constitutes the legal basis for the harmonization of the area of company law by means of Directives.

G. Marengo expresses his objections as to whether nationality and a company's registered office are characterized by common elements and as a result could be treated in the same way. There can never be more than a partial equivalence of the nationality condition and that of the company's registered office on national territory.¹⁴ The former

⁹ A.G. Toth, *The Oxford Encyclopaedia of European Community Law-vol.2 The law of the internal market* (Oxford Clarendon Press, Oxford 2005) 242

¹⁰ A.G. Toth (n 9) 242. C. Gavalda and G. Parleani *Droit des Affaires del' Union Europeenne* (5th ed. Litec LexisNexis, Paris 2006) 126-127.

¹¹ A.G. Toth, (9) 242.

¹² P. Craig and G. De Burca, *EU Law, Text, cases and Materials* (4th ed. OUP, Oxford 2008) 806

¹³ The case law of the ECJ discussing the exercise of the primary and secondary establishment of companies and its influence on Takeovers and cross-border corporate restructuring will be analysed below in a separate chapter.

¹⁴ G. Marengo, 'The notion of restriction on the freedom of establishment and provision of services in the case-law of the court' (1991) 11 YEL 113-114. S. Fazio *The Harmonization of International Commercial Law* (Kluwer, AH Alpen aa den Rijn 2007) 81. In Case C-369/90 *Micheletti* ([1992] ECR I-4239), the ECJ presumed that the conferral of nationality of a Member State to a natural person is a matter that must be decided solely by that Member State and the rest of the Member States have to respect this decision and must not restrict the exercise of fundamental freedoms by imposing an additional condition for the recognition of this citizenship. It is interesting that this case concerned the

indeed uses a purely formal criterion, with no concrete or substantial content, to exclude equality of treatment.¹⁵ Thus, it cannot be justified on economic grounds, which is where freedom of establishment operates.¹⁶ By contrast, the registered office as a criterion for the connection of a company with a state is simultaneously a concrete situation which might justify a difference in treatment. Thus, it cannot be equated purely and simply with nationality.¹⁷ This argument is underpinned by *Commission v France*¹⁸ that examined the legality of a French discriminatory tax provision. The ECJ declared that by not granting to the branches and agencies in France of insurance companies whose registered office is in another Member State on the same terms as apply to insurance companies whose registered office is in France the benefit of shareholders' tax credits in respect of dividends paid to such branches or agencies by French companies, France had breached the freedom of establishment of companies. Nevertheless, the ECJ admitted that a distinction based on the location of the registered office of a company or the place of residence of a natural person may, under certain circumstances, be justified in an area such as tax law. The registered office is thus compared first with the nationality of physical person and then with their residence.¹⁹ This double comparison reveals that the registered office condition plays a role at once formal and substantial.²⁰ Hence, the location of the registered office of a company carries a content which could result in justified exemptions from the fundamental freedom of establishment.

effective exercise of the freedom of establishment. P. Dyrberg, 'Full Free Movement of Companies at the European Community at Last?' (2003) 4 ELRev. 528 528.

¹⁵ G. Marengo (n 14) 113-114.

¹⁶ G. Marengo (n 14) 113-114.

¹⁷ G. Marengo (n 14) 113-114.

¹⁸ Case 270/83 *Commission v France* [1986] ECR 273.

¹⁹ G. Marengo (n 14) 113-114.

²⁰ G. Marengo (n 14) 113-114.

1.3) Discriminatory restrictions.

Article 43 EC Treaty applies to the terms under which business may be carried on.²¹ The conditions under which business activities are conducted could often result in discriminatory restrictions treating differently non-nationals or foreign companies on the basis of their nationality. Directly discriminatory restrictions treating non-nationals less favourably than nationals should be distinguished from indistinctly applicable (indirectly discriminatory) measures which ostensibly treat non-nationals and nationals in the same way but in fact disadvantage the non-nationals.²²

Article 43 EC Treaty may be invoked to challenge a national rule, whether in the form of a nationality or a residence requirement, which is discriminatory.²³ Moreover, by prohibiting any discrimination on grounds of nationality resulting from national laws, regulations or practices, Article 43 EC Treaty seeks to ensure that, as regards the right of establishment, a Member State accords to nationals of other Member States the same treatment as it accords to its own nationals. These business terms could also include securities regulation and company law issues of cross-border takeover bids.

1.4) Non-discriminatory restrictions

As far as the ambit of Article 43 EC Treaty is concerned, some of the early cases supported the idea that Article 43 (then 52) EC Treaty did not apply to non-discriminatory restrictions. Thus, in *Commission v. Belgium* ('*Clinical Biology Services*')²⁴, the Court rejected the Commission's argument that restrictions on freedom of establishment were not confined to discriminatory measures, but also included measures that were indistinctly applicable to nationals and foreigners when they

²¹ J. Steiner, L. Woods and C. Twigg-Flesner *EU Law* (9th ed., OUP, Oxford 2006) 452. E. Stein *Harmonization of European Company Laws* (Merrill, Michigan 1971) 26.

²² C. Barnard *The Substantive Law of the EU* (2nd ed, OUP, Oxford 2007) 312.

²³ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 452.

²⁴ Case 221/85 *Commission of the European Communities v Kingdom of Belgium*. [1987] ECR 00719

constituted an unjustified restriction for the latter.²⁵ Furthermore, in *Fearon*²⁶, the Court followed the same rationale and it found that certain Irish legislation relating to the compulsory acquisition of land applied equally to Irish nationals and non-nationals, and did not infringe Article 43 EC Treaty.²⁷

However, non-discriminatory rules may also breach Article 43 EC Treaty by obstructing or making less attractive the exercise of this fundamental freedom.²⁸ Some non-discriminatory (indistinctly applicable) rules are related to market access and to the conditions of penetrating into a new market. This approach was introduced in the field of establishment in *Gebhard*²⁹ which examined the requirement to be registered with the local bar. Gebhard was a German citizen and was residing in Italy. This preliminary reference arose out of disciplinary proceedings brought by the Milan Bar against this German member of the Stuttgart Bar for using the term ‘avvocato’ contrary to Italian law. National provisions different from those of the home country are suspect and must be justified.³⁰ Member States must justify these different requirements if they want to continue to apply them. The four requirements of the justification test employed in *Gebhard*³¹ and *Centros*³² apply here with regard to non-discriminatory restrictions. In these cases, the Court held that national measures liable to hinder or render less attractive the exercise of fundamental freedoms guaranteed by the Treaty must be

²⁵ F. Weiss and F. Wooldridge, *Free Movement of Persons within the European Community* (European Monographs, 2nd ed Kluwer Law International, Alphen aan den Rijn) 109.

²⁶ Case 182/83, *Robert Fearon & Company Limited v Irish Land Commission*. [1984] ECR 03677

²⁷ F. Weiss and F. Wooldridge (n 25) 110.

²⁸ F. Weiss and F. Wooldridge (n 25) 111. National measures which have direct or sufficiently substantial (possibly exclusionary) effects on the exercise of the Treaty rights stipulated by Articles 18, 39, 43 and 49 EC Treaty constitute *prima facie* infringements of the EC Treaty and need to be justified. H. Toner ‘Non-discriminatory obstacles to the exercise of Treaty rights-Articles 39, 43, 49, and 18’ (2004) 23 YEL 274, 301.

²⁹ Case C-55/94, *Reinhard Gebhard v Consiglio dell’Ordine degli Avvocati e Procuratori di Milano*. [1995] ECR I-04165

³⁰ P. Kent *Law of the European Union* (4th ed. Pearson Longman, Essex 2008) 240, J. Shaw, J. Hunt and C. Wallace *Economic and Social Law of the European Union* (Palgrave Macmillan, Basingstoke 2007) 151.

³¹ Case C-55/94, *Reinhard Gebhard v Consiglio dell’Ordine degli Avvocati e Procuratori di Milano*. [1995] ECR I-04165

³² Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, [1999] ECR I-01459.

applied in a non-discriminatory way, must be justified by imperative requirements in the general interest, must be suitable for obtaining the objective they pursue and must not go beyond what is necessary to attain it.³³ After *Gebhard*, the ECJ focused very often on whether the national requirements is liable 'to prohibit, impede or make less attractive' access to the right of establishment (e.g. *Payroll Data Services*³⁴).³⁵

In *Kraus*³⁶, the Court adopted the following propositions: 1) that the right of establishment is a fundamental freedom in EC Law, and would not be fully realized if the Member States were able to refuse to grant the benefit of the provisions of Community law to those of their nationals who have taken advantage of its provisions to acquire vocational and academic qualifications in a Member State other than that of which they were nationals, and 2) that Articles 48 and 52 EC Treaty (now 39 and 43 EC Treaty) prohibited the invocation of national legislation regulating the use of an academic qualification, which applied equally to nationals and non-nationals, but which was 'liable to hamper or render less attractive the exercise by Community nationals, including those of the Member States, which enacted the measures, of fundamental freedoms guaranteed by the Treaty'.³⁷ This market access proposition constituted one of the harmonization rationales that the European legislature invoked in its European Company Law Harmonization Programme. Although national company laws could possibly treat equally nationals and non-nationals, the various differences among them could hamper or render less attractive the exercise by companies of their fundamental

³³ In Case C-222/95 *Societe civile immobiliere Parodi v Banque Albert de Bary et Cie* [1997] ECR I-3899, the Court held that imperative requirements in the general interest could justify compliance with stricter national conditions for mortgage loans than those prescribed by the first Banking Directive ([1977] OJ L33/30). J. Usher *The Law of Money and Financial Services in the EC* (Oxford EC Law Library, 2nd ed., OUP, Oxford 1999) 90. Weiss and F. Wooldridge (n 25) 112.

³⁴ Case C-79/01 *Payroll Data Services* [2002] ECR I-8923, para. 26.

³⁵ C. Barnard (n 22) 313.

³⁶ Case C-19/92 *Dieter Kraus v Land Baden-Württemberg*. [1993] ECR I-01663.

³⁷ Weiss and F. Wooldridge (n 25) 111.

right of establishment. For example, in *Centros*, the measure in question was ‘liable to hinder or make less attractive the exercise of fundamental freedoms’.³⁸

Non-discriminatory restrictions have sometimes been treated as being outside the scope of Article 43 EC Treaty (for example Case C-182/83 *Robert Feron*³⁹, Case C-221/85 *Commission v Belgium* (‘*Clinical Biology Services*’)⁴⁰), but it is now clear from cases such as *Kraus*⁴¹, *Gebhard*⁴² and *Centros*⁴³ that such restrictions may require justification by imperative requirements in the public interest.⁴⁴ Such justification was held to exist in *Pfeiffer*⁴⁵ in which a restriction on the right of establishment brought about by an indistinctly applicable provision of national law whose aim was to protect trade names against the risk of confusion was held to be so justified.⁴⁶ In *Pfeiffer*, the ECJ examined if a restraining order which prevented an Austrian subsidiary of a German parent operating discount stores in Austria from using a trade name used by the German parent Germany and other Member States is compatible with Article 43 EC Treaty. The restriction operates to the detriment of undertakings whose seat is in another Member State where they lawfully use a trade name which they would like to use beyond the boundaries of that State. However, such a restriction on the right of establishment, brought about by a provision of national law whose primary aim is to safeguard trade names against the risk of confusion, is justified by overriding

³⁸ Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, [1999] ECR I-01459 para. 30. J. Shaw, J. Hunt and C. Wallace (n 30) 151.

³⁹ Case 182/83, *Robert Feron & Company Limited v Irish Land Commission*. [1984] ECR 03677

⁴⁰ Case 221/85, *Commission of the European Communities v Kingdom of Belgium*. [1987] ECR 00719

⁴¹ Case C-19/92, *Dieter Kraus v Land Baden-Württemberg*. [1993] ECR I-01663 para. 32.

⁴² Case C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. [1995] ECR I-04165 para. 37. See also Case C-108/98 *MacQueen* [2001] ECR I-837.

⁴³ Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, [1999] ECR I-01459 para. 34

⁴⁴ Weiss and F. Wooldridge (n 25) 90. In *Commerzbank* (Case C-330/91 [1991] ECR I-4017), it was stipulated that equality of treatment did not include only discrimination on the basis of nationality or on the basis of a company's seat but all covert forms of discrimination applied through differentiated standards and leading to the same result. T. Tridimas ‘The case-law of the European Court of Justice on corporate entities’ (1993) 13 YEL 335, S. Fazio (n 14) 82.

⁴⁵ Case C-255/97, *Pfeiffer Großhandel GmbH v Löwa Warenhandel GmbH*. [1999] ECR I-02835 para. 21

⁴⁶ F. Weiss and F. Wooldridge (n 25) 87-90. D. A. Wyatt and A. Dashwood *European Union Law* (5th ed. Thomson Sweet & Maxwell, London 2006) 847.

requirements in the general interest pertaining to the protection of industrial and commercial property. No exception can be taken under Community law to the protection granted by a national law against the risk of confusion, since it corresponds to the specific subject-matter of a trade name, that is to say, protection of the proprietor of the trade name against that risk. The fact that non-discriminatory restrictions fall within the scope of freedom of establishment is very important for the examination of defensive actions of the company's board and defensive measures embedded in the articles of association of the offeree company as potential non-discriminatory takeover barriers which obstruct the exercise of the fundamental freedom of establishment.

Furthermore, it is relevant here to mention the case of national rules reinforcing barriers to market entry which hinder market access of subsidiaries (and must be justified if they are going to be preserved).⁴⁷ In *CaixaBank France*, the ECJ held that Article 43 EC Treaty precludes legislation of a Member State which prohibits a credit institution which is a subsidiary of a company from another Member State from remunerating sight accounts in euros opened by residents of the former Member State. That prohibition hinders credit institutions which are subsidiaries of foreign companies in raising capital from the public, by depriving them of the possibility of competing more effectively, by paying remuneration on sight accounts, with the credit institutions traditionally established in the Member State of establishment, which have an extensive network of branches and therefore greater opportunities than those subsidiaries for raising capital from the public. Where credit institutions which are subsidiaries of foreign companies seek to enter the market of a Member State, competing by means of the rate of remuneration paid on sight accounts constitutes one of the most effective methods to that end. Access to the market by those establishments is thus made more

⁴⁷ D. A. Wyatt and A. Dashwood (n 46) 848.

difficult by such a prohibition.⁴⁸ First, this prohibition enhances a barrier to market entry which is constituted by a prohibition to compete efficiently with already established market operators owning an extensive and well-organized network of branches and subsidiaries.⁴⁹ Secondly, this prohibition lessens the available means of competing with established market operators and obstructs access to the market (which should be justified).⁵⁰ Thus, we understand that freedom of establishment also catches national measures reinforcing obstacles to market access and rendering market operators unable to compete with other established market operators with a strong and well-organized participation in the specific sector of the market.

The fact that the boundary between discriminatory and non-discriminatory measures is blurred results in an additional problematic situation.⁵¹ The ECJ often applies an obstacle based test rather than one that looks at the notion of direct or indirect discrimination and, as a result, it does not always characterize clearly a measure as discriminatory or not.⁵² One example underpinning this argument in the area of establishment of companies is the corporate taxation case of *Marks and Spencer*. In *Marks and Spencer*⁵³ the measure could be categorized as directly discriminatory, as different rules applied depending on place of establishment.⁵⁴ However, the ECJ proceeded to examine possible justifications for this law and did not refer solely to the justifications set out explicitly in specific Treaty provisions (Article 46 EC Treaty).⁵⁵

⁴⁸ Case C-442/02 *CaixaBank France v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-8961 paras 13-14. E. Spaventa 'Case Note, Caixa-Bank' [2005] CMLRev. 1151-1168.

⁴⁹ D. A. Wyatt and A. Dashwood (n 46) 848.

⁵⁰ D. A. Wyatt and A. Dashwood (n 46) 848.

⁵¹ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 458.

⁵² J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 458.

⁵³ Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837

⁵⁴ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 458

⁵⁵ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 458

1.5) Possible derogations.

As far as the ‘survival’ of a restriction is concerned, if there is a restriction on the freedom of establishment, it will be examined whether this restriction could be justified.⁵⁶ Article 45 (participation in the exercise of official authority) and Article 46 (1) (public policy, public security and public health) EC Treaty provide the basis for justification of discriminatory measures.⁵⁷ However, Article 46 EC Treaty is very narrowly worded and is on the other hand also narrowly interpreted by the ECJ. As a matter of fact, in the majority of the cases, it is quite difficult to invoke successfully this article. Besides that, the possibility to justify an indistinctly applicable restriction which the ECJ developed within *Cassis de Dijon*⁵⁸-although regarding the free movement of goods- is applicable to the freedom of establishment (see *Thieffry*⁵⁹).⁶⁰ According to this case law, restrictions on both foreign and domestic citizens can be justified by the ‘general good [...] provided that such application is affected without discrimination’.⁶¹ Thus, non-discriminatory measures must be justified by imperative requirements in the general interest, must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it (the so-called *Gebhard*⁶² test).

1.6) The freedom of establishment applies only to cross-border situations.

The protective scope of the freedom of establishment catches only cross-border situations. This is very important in case of cross-border takeovers and mergers. It is in

⁵⁶ I. Saenger, ‘Recent Developments in European Company and Business Law’ (2005) 10 DeakinLR 297, 302.

⁵⁷ I. Saenger (n 56) 302.

⁵⁸ Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* (‘*Cassis de Dijon*’) [1979] ECR 649.

⁵⁹ Case 71/76 *Jean Thieffry v Conseil de l’ordre des avocats à la cour de Paris*, [1977] ECR 765

⁶⁰ I. Saenger (n) 302. E.I. Kaldellis ‘Freedom of establishment versus freedom to provide services: An evaluation of case-law developments in the area of indistinctly applicable rules’ (2001) 28 LIEI 23, 46.

⁶¹ I. Saenger (n 56) 302.

⁶² Case C-55/94 *Gebhard* [1995] ECR I-4165 para. 37.

those specific cases that members and others fall within the protective scope of the freedom of establishment. The national takeover laws follow quite divergent models for the protection of members and others and the Takeover Bid Directive does not manage to achieve uniformity in the protection of the various interests during cross-border investment activities (due to the opt-in/opt-out/reciprocity system that will be examined below). Hence, the fundamental freedom of establishment could still play a very important protective role in this harmonized part of the internal market. The relevant case law of the ECJ is quite interesting. In *Nino*⁶³, the ECJ held that the provisions of the Treaty on freedom of establishment do not apply to purely internal situations in a Member State such as a situation where nationals of a Member State engage within its territory in a self-employed professional activity in respect of which they cannot rely on any previous training or experience in another Member State.⁶⁴ As the ECJ stated in its judgment in *Bekaert*, the absence of any element going beyond a purely national setting in a given case means, in matters of freedom of establishment, that the provisions of Community law are not applicable to such a situation.⁶⁵ Nonetheless, the requirement of a cross-border element seems quite easy to satisfy. This can occur when an individual moves, or when a company moves, or sets up a branch, agency or subsidiary in another Member State. Establishment rights may be exercised against home and host Member State. In *Marks and Spencer*⁶⁶, British tax legislation did not permit a parent company from deducting losses suffered by its subsidiaries in other Member States, though it could deduct losses made by British subsidiaries. The effect of this rule was to discourage companies established in the UK from establishing subsidiaries (secondary

⁶³ Joined cases C-54/88, C-91/88 and C-14/89. *Criminal proceedings against Eleonora Nino and others*. [1990] ECR I-03537

⁶⁴ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 450.

⁶⁵ Case 204/87 *Bekaert* [1988] ECR 2029, Joined cases C-54/88, C-91/88 and C-14/89. *Criminal proceedings against Eleonora Nino and others*. [1990] ECR I-03537 para. 11.

⁶⁶ Case C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837

establishments in general) in other Member States. The cross-border element in that case was provided by the impact on its choices about whether to set up subsidiaries in other Member States.⁶⁷ The discouragement, the limitation of choices and the sole restriction of the possibility to establish a secondary establishment of a company in another Member State could satisfy the ‘cross-border’ criterion. A cross-border takeover bid constitutes definitely a situation fulfilling this ‘cross-border’ criterion. The aim of a takeover bid is the acquisition of control of the offeree company, which becomes very frequently a subsidiary of the offeror company. Thus, the impact on the offeror company’s choices about whether to set up subsidiaries in other Member States by taking them over satisfies the requirement of a cross-border element.

1.7) A few closing remarks.

The right of establishment is granted to natural and legal persons, and subject to relevant exceptions, it allows all types of self-employed activity to be taken up and pursued on the territory of any other Member State, undertakings to be formed and operated, and agencies, branches and subsidiaries to be set up.⁶⁸ It follows that a person may be established within the meaning of the Treaty, in more than one Member State-in particular, in the case of companies through the setting up of agencies, branches or subsidiaries, and in case of the members of professions, by establishing a second professional base.⁶⁹ The abolition of national laws constituting restrictions on freedom

⁶⁷J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 450. Other cases discussing the cross-border character of freedom of establishment: Case C-134/95 *Unità Socio-Sanitaria Locale n° 47 di Biella (USSL)* [1997] ECR I-195 para. 19, Case C-108/98 *RI.SAN. Srl* [1999] ECRI-5219 para. 23, *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris* [1977] ECR 765 paras. 27 Case C-19/92 *Dieter Kraus v Land Baden-Württemberg*. [1993] ECR I-01663. paras. 15-16, Case 115/78 *J. Knooks v Secretary of State for Economic Affairs* [1979] ECR-399 paras. 20-24.

⁶⁸ D. A. Wyatt and A. Dashwood (n 46) 750.

⁶⁹ D. A. Wyatt and A. Dashwood (n 46) 751.

of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by natural or legal persons of any Member State established in the territory of any Member State.⁷⁰ In addition to that, the ECJ in *Thieffry* held that under Article 3 (c) EC Treaty, the activities of Community include, *inter alia*, the abolition of obstacles to freedom of movement for persons and services.⁷¹ The *Gebhard*⁷² case law is quite crucial in defining the scope of this fundamental freedom.⁷³ The concept of establishment within the meaning of the Treaty is a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his or her State of origin and to profit therefrom so contributing to economic and social interpenetration within the Community, in the sphere of activities of self-employed persons.⁷⁴ The Court has held that an undertaking of one Member State which maintains a permanent presence in another is covered by the provisions on establishment 'even that presence does not take the form of a branch or agency, but consists merely of an office managed by the undertaking's own staff or by a person who is independent but authorized to act on a permanent basis for the undertaking as would be the case with an agency'.⁷⁵ Although the primary objective of these provisions is to guarantee the right of establishment to foreign nationals and companies in, as well as their equal treatment with the nationals of, the host Member State, they also prohibit the Member State of origin from hindering the establishment in another Member State of its own nationals and companies, for example by preventing

⁷⁰ Case 270/83 *Commission of the European Communities v French Republic* [1986] ECR 273 para. 13.

⁷¹ Case 71/76 *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris*, [1977] ECR 765 para. 78.

⁷² Case C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*. [1995] ECR I-04165

⁷³ Case C-55/94 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, paras. 23, 24, 25.

⁷⁴ D. A. Wyatt and A. Dashwood (n 46) 751.

⁷⁵ Case 205/84 *Commission v Germany* [1986] ECR 3801 para. 21.

them from leaving the national territory in order to establish themselves elsewhere⁷⁶ or by applying unfavourable tax measures that discourage them from setting up a primary or secondary establishment in another Member State⁷⁷.

The scope of Article 43 EC Treaty is quite broad and covers many different areas, from pure economic activities, such as liberal professions, to personal situations, such as family rights of residence.⁷⁸ Company law is a distinctive part of the regulatory scope of the fundamental freedom of establishment due to both the special national nature of company laws and the way in which companies or groups of companies can reside in more than one Member State at a time.⁷⁹ These special features should be taken into account by the European legislature or by the ECJ, when they are dealing with a situation involving the freedom of establishment of companies.

⁷⁶ Case 81/87 *Daily Mail* [1988] ECR 5483, 5510

⁷⁷ Case C-264/96 *ICI* [1998] ECR I-4695 and Case C-251/98 *Baars* [200] ECR I-2787.

⁷⁸ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 466.

⁷⁹ J. Steiner, L. Woods and C. Twigg-Flesner (n 21) 466.

CHAPTER 2

LEGAL BASES FOR THE HARMONIZATION OF COMPANY LAW AND CAPITAL MARKET LAW AT EU LEVEL.

2.1) Introduction

This chapter will discuss the available legal bases for the harmonization of company law and capital market law at EU level. It will also analyze briefly the ECJ's case law on community competence to regulate certain parts of the internal market. This is necessary in order to understand the foundations of this harmonizing instrument and to see how the European legislature perceives and uses the available legal bases.

2.2) Harmonizing Company Law and Capital Market Law: preliminary issues.

Two basic premises underpin the harmonization of company law in the European Union. The first premise stresses the significance of companies as the most important economic actors of the Community, playing a crucial role in cross-border investments and other entrepreneurial activities.⁸⁰ The second premise is based on the existence of a strong link between the harmonization of company law and securities regulation and the progress of market integration as proclaimed by the EC Treaty.⁸¹

⁸⁰ R. Buxbaum and K. Hopt *Legal Harmonization and the Business Enterprise* (Integration through Law Series, de Gruyter, Berlin 1988) 167.

⁸¹ R. Buxbaum and K. Hopt (n 80) 167.

Company law regulates ‘companies’ i.e. unions or associations of persons for carrying on a commercial or industrial enterprise, while capital market law or securities regulation is addressed to the market for long-term investment funds.⁸² The function of capital market law has been viewed as: 1) protecting investors, 2) increasing market efficiency, 3) completing organization of the market ‘firm’, 4) capturing wealth for some members of the industry and 5) affecting competition in the industry.⁸³ The main use of capital markets is to secure financing for companies through equity or bonds. With regard to the scope of these two areas of law, their distinction⁸⁴ is blurred by the development of the law of listed companies, a law that is a mixture of traditional company law and traditional capital markets law.⁸⁵ The adoption of legislation addressed specifically to listed companies, and incorporated into capital market law, shows that capital market law can play an important role in many of the aspects of the regulation of listed companies (e.g. listing standards, disclosure and structure of governance, accounting, auditing, prospectus and proxy rules etc).⁸⁶ Ideas and concepts that have been cultivated in the field of capital market law exercise an influence on company law. One characteristic example is the notion of legal capital deriving from company law; capital market law challenges the effectiveness of this notion and argues that equivalent protection could be provided by transparency and

⁸² H.C. Black *Black’s Law Dictionary* (Fifth ed. West Publishing Co, St. Paul Minn. 1979) 190, 255. P.L. Davies *Gower and Davies’ Principles of Modern Company Law* (7th ed Sweet & Maxwell, London 2003) 3.

⁸³ E. Kitch ‘Regulation of the Securities Market’ in B. Bouckaert and G. De Geest (eds) *Encyclopedia of Law & Economics* (Elgar and the University of Ghent, London 1999) 813.

⁸⁴ The contrast between the company law and the capital market law approaches raises the most important questions in the area of the choice of the relationship which is to be regulated, because this choice will determine the definition of basic concepts (e.g. those of ‘insider’ and ‘inside information’ in insider dealing laws). P.L. Davies ‘The European Community’s Directive on Insider Dealing: From Company Law to Securities Markets Regulation?’ [1991] OJLS 92, 93.

⁸⁵ J. Garrido-Garcia ‘Company Law and Capital Markets Law’ [2005] *RabelsZ* 761, 776.

⁸⁶ J. Garrido-Garcia (n 85) 777.

conduct of business rules.⁸⁷ Company law harmonization should also take into account the needs of the capital markets⁸⁸ and should not be confined only to company law considerations. It could be argued that the harmonization of company law could enhance capital markets' security, transparency⁸⁹ and efficiency because divergent⁹⁰ national company law standards (e.g. special classes of publicly traded securities, information asymmetries) have a negative influence on capital markets' transparency.⁹¹ In countries where capital markets are efficient, company law can be less intrusive relying on markets to exert pressure on market participants and leaving more room for parties to conclude their own arrangements. If capital markets are ineffective, company law has to cope with these problems and the legislature will adopt more mandatory standards.⁹² Therefore, there is a potential overlap between the scopes of these two fields of law.

In modern industrialized societies, the company, in a solitary form or as group of interconnected and dependent undertakings, has become the main vehicle of economic organization.⁹³ Companies are considered to be the central mode for the conduct of business because, apart from being the major traders of goods, they are the major borrowers and lenders of capital flowing between countries and the principal conveyors of new technology. Consolidated groups of companies constituted by companies based

⁸⁷ E. Wymeersch 'European Company law and Corporate Governance' Quo Vadis?' [2005] RabelZ 789.

⁸⁸ See also J. Heiser 'Can Capital Market Law approaches be harmonized with essential principles of Company Law?' [2000] EBLR 60-82.

⁸⁹ For the influence of transparency requirements on company law: W. Ebke 'The impact of transparency regulation on company law' in K. Hopt and E. Wymeersch (eds) *Capital Markets and Company Law* (OUP, Oxford 2003) 173.

⁹⁰ I.H.Y. Chiu *Regulatory Convergence in EU Securities Regulation* (Kluwer Law International, Alphen aan den Rijn 2008) 185.

⁹¹ E. Wymeersch 'About Techniques of Regulating Companies in the EU' in G. Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 158, 173. See also G. Ferrarini 'Introduction' and R. Dale 'The Regulation of Investment Firms in the European Union' in G. Ferrarini (ed) *Prudential Regulation of Banks and Securities Firms* (Kluwer, London 1995) 10 and 27.

⁹² Z. Goshen 'The impact of insider trading rules on company law' in K. Hopt and E. Wymeersch (eds) *Capital Markets and Company Law* (OUP, Oxford 2003) 566.

⁹³ C.M. Schmitthoff 'The Future of the European Company Law Scene' in C.M. Schmitthoff(ed) *The Harmonization of European Company Law* (UKNCCL, London 1973) 6-7.

on different Member States play a crucial role in corporate restructuring and in market integration. Thus, the particular concern of the Community for the regulation of companies is justified.⁹⁴ The power of the European legislature to adopt a legislative measure lays in a specific legal basis in the Treaties. The European legislature is bound to select the most appropriate legal basis for the legislative measures that it plans to adopt; otherwise, if the legislative measure is based on a wrong legal basis, there is a violation of the principle of attributed competence (Article 5 EC Treaty)⁹⁵ which could be brought before the European Court of Justice. The choice of legal basis will also determine the legislative process which will be followed.⁹⁶ The treaty basis for the company law harmonization programme is Article 44 (2)(g). The regulatory goal of this provision is provided by Article 44 (1) EC Treaty and is the attainment of freedom of establishment. Any harmonising legislation in the field of company law must eliminate obstacles to cross-frontier business activities, mobility, expansion and investment and/or eliminate appreciable distortions of competition.⁹⁷ Additionally, the high degree of competitiveness of EU businesses and market proclaimed by Article 2 EC Treaty as one of the primary tasks of the Community shall also be pursued by the harmonising measures which have to try to reduce the transaction costs involved in cross-border business activity.⁹⁸

Articles 94 and 95 EC Treaty have never been invoked in company law directives. Apart from the general legal bases providing the competence to harmonize internal market law in general (Articles 94 and 95 EC Treaty), the EC treaty does not deal with

⁹⁴ E. Stein (n 21) 23.

⁹⁵ D. A. Wyatt and A. Dashwood (n 46) 85.

⁹⁶ V. Edwards *EC Company Law* (Oxford EC Law Library, Oxford Clarendon Press, Oxford 1999) 4. D. A. Wyatt and A. Dashwood (n 46) 55 and 938.

⁹⁷ Case C-376/98 *Germany v Council and European Parliament* (Tobacco Advertising ruling) [2000] ECR I-8419. D. A. Wyatt and A. Dashwood (n 46) 864. The way the aims of market integration are incorporated into the company law directives and are understood by the Community institutions is criticized in R. Buxbaum, G. Hertig and others (eds) *European Business Law* (de Gruyter, Berlin-New York 1991) 131.

⁹⁸ D. A. Wyatt and A. Dashwood (n) 864.

company law as such, but approaches the position of companies in terms of freedom of establishment in a cross border framework.⁹⁹ Hence, the legal basis for the harmonization of freedom of establishment of companies is found in Articles 44 (2)(g) (Title III: Free movement of persons, services and capital, Chapter 2: Right of establishment) which requires qualified majority¹⁰⁰ voting in the Council in accordance with the Article 251 EC Treaty legislative process. It should also be mentioned that the initial Article 47(2) (as it appeared in the original EEC Treaty) providing for the harmonization of the taking up and pursuit of activities as self-employed persons required unanimity. This potential legal basis would add more difficulties in the initial stages of the harmonization process in comparison with Article 44(2)(g), requiring qualified majority and constituting a more specific legal basis. Article 95 EC Treaty requiring qualifying majority operates by way of derogation from Article 94 EC Treaty which enables the Council acting unanimously, to issue directives for the approximation of national provisions directly affecting the establishment or functioning of the common market. Article 94 EC Treaty has been left with a residual role and is available in cases expressly excluded by the second paragraph of Article 95 EC Treaty from the scope of that latter article.¹⁰¹ Free movement of persons (and as a consequence

⁹⁹ E. Wymeersch (n 91) 161. It should be noted that the founding Member States did not include a specific legal basis for the harmonization of company law only as an instrument to facilitate market integration but also as a political compromise for their agreement to confer the right of establishment on companies because they were afraid that the fairly liberal and lax company law of Netherlands would attract many companies and would become the 'Delaware of Europe'. R. Buxbaum, G. Hertig and others (eds) (n 97) 132.

¹⁰⁰ E. Stein (n 21) 175. Article 54.(3)(g) (now Article 44 (2)(g)) EC Treaty required directives to be adopted by a unanimous vote in the Council until the end of the first stage of the transitional period of the Community's harmonization programme, but they may adopted subsequently by qualified majority. C. Villiers 'Harmonization of company laws in Europe-With an introduction to some comparative issues' in G. Howells(ed) *European Business Law* (Dartmouth, Aldershot 1996) 171, E. Stein (n 21) 24-25.

¹⁰¹ D. A. Wyatt and A. Dashwood (n 46) 929. The Commission abandoned its idea to invoke both Articles 44 (2)(g) and 94 EC Treaty as the legal bases for company law directives (such as the 11th Directive) applying also to companies incorporated in a non-Member State but having an establishment within the Community. The Community considers Article 44(2)(g) EC Treaty as a sufficient legal basis for these cases. R. Buxbaum, G. Hertig and others (eds) (n 97) 144. The debate on democracy both at EU level and at company level is quite important in the legislative process of market integration. At EU

the freedom of establishment of companies) is among those fields which fall outside the harmonising scope of Article 95 EC Treaty. Those qualifications of the second paragraph of Article 95 EC Treaty were probably inserted in order to alleviate the concerns of Member States about the adoption of harmonization measures by qualified majority and the possibility of being outvoted in the Council.¹⁰² Additionally, Article 95 EC Treaty itself constitutes a residual provision because it applies ‘save where otherwise provided in this Treaty’. This means that wherever there is a specific legal basis for the harmonization of a specific part of the internal market, such as Article 44(2)(g) EC Treaty and the freedom of establishment of companies, Article 95 EC Treaty should not be used as a legal basis of the harmonizing measures.¹⁰³

In the area of securities regulation, one can encounter various situations: Article 95 EC Treaty constitutes an often invoked legal basis, along with Art. 44 (2)(g) EC Treaty because those specific directives cover not only companies formed in accordance with a national company law (Article 48 EC Treaty) but also companies established in third countries which issue securities on the capital markets of one or several Member States, or pursue listing on capital markets established in Member States.¹⁰⁴ But other EC

level, democracy should be representative and at company level democracy participative. C. Villiers examines the extent to which the harmonization of company law has changed the structure (internal and external corporate governance of corporations) and whether or not it has created greater opportunities for participatory democracy within those business structures. C. Villiers *European Company Law-Towards Democracy?* (Ashgate, Aldershot 1998) 1 and 6. It is also argued that Article 95 EC Treaty is a *lex specialis* of Article 94 EC Treaty and also a *lex specialis* of Article 308 EC Treaty. (Case 45/86 *Commission v Council*[1987] ECR 1493 para. 13). As a matter of fact, Article 95 EC Treaty is *lex generalis* of some other Treaty articles (Case 84/94 *United Kingdom v Council* [1996] ECR 5755, para. 12 and Case 202/88 *France v Commission* [1991] ECR 1223 para. 25). P. Craig and G. De Burca (n 12) 1119, A. Knook ‘Guns and Tobacco. The effect of interstate trade case law on the vertical division of powers’ (2004) 11 MJ 347, 348.

¹⁰² D. A. Wyatt and A. Dashwood (n 46) 930. R. Buxbaum, G. Hertig and others (eds) (n 97) 143.

¹⁰³ D. A. Wyatt and A. Dashwood (n 46) 929.

¹⁰⁴ G. Wolff ‘The Commission’s Programme for company Law Harmonisation: the Winding Road to a Uniform European Company Law?’ in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell , London 1993) 20.

Treaty articles have also been invoked: Article 47 for the UCITS Directive¹⁰⁵.¹⁰⁶ Article 94 and, in the case of the Insider Dealing Directive Article 95 have been used in some cases as an additional or alternative legal basis for the directives in the area of securities regulation.¹⁰⁷ These legal bases are capable of producing a harmonized capital-raising regime which is designed to promote the development of a common capital market by boosting investor confidence in capital markets and by removing any regulatory obstacles.¹⁰⁸ Legal diversity in the area of securities regulation amounts to non-tariff barriers with high costs inhibiting market access. Competition is appreciably distorted and the level playing field could not be established. Moreover, investor confidence fosters cross-border investment and market integration.¹⁰⁹ An integrated securities market, within which markets are easily accessed by investment services providers, investors and issuers, could strengthen European capital markets.¹¹⁰ Since

¹⁰⁵ Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [1985] OJ L375/3-18.

¹⁰⁶ E. Wymeersch 'Company Law in Europe and European Company Law' University of Gent, Financial Law Institute Working Papers (2001) 3 and 14-15. E. Wymeersch proceeds to a theoretical analysis and comparison between Article 44 (2)(g) and Articles 94 and 95 EC Treaty as potential basis for company law harmonisation. In so far as the European legislature had chosen only Article 44 (2)(g) EC Treaty as the legal basis for company law harmonization, this discussion and the comparison between potential legal bases is interesting only from an EU market governance and efficient market-making perspective. Additionally, the argument that Community can adopt directives based on Article 94 or 95 EC Treaty regulating almost the areas of company law and corporate governance could be strictly scrutinized under the principle of attributed competence and the principle of subsidiarity (Article 5 EC Treaty) as developed by ECJ's case law (for an analysis of this case law see: D.A. Wyatt 'Community Competence to Regulate the Internal Market' Oxford Legal Studies Research Paper No. 9/2007). <<http://ssrn.com/abstract=997863>> accessed 21 August 2008 [also published in M. Dougan and S. Currie(eds) *50 years of the European Treaties, looking back and thinking forward* (Hart, Oxford 2009) 93-136].

¹⁰⁷ V. Edwards (n 96) 4. In general, Article 94 EC Treaty has been used frequently as a legal basis for securities law, worker participation measures, banking regulation, insurance law and taxation rather than mainstream company law. C. Villiers (n 101) 18.

¹⁰⁸ N. Moloney *EC Securities Regulation* (Oxford EC Law Library, OUP, Oxford 2002) 66.

¹⁰⁹ This internal market orientation had affected significantly the substance of the harmonization of capital markets. The place of investor protection rationale in this harmonizing agenda is still discussed in a very interesting constitutional debate. N. Moloney (n 108) 7, 9. Most of the concerns about the investor confidence rationale are related to Article 5 EC Treaty (in accordance to *Tobacco Advertising* case law that will be discussed extensively in the chapter on subsidiarity). N. Moloney 'Confidence and Competence: The Conundrum of EC Capital Markets Law' (2004) 1 JCLS 1, 46, N. Moloney 'New Frontiers in EC Capital Markets Law: From Market Construction to Market Regulation' [2003] CMLRev. 809, 812, 833-840.

¹¹⁰ N. Moloney (n 108) 6-7.

investor protection is a clear objective of all the securities directives and since it is clear from the preamble to all these directives that market integration is a direct and specific aim, there is little room for doubt as to the appropriateness of their legal basis, leading to no objections to the choice of legal basis for capital market directives.¹¹¹

2.3) Article 43 and Article 44(2)(g) EC Treaty.

Article 43 EC Treaty defines the freedom establishment¹¹², which is not only available to natural persons but also to legal persons and especially companies (Article 43(2) EC Treaty). Moreover, the harmonization programme of the freedom of establishment of companies is based on Article 44 (2)(g) EC Treaty. Article 48 EC Treaty provides a definition for companies or firms which also enjoy the freedom of establishment. There is also Article 293 EC Treaty which urges Member States to reach an international agreement on mutual recognition of companies and entities carrying legal personality. We should always have in our minds that the main purpose of harmonization in the area of company law is the realization of an internal market as proclaimed by Article 3(c) and (h) EC Treaty.

The EC Treaty articles dealing with the freedom of establishment and more specifically with the freedom of establishment of companies are the following:

Article 43 (EC Treaty)

‘Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to

¹¹¹ V. Edwards (n 96) 4-5.

¹¹² I. Saeger distinguishes between the factual and the personal scope of the protection that the fundamental freedom of establishment provides. Within the factual scope of protection, it has to be clarified whether the affected activity is indeed an act of free movement. As far the personal scope of the protection is concerned, due to Article 48 (1) EC Treaty the freedom of establishment should be applicable to companies which comply with Article 48 (2) EC Treaty. I. Saenger, (n 56) 299.

restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital. ‘

Article 44 (EC Treaty)

‘1. In order to attain freedom of establishment as regards a particular activity, the Council, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, shall act by means of directives.

2. The Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular:

... (g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent throughout the Community;...’

Article 48 (EC Treaty)

‘Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.’

As far as the scope of Article 44 (2)(g) EC Treaty is concerned, two views on this issue were developed: a broad view and a narrow one. On the one hand, the restrictive view requires harmonization measures only when harmonization is going to abolish a specific discriminatory national law or practice which inhibits companies established in other Member States exercising their right of establishment, by proving equivalent specific safeguards for the protection of the interests of members and/or others.¹¹³

¹¹³ V. Edwards (n 96) 6-7. R. Buxbaum and K. Hopt (n 80) 204

Taking into account the scope of the restrictive view, it seems that directives seeking in more general terms to harmonize specific parts of company law and corporate governance would not be permitted.¹¹⁴ On the other hand, the broader view stresses the importance of the existence of a particular legal basis for company law harmonization. Article 43 EC Treaty requires a host State to treat equally both members and others of a foreign company exercising its right of establishment in the host Member State and members and others of a company registered originally in the host State.¹¹⁵ It is easily understood that the majority of areas of company law are open and available for harmonization by the European legislature.¹¹⁶ Of course, this would not be a viable project for the European legislature and more moderate approaches should be followed. The evolution of the harmonization of company law at EU Law shows that the restrictive approach did not prevail. Eleven directives regulating very different parts of company law and corporate governance were adopted and implemented on the basis of Article 44 (2)(g).¹¹⁷ It is obvious that the European Commission envisaged harmonization as a means of promoting more intensively cross-border business activity and of boosting the competitiveness of European enterprises. This approach derived from the fact that the legal basis for company law harmonization was located in the chapter on freedom of establishment. Yet, not all Member States were satisfied with this approach towards company law harmonization because they realized that some of their company law doctrines were under attack.¹¹⁸ However, this broader view should always be scrutinized by the principles of attributed competence and of subsidiarity as had been constructed by the ECJ's case law.

¹¹⁴ V. Edwards (n 96) 6-7. Corporate governance is a notion evolved from commercial law through business law and commercial regulation. L. Nottage 'Commercial Regulation' in J.M Smits(ed) *Elgar Encyclopedia of Comparative Law* (Elgar, Cheltenham 2008) 135-144.

¹¹⁵ V. Edwards (n 96) 7.

¹¹⁶ V. Edwards (n 96) 7. R. Buxbaum and K. Hopt (n 80) 205.

¹¹⁷ V. Edwards (n 96) 6-7. R. Buxbaum and K. Hopt (n 80) 204-205.

¹¹⁸ D. A. Wyatt and A. Dashwood (n 46) 885.

Although the harmonization of company law is not a self-standing objective and requires the existence of a link between the adopted legislation and the fundamental freedom of establishment, that goal calls for a wide and flexible interpretation in accordance with the general approach of ECJ over the last five decades to the construction of Treaty articles.¹¹⁹ In *Saldanha and MTS Securities Corporation*¹²⁰, the ECJ stated that:

‘Article 44(2)(g) EC Treaty empowers the Council and the Commission, for the purpose of *giving effect to the freedom of establishment*, to coordinate to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 of the EC Treaty with a view to making such safeguards equivalent throughout the Community. *It follows that rules which, in the area of company law, seek to protect the interests of shareholders come within the scope of the Treaty and are for that reason subject to the prohibition of all discrimination based on nationality.*’(emphasis added).

While Article 44(2)(g) EC Treaty talks about ‘coordinating’ certain areas of company law, there are other terms used in other legal bases of the EC Treaty such as ‘approximation’ and ‘harmonization’ of laws.¹²¹ Scrutiny of the EC Treaty supports the common sense view that no differences exist among these three terms; the Treaty adopts the same content for these terms.¹²² The major component of this content is the avoidance of complete unification of national laws. That conclusion is confirmed by the objective described in Article 44(2)(g) EC Treaty: ‘with a view to making such safeguards equivalent’ rather than identical or uniform.¹²³ However, there are areas of

¹¹⁹ V. Edwards (n 96) 7.

¹²⁰ Case C-122/96 *Stephen Austin Saldanha and MTS Securities Corporation v Hiross Holding AG*. [1997] ECR I-05325.

¹²¹ V. Edwards (n 96) 8.

¹²² V. Edwards (n 96) 8.

¹²³ V. Edwards (n 96) 8. Cf. Lempereur ‘Myth and Reality in the European Harmonization Process’ in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New

company law (some of them rather technical ones) where unification is the only way forward and coincides with the meaning of harmonization. There are parts of company law where in practice only unification will result in equivalence by imposing a uniform rule valid all over the EU (e.g. mandatory disclosure in favour of third parties).¹²⁴ This ‘disguised’ unification available through harmonization is mainly found in technical aspects of company law such as disclosure of information, accounting provisions, auditing regulations etc.

The original EEC Treaty demanded the abolition of various barriers to freedom of establishment in progressive stages during the transitional period. The required secondary legislation on the abolition of restrictions was to be preceded by a General Programme.¹²⁵ In *Thieffry*, the ECJ characterized the General Programme on the abolition of restrictions on freedom of establishment¹²⁶, adopted on 18 December 1961 as a mean providing ‘useful guidance for the implementation of the relevant provisions of the Treaty’.¹²⁷ The main purpose of the 1961 Programme is to set certain minimum requirements in order to promote the freedom of establishment on cross-border level.¹²⁸

York 1994) 242, S. Fazio (n 14) 92, C. Villiers (n 100) 176-177, C.M. Schmitthoff ‘The Future of the European Company Law Scene’ and H.C. Ficker ‘The EEC Directives on Company Law Harmonization’ in C.M. Schmitthoff(ed) *The Harmonization of European Company Law* (UKNCCL, London 1973) 6-7, 67-70.

¹²⁴ V. Edwards (n 96) 8. M. Lutter declared that future company law should not be purely national, nor exclusively European, but is to be conceived as a system with continuing roots in the national traditions and realities, but characterized by largely uniform structure all over Europe (as translated and cited by E. Wymeersch). M. Lutter ‘Perspektiven eines Europäischen Unternehmensrechtes-Versuch eines Summe’ [1992] ZGR 450, E. Wymeersch ‘The Regulation of Takeover Bids in a Comparative Perspective’ in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 322. M.J.G.C Raaijmakers ‘Which way with company law harmonization?’ in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New York 1994) 239.

¹²⁵ D. A. Wyatt and A. Dashwood (n 46) 763.

¹²⁶ General Programme for the abolition of restrictions on freedom of establishment [1962] OJ 2/36-45 and [English spec ed: Series II Volume IX/7-15]

¹²⁷ Case 71/76 *Jean Thieffry v Conseil de l'ordre des avocats à la cour de Paris*, [1977] ECR 765 I.G.F. Cath (n), 453. Other cases referring to General Programme: Case 182/83, *Robert Fearon & Company Limited v Irish Land Commission*. [1984] ECR 3677, Case 136/78 *Criminal proceedings against Vincent Auer* [1979] ECR 437, Case 107/83. *Ordre des avocats au Barreau de Paris v Onno Klopp* [1984] ECR 2971, D. A. Wyatt and A. Dashwood (n 46) 764.

¹²⁸ I.G.F. Cath (n 2), 453. This programmatic fixation of legislative goals should not undermine the dynamic character of Community’s harmonizing measures and should not neglect the importance of the

Among the beneficiaries of freedom of establishment, there were also companies, provided that, 'where only the seat prescribed by their statutes is situated within the Community, their activity shows a real and continuous link with the economy of a Member State'. It is further explained that such link is not permitted to be 'one of nationality, whether of the members of the company or firm, or of the persons holding managerial or supervisory posts therein, or of the holders of the capital, who wish to set up agencies, branches or subsidiaries in a Member State'. If this requirement is met, then, Community law prohibits any formal or informal, direct or indirect, difference in treatment between national legal entities and foreign legal entities, which have established themselves cross-border on a secondary basis, or any kind of barrier capable of obstructing their access to the market of the host Member State.¹²⁹ Title III of the General Programme required the abolition of discriminatory measures which might impair access to the non-wage-earning activities of nationals of the Member States.¹³⁰ In addition, Title III of the 1961 Programme provides a long and non-exhaustive list of examples of express or implied 'restrictions' on the freedom of secondary establishment, such as restrictions on access to economic activities in general, licensing or specific document requirements, imposition of specific conditions, prior practical training requirements, financial impediments, such as specific fiscal or other charges, guarantees or security, access to professional training, participation rights in legal entities, compensation in the social security system, different treatment in the event of expropriation, agreements to be concluded, public procurement, administrative concessions or licenses, purchase, sale or use of assets and intellectual property rights,

facts of specific situations. It seems that the 2003 Company Law Action Plans takes into account those considerations. R. Buxbaum and K. Hopt (n 80) 208.

¹²⁹ I.G.F. Cath (n 2) 453.

¹³⁰ D. A. Wyatt and A. Dashwood (n 46) 764.

loans, State Aids, procedural rights and membership of professional associations.¹³¹ It is quite interesting for EU Company Law that Title III of the General Programme called for the abolition of national provisions barring or limiting membership in companies, particularly with regard to the activities of their members.¹³² The subject matter of takeover bids is closely related to the following restrictions that this Programme tried to abolish: restrictions on access to economic activities in general, financial impediments, such as specific fiscal or other charges, especially the participation rights in legal entities and purchase, sale or use of assets. Furthermore, a generic statement of the Preamble of Council Directive 64/225/EEC on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession¹³³ is very important for the aim of the promotion of freedom of establishment at EU level (even if this Directive addresses reinsurance and retrocession):

‘Whereas, for the purposes of applying measures concerning the right of establishment and freedom to provide services, companies and firms are to be treated in the same way as natural persons who are nationals of Member States, subject only to the conditions laid down in Article 58 (now Article 48) EC Treaty and, where necessary, to the condition that there should exist a real and continuous link with the economy of a Member State ; whereas therefore no company or firm may be required, in order to obtain the benefit of such measures, to fulfil any additional condition, and in particular no company or firm may be required to obtain any special authorisation not required of a domestic company or firm wishing to pursue a particular economic activity ; whereas, however, such uniformity of treatment should not prevent Member States from requiring that a company having a share capital should operate in their countries under the description by which it is known in the law of the Member State under which it is constituted, and that it should indicate the

¹³¹ I.G.F. Cath (n 2) 453.

¹³² D. A. Wyatt and A. Dashwood (n 46) 764.

¹³³ Council Directive 64/225/EEC of 25 February 1964 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession [1964] OJ 56/878-883. A. McGee ‘The Single Market in Insurance-Breaking Down the Barriers’ in G. Howells(ed) *European Business Law* (Dartmouth, Aldershot 1996) 223, D. Weber-Ray ‘Harmonization of European Insurance Contract Law’ in S. Vogenauer and S. Weatherill (eds) *The Harmonization of European Contract Law* (Hart, Portland 2006) 207. For a very interesting and up-to-date analysis of insurance law, see: M. Clarke *Policies and Perceptions of Insurance Law in the Twenty-First Century* (OUP, Oxford 2007).

amount of its subscribed capital on the business papers which it uses in the host Member State;’

2.4) Article 293 EC Treaty.

Article 293 EC Treaty prompts Member States to conclude an international agreement on mutual recognition of companies and entities carrying legal personality:

Article 293 (EC Treaty)

‘Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals:

...- the mutual recognition of companies or firms within the meaning of the second paragraph of Article 48, the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries,...’

As far as the application of Article 293 EC Treaty is concerned, it has not contributed much to market integration in the field of EU Company Law.¹³⁴ It could be assumed that this provision for agreements was inserted because the founding Member States were not sure that the Treaty contained sufficient legal basis for dealing with these substantive areas. Nevertheless, this assumption does not mean that Article 293 EC Treaty has a pre-emptive effect and excludes harmonization of these areas on the basis of Article 44(2)(g) EC Treaty.¹³⁵ The original six Member States had signed in 1968 an agreement on the mutual recognition of companies and legal persons.¹³⁶ However, this agreement never came into effect due to its non-ratification by Netherlands. Nowadays, this international agreement is considered as abandoned but it had some impact on the

¹³⁴ R. Buxbaum and K. Hopt (n 80) 210. E. Stein (n 21) 41-45, 394-424.

¹³⁵ R. Buxbaum and K. Hopt (n 80) 210.

¹³⁶ C. Schmitthoff ‘Introduction’ in C. Schmitthoff *European Company Law Texts* (M. Bender-Stevens & Sons, New York-London 1974) 3-4, 44-49.

domestic case law of Member States having ratified it (e.g. Belgium).¹³⁷ In 1967 and 1972, the EU legislature tried to regulate cross-border mergers by drafting a Convention under Article 220 (now Article 293) EC Treaty. However, the regulatory choice of Convention based on Article 293 EC Treaty was finally abandoned and the European Union decided to choose the directive as the most appropriate harmonizing legal instrument.

2.5) Article 308 EC Treaty.

Article 308 EC Treaty is supposed to supplement Article 44 (2)(g) EC Treaty as a basis for market making, and promotes integration even where the Treaty basis itself could not encompass the required measures.¹³⁸ The role of Article 308 EC Treaty should also be mentioned.

Art. 308 (EC Treaty)

If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.

This article was used as the legal basis of two EU Regulations, the European Economic Interest Grouping (EEIG) and the European Company Statute¹³⁹ (SE Statute). The justification for recourse to Article 308 EC Treaty instead of Article 44 EC Treaty is

¹³⁷ E. Wymeersch (n 106), C. Villiers (n 100) 175, R. Schutze 'Organized Change towards an 'Ever-Closer Union': Article 308 EC and the Limits to the Community's Legislative Competence' (2003) 22 YEL 79.

¹³⁸ R. Buxbaum and K. Hopt (n 80) 212.

¹³⁹ E. Stein (n 21) 427, 445. The same legal basis (see Recital 17 of the Preamble) was used for the Worker's Participation Directive completing the SE Statute. Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ 2001 L294/0022.

that Article 44 EC Treaty constitutes a basis for the adoption of directives requiring Member States to harmonize their national company structures whereas in the case of the EEIG and the European Company what was necessary for market integration were directly applicable EU regimes introducing European corporate entities operating in parallel with existing national company law regimes.¹⁴⁰ An additional political argument in favour of this choice of legal basis is that Article 308 EC Treaty requires a unanimous decision in the Council.¹⁴¹ Recourse to Article 308 EC Treaty does not mean that these EU vehicles for corporate restructuring should not contribute to the facilitation of the exercise of freedom of establishment because Article 308 EC Treaty applies ‘in the course of operation of the common market’, while the ‘objectives of the Community’ applicable in such a context are internal market/common market objectives.¹⁴² In the 1970s, 80s and 90s, the Community institutions had used this legal basis in a rather broader way than that affirmed by the ECJ in Opinion 2/94.¹⁴³ In paragraph 30 of this opinion, the ECJ characterized this basis as an integral part of the institutional system based on the principle of attributed competence and as such can not broaden the scope of Community competences beyond the general framework created by the provisions of the EC Treaty, as a whole and, in particular, by those that define the tasks and the activities of the Community.¹⁴⁴ R. Buxbaum and K. Hopt considered that this broadly worded provision is found in the area between legal and political definition.¹⁴⁵ The ECJ had the opportunity to discuss the appropriateness of Article 308

¹⁴⁰ D. A. Wyatt and A. Dashwood (n 46) 864.

¹⁴¹ D. A. Wyatt and A. Dashwood (n 46) 864.

¹⁴² D. A. Wyatt and A. Dashwood (n 46) 864.

¹⁴³ Opinion 2/94 *Accession by the Community to the European Convention for the Protection of Human Rights and Fundamental Freedoms* [1996] ECR I-1759. D. A. Wyatt ‘Constitutional Significance of the Tobacco Advertising Judgment of the European Court of Justice’ in *The ECJ’s Tobacco Advertising Judgment CELS Occasional Paper No. 5*, 20.

¹⁴⁴ S. Weatherill states that the reference in Article 308 EC Treaty to the ‘course of the operation of the common market’ has exerted little if any restriction on legislative resort to Article 308. S. Weatherill ‘Competence creep and competence control’ (2004) 23 YEL 1, 28 (as cited by D. A. Wyatt (n 106) 3)

¹⁴⁵ R. Buxbaum and K. Hopt (n 80) 211.

EC Treaty instead of Article 95 EC Treaty as a legal basis for a transnational corporate entity such as the European Cooperative Society. In *European Parliament v Council*¹⁴⁶, the ECJ clarified the purpose of Article 308 and Article 95 EC Treaty as potential legal bases for harmonization measures aiming at market integration. It stated that Article 308 EC Treaty may be used as the legal basis for a measure only where no other provision of the Treaty gives the Community institutions the necessary power to adopt it.¹⁴⁷ Article 95 EC Treaty empowers the Community legislature to adopt measures to improve the conditions for the establishment and functioning of the internal market and they must genuinely have that object, contributing to the elimination of obstacles to the economic freedoms guaranteed by the Treaty, which include the freedom of establishment.¹⁴⁸ Recourse to that article as a legal basis is also possible if the aim is to prevent the emergence of obstacles to trade resulting from heterogeneous development of national laws; the emergence of such obstacles must, however, be likely and the measure in question must be designed to prevent them.¹⁴⁹ Then, the ECJ proceeds to explain the basic legislative goals of the European Cooperative Society in order to justify recourse to Article 308 EC Treaty and not to Article 95 EC Treaty. Regulation No 1435/2003 on the Statute for a European Cooperative Society (SCE) aims to introduce a new legal form in addition to the national forms of cooperative societies, since the SCE must be considered to be a European legal form for cooperative societies which has specific Community character.¹⁵⁰ The legal form of the SCE is governed first and foremost by that regulation, the conditions of its formation are specific to that form

¹⁴⁶ Case C-436/03 *European Parliament v Council of the European Union* [2006] ECR I-3733.

¹⁴⁷ Case C-436/03 paras. 35-37 referring to Case 45/86 *Commission v Council* [1987] ECR 1493, para. 13, and Case C-350/92 *Spain v Council* [1995] ECR I-1985, para. 26. In Case 45/86 *Commission v Council*, the ECJ stated that the choice of legal basis for a legislative measure have to be based on objective factors amenable to judicial review. N. Moloney (n 108) 8.

¹⁴⁸ Case C-436/03 para. 38.

¹⁴⁹ Case C-436/03 para.39 referring to Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419, paras. 83, 84, 86 and 95, and Case C-491/01 *British American Tobacco (Investments) and Imperial Tobacco* [2002] ECR I-11453, paras. 60-61

¹⁵⁰ Case C-436/03 para. 40.

of society, and the possibility of transferring its registered office from one Member State to another, without that resulting in the winding-up of the SCE or in the creation of a new legal person is also specific to the SCE.¹⁵¹ In addition, the European cooperative society is a form which coexists with cooperative societies under national law.¹⁵² In those circumstances, that regulation, which leaves unchanged the different national laws already in existence, cannot be regarded as aiming to approximate the laws of the Member States applicable to cooperative societies.¹⁵³ Consequently, Article 95 EC Treaty could not constitute an appropriate legal basis for the adoption of the regulation, which was thus correctly adopted on the basis of Article 308 EC Treaty.¹⁵⁴

2.6) Important ECJ case law on regulatory competence to harmonize the internal market.

A very important case, which is relevant to the debate on community competence to regulate the internal market, is the *Tobacco Advertising*¹⁵⁵ case. Article 95 EC Treaty pertaining to adoption of internal market measures was used as the legal basis of a directive prohibiting many forms of tobacco advertising.¹⁵⁶ Germany challenged this directive. It argued that this measure was adopted due to public health and not market considerations and as a result should have been enacted under Article 152 EC Treaty expressly prohibiting harmonizing legislation.¹⁵⁷ The ECJ held that a measure based on Article 95 EC Treaty must genuinely have as its object the improvement of conditions

¹⁵¹ Case C-436/03 paras. 41-42.

¹⁵² Case C-436/03 para. 43.

¹⁵³ Case C-436/03 para. 44.

¹⁵⁴ Case C-436/03 para. 46.

¹⁵⁵ Case C-376/98 *Germany v European Parliament and Council of the European Union* [2000] ECR I-8419. G. de Burca 'The Tobacco Advertising Saga: Political Aspirations and Constitutional Constraints' in *The ECJ's Tobacco Advertising Judgment CELS Occasional Paper No. 5*, 5.

¹⁵⁶ D. A. Wyatt and A. Dashwood (n 46) 929-959. An EU-US comparative perspective: A. Knook (n 101), R. Buxbaum, G. Hertig and others (eds) (n 97) 35, 61 and 399. For the recent case law concerning the scope of Article 95 EC Treaty: K. Gutman 'Case not: Case C-66/04 *Smoke Flavourings*, Case C-436/03 *SCE* & Case C-217/04 *ENISA*' [2006] 13 *ColJEL* 147.

¹⁵⁷ N. Foster *EU Law Directions* (OUP, Oxford 2008) 114.

for the establishment or functioning of the internal market¹⁵⁸; other Treaty articles should not be used as a legal basis in order to circumvent the express exclusion of harmonization. It was also held that provided that the conditions for recourse to Articles 95, 47 and 55 EC Treaty as a legal basis are fulfilled, the Community legislature cannot be prevented from relying on that legal basis on the ground that public health protection is a decisive factor in the choices to be made.¹⁵⁹ The Community legislature does not possess a general power to regulate the internal market because this would be in direct opposition with the principle of attributed competence of Article 5 EC Treaty.¹⁶⁰ The ECJ also criticized the legislative practice of Community institutions in the 1970's, 80s and 90s by disapproving the rationale of many harmonizing measures¹⁶¹ and held that if a mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms or of distortions of competition liable to result therefrom were sufficient to justify the choice

¹⁵⁸ Case C-376/98 para. 84.

¹⁵⁹ Case C-376/98 para. 88. The ECJ does not adopt the 'centre of gravity' argument (paras. 32-34) supported by Germany but it alleges that the definition of competence could not be strictly defined *rationae materiae* or *rationae personae*. The relevance of the measure in the broader context of the internal market could be an important element of that definition. Following this thread, the ECJ contended that the ban on advertising of tobacco products in press (periodicals, magazines, newspapers) could be based on Article 95 EC Treaty. C. Hillion 'Case Annotation, Tobacco Advertising: If you must, you may' [2001] CLJ 486, 488-489. It is quite ironic that, in the *second Tobacco Advertising* (Case C-380/03 [2006] ECR I-11573-the case brought before the ECJ when Germany challenged the new Directive passed after the *first Tobacco Advertising* ruling prohibiting mainly tobacco product advertising in press and in certain categories of mass media), the ECJ held that Article 95 EC Treaty could constitute the legal basis for harmonizing measures requiring all the Member States to authorize the marketing of the products under specific conditions or definitely prohibiting the marketing of products (paras. 43-44). If the ECJ had adopted this approach in the *first Tobacco Advertising* case, the first directive would have survived. D. A. Wyatt (n 106) 11, 29, M. Ludwigs 'Case Note, Case C-380/03 *Germany v European Parliament and Council of the European Union (second Tobacco Advertising ruling)* [2006] ECR I-11573' (2007) 44 CMLRev 1159. It should be added that economic and non-economic political pressures to create a rational and sensible accommodation and division of state and federal competences over the same area of law are equally important and can be analysed better and more extensively by a comparative research between EU and US. R. Buxbaum and K. Hopt (n 80) 22-23.

¹⁶⁰ N. Foster (n 157) 114. For an interesting overview and analysis of the debate about EU competence to legislate in the field of contract law: S. Weatherill 'Constitutional Issues-How much is Best Left Unsaid?' and S. Vogenauer and S. Weatherill 'The European Community's Competence to Pursue the Harmonization of Contract Law-an Empirical Contribution to the Debate' in S. Vogenauer and S. Weatherill (eds) *The Harmonization of European Contract Law* (Hart, Portland 2006) 89 and 105.

¹⁶¹ D. A. Wyatt 'Constitutional Significance of the Tobacco Advertising Judgment of the European Court of Justice' in *The ECJ's Tobacco Advertising Judgment CELS Occasional Paper No. 5*, 19-21.

of Article 100a EC Treaty as a legal basis, judicial review of compliance with the proper legal basis might be rendered nugatory.¹⁶²

This ruling tried to set a few criteria essential for the delimitation of community competence to regulate the internal market. Any harmonizing initiative of the European legislature should focus on combating appreciable distortions¹⁶³ of competition and not on disparities between national laws having a remote and indirect effect on competition.¹⁶⁴ It is easily understood that the ECJ does not consider that all disparities between national laws could constitute an appreciable distortion of competition. The case law of the ECJ on the exercise of the fundamental freedoms would be the most important factor in determining whether legal diversity at EU level could amount to a barrier restricting trade and/or to distortions of competition; national measures treated by that case law as being incapable of affecting inter-state trade (e.g. *Keck and Mithouard*¹⁶⁵ and subsequent case law) fall outside the scope of the definition of a barrier restricting trade and of a measure appreciably distorting competition.¹⁶⁶ Thus, the existence of a barrier to free movement of goods, persons, services and establishment is a very crucial condition for the justification of harmonization. It should be decided if a national provision falls within the definition of a trade barrier or not. National measures may be harmonized where their effect on trade is actual or potential,

¹⁶² Case C-376/98 para. 84.

¹⁶³ The element of appreciable distortions of competition was referred by the ECJ in Case 300/89 *Commission v Council (Titanium Dioxide)* [1991] ECR I-2867 para. 23 and Cases 91/79 and 92/79 *Commission v Italy* [1980] ECR 1099 para. 8. Appreciable distortions of competition, as an aspect of subsidiarity, are related to the identity of the decision-maker; this identity could have an important impact on the content of internal market regulation. This effect depends on competition in the whole market and on the exercise of fundamental freedoms. Competition between the EU and non-Member States is less complicated than competition within the EU because EU possess wider powers to impose restrictions against other non-Member States but is bound by the aims of market integration in trade among the various Member States. F. Easterbrook 'Federalism and European Business Law' in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 2.

¹⁶⁴ D. A. Wyatt (n 106) 22.

¹⁶⁵ The 'certain selling arrangements' test. Joined Cases C-267 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097. See also Case C-412/93 *Leclerc-Siplec* [1995] ECR I-179 para. 21 and Case C-292/92 *Huenermund* [1993] ECR I-6787 para. 21

¹⁶⁶ D. A. Wyatt (n 106) 23.

direct or indirect (but not too remote and indirect to inhibit trade).¹⁶⁷ Additionally, the ECJ held that harmonization is permissible even if no disparities in national laws currently exist but it is probable that barriers to freedom of movement will arise in the future.¹⁶⁸ It is quite interesting to mention here the alternative (as opposed to cumulative) character of those two elements providing the required internal market dimension in Article 95 EC Treaty. The ECJ stated in both the *second Tobacco Advertisement ruling* (paragraph 67) and in *BAT* (paragraph 60) that when the existence of obstacles to trade has been established, it is not necessary also to prove distortions of competition in order to justify recourse to Article 95 EC Treaty. Hence, when the first element is fulfilled, the second element is not required to be fulfilled, and presumably *vice versa*.¹⁶⁹ Moreover, harmonization of national laws aiming at the abolition of trade barriers will be open to question if the harmonized rules do not ensure the free movement of products being in conformity with the harmonized provisions.¹⁷⁰ The barriers that the directive proposes to abolish should exist both in fact and in law and the fulfilment of this condition should be scrutinized by the ECJ. The ECJ is willing to accept that the mere likelihood that trade barriers might arise in the future could satisfy the factual existence of trade barriers open to harmonization. It is not a positive development that the ECJ had set quite low standards for the establishment of the probability of the emergence of obstacles to trade.¹⁷¹ As far as the appreciable distortions of competition are concerned, the Community institutions are not required to conduct the detailed analysis used in the field of competition law.¹⁷² It obvious that this

¹⁶⁷ D. A. Wyatt (n 106) 23.

¹⁶⁸ D. A. Wyatt (n 106) 23. L. Woods *Free Movement of Goods and Services within the European Community* (Ashgate, Aldershot 2004) 266.

¹⁶⁹ M. Ludwigs (n 159) 1159, 1166-1167.

¹⁷⁰ D. A. Wyatt (n 106) 23.

¹⁷¹ M. Ludwigs (n 159) 1176.

¹⁷² D. A. Wyatt (n 106) 31.

lack of factual assessment and the absence of a more empirical approach toward these potential trade barriers constitute a shortcoming of this case law.¹⁷³

Nevertheless, subsequent case law had reached different conclusions from the *Tobacco Advertisement* judgment contradicting or eroding many of its elements. In *Swedish Match*¹⁷⁴, obstacles to trade could be confronted by simply banning the trade.¹⁷⁵ In *BAT*¹⁷⁶, disparities between national labeling rules result in hypothetical trade barriers which could be addressed by eliminating these disparities, even if this makes no contribution to cross-border trade in the products in question.¹⁷⁷ In *Leitner*¹⁷⁸, the ECJ confirmed that the lax assessment of the criterion of appreciable distortions of competition could be applied by the European legislature in the regulation of the internal market.¹⁷⁹ In *Rundfunk*¹⁸⁰, the ECJ stipulated that as long as a measure makes a contribution to the internal market, this measure could regulate situations with no link at all with the fundamental freedoms¹⁸¹ This conclusion of *Rundfunk* is not in conformity with the *Tobacco Advertisement* judgment but follows the pattern of the case law dating from the 1960s which adopts a broad interpretation of the competence to regulate the internal market.¹⁸² The major conclusion of this subsequent case law is

¹⁷³ D. A. Wyatt (n 106) 31. Empiricism was also proclaimed as a very important element of market integration in the field of EU Company Law.

¹⁷⁴ Case C-210/03 *Swedish Match* [2004] ECR I-11825.

¹⁷⁵ D. A. Wyatt (n 106)

¹⁷⁶ Case C-491/01 [2002] ECR I-11453.

¹⁷⁷ D. A. Wyatt (n 106) 1, 29.

¹⁷⁸ Case C-158/00 *Simone Leitner v TUI* [2002] ECR I-2631.

¹⁷⁹ D. A. Wyatt (n 106) 1, 34.

¹⁸⁰ Joined Cases C-465/00, C-138/01 and C-139/01 *Rundfunk* [2003] ECR I-4989.

¹⁸¹ D. A. Wyatt (n 106) 1, 37.

¹⁸² See various examples of Directives which were adopted under this wide construction of Community competences in D. A. Wyatt (n 106) 2-9. A wide interpretation of community competence to regulate the internal market (the so-called 'spillover' at EU level) could also produce a legislative 'spillover' at national level when the directives are implemented. The national legislature could also follow a wide interpretation. The implementation of a directive might involve a choice to extend the relevant regulatory regime beyond the sphere mandated by the EC (through stricter rules in case of minimum harmonization, through introduction of the directive's provisions into new areas beyond the directive's material or personal reach, through more vigorous enforcement or through early implementation before the end of the relevant deadline) S. Weatherill 'Harmonization: How much, How little?' [2005] EBLR 533, 538-539.

that Community competence to regulate the internal market has not in practice been confined to eliminating trade barriers and appreciable distortions of competition, but extended to harmonising national rules which facilitate freedom of movement and abolishing legal diversity among Member States which creates uncertainty for those planning cross-border transactions or expansion of their activities.¹⁸³ As far as EU company law is concerned, community measures aiming at the promotion of cross-border cooperation and establishment of legal persons according to Article 308 EC Treaty, and the adoption of company law directives pursuant to Article 44(2)(g) EC Treaty were based on similar arguments of legal certainty resulting from different national provisions.¹⁸⁴ The approach, that the elimination of psychological obstacles caused by legal uncertainty could constitute the reasoning of harmonizing measures regulating the internal market, might be also be considered as an aspect of a broader proposition, to the effect that internal market measures could be justified by the need to facilitate the exercise of fundamental freedoms.¹⁸⁵

2.7) Conclusion.

The market integration and the economic benefits accrued by companies exercising their right of establishment are revealed by the intra-Community direct investment flows over the last 10 years.¹⁸⁶ The Community's proclaimed regulatory aim was to

¹⁸³ D. A. Wyatt (n 106) 1.

¹⁸⁴ D. A. Wyatt (n 106) 6.

¹⁸⁵ D. A. Wyatt (n 106) 6.

¹⁸⁶ P. Pelle 'Companies crossing borders within Europe' (2008) 4 Utr.LR 6, 7. Law and the related institutional framework are fundamental to economic development and an effective financial sector is

promote an equivalent level of protection of members of companies and third parties; this development was prescribed indeed by Article 44 (2)(g) EC Treaty.¹⁸⁷ The Community's company law harmonization programme adopted frequently the lowest common denominator Member States could agree upon.¹⁸⁸ A minimum that was relatively easy to reach as it essentially amounted to a replication at Community level of the main content of existing national laws, not forgetting some domestic peculiarities.¹⁸⁹ This is shown by the number of options in some directives (up to 40 in the Accounting Directives¹⁹⁰) and the content and intensity of the opt-in/opt-out/reciprocity system in the Takeover Bid Directive (waiving the most important parts of the Takeover Bid Directive).¹⁹¹

essential to economic growth. D.W. Arner *Financial Stability, Economic Growth and the Role of Law*(CUP, Cambridge 2007) 1-2.

¹⁸⁷ P. Pelle (n 186) 7.

¹⁸⁸ P. Pelle (n 186) 7.

¹⁸⁹ P. Pelle (n 186) 7.

¹⁹⁰ The Accounting Regulation 1606/2002 ([2002] OJ L243/1) which implements the International Accounting Standards on EU level will probably enhance uniformity in this area of law. C. Villiers 'European integration and globalisation: The experience of financial reporting' (2006) 8 CYELS 109.

¹⁹¹ P. Pelle (n 186) 7. S. Fazio (n 14) 93-94.

CHAPTER 3

ASPECTS OF EU COMPANY LAW HARMONIZATION

3.1) 'Directives'

Without entering into discussion of what 'harmonization' exactly means, or whether there is or should be a difference between harmonization, approximation, co-ordination etc of laws, harmonization constitutes a form of limited regulatory intervention.¹⁹² The Member States should adopt the necessary provisions only as far as this is necessary for the attainment of the legislative goals of the relevant Treaty provision upon which the directive was based.¹⁹³ The directive is an instrument which corresponds very well to this idea of limited intervention. Being binding 'as to the result to be achieved' but leaving the Member States the choice of 'form and methods', it is by its nature very suitable for bringing about the necessary changes in national laws while respecting as far as possible the national legal systems, with their own conceptions and terminology.¹⁹⁴ Each Member State could use its own method of implementation while implementing the directive. In the Declaration on Article 100a (now Article 95) EC Treaty of the then EEC Treaty annexed to the Single European Act, the Member States expressed their preference for directives as instruments of harmonization of laws above the use of regulations.¹⁹⁵ The same is also true for Article 44 (2)(g) EC Treaty which is the legal basis for company law harmonization. At the Edinburgh Summit¹⁹⁶ the Member States clarified that the principle of proportionality stipulated in Article 3B (now 5(3)) EC Treaty should imply that wherever the European legislature should

¹⁹² S. Prechal, *Directives in EC Law* (Oxford EC Law Library, 2nd ed. OUP, Oxford 2004) 4.P. J. Slot 'Harmonization' (1996) 21 ELRev. 378.

¹⁹³ S. Prechal (n 192) 4.

¹⁹⁴ S. Prechal (n 192) 4, N. Moloney (n 108) 17.

¹⁹⁵ S. Prechal (n 192) 4

¹⁹⁶ *Edinburgh European Council*, Bull EC 12-1992, 15 confirmed in the Protocol on subsidiarity and proportionality to the Treaty of Amsterdam, in point 6 and by the Commission, in the *White Paper on European Governance*, COM (2001) 428, final, 20.

regulate a specific area, preference should be given to Directives above regulations and to framework Directives above detailed measures.¹⁹⁷

3.2) Obstacles impeding the effective exercise of the freedom of establishment by companies.

Measures which *prima facie* have little immediate impact on cross-border establishment would after empirical study be found to facilitate freedom of establishment of companies¹⁹⁸. The Third¹⁹⁹ and Sixth²⁰⁰ Directives on domestic mergers and divisions of public companies have a two-fold importance for cross-border activities: a) they combat psychological obstacles by encouraging foreign investors to establish companies in other member States and then to expand their activities in this new market by conducting mergers with other companies established in that new Member State; b) they inspired the adoption of the relevant legal instrument for cross-border mergers i.e. the 10th Company Law Directive on Cross-border mergers²⁰¹. The existence of many similar provisions in the regulation of national and cross-border mergers could diminish some of the costs and could facilitate companies planning to merge with other companies.²⁰² Similarly directives with narrow scope and specific, apparently protective, goals, such as the Eleventh Directive on branch disclosure and the Twelfth Directive on single-member companies, in fact facilitate cross-border establishment: the former is designed to reduce administrative costs of branches of

¹⁹⁷ S. Prechal (n 192) 4.

¹⁹⁸ V. Edwards (n 96) 7.

¹⁹⁹ Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] OJ L295/36.

²⁰⁰ Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies [1982] OJ L378/47.

²⁰¹ Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (Text with EEA relevance) [2005] OJ L310/1.

²⁰² V. Edwards (n 96) 7.

companies established in other Member States, the latter to ensure equivalent protection for creditors and enhance credibility of single-member companies.²⁰³

The barriers inhibiting the effective exercise of the fundamental freedom of establishment by companies could be categorized into:

1) national legal diversity in the same subject matter of company law which discourage cross-border establishment to the extent that economic operators in one Member State are unfamiliar with national company law provisions in another (psychological obstacles). The shareholders and creditors provide capital and credit when they are protected by harmonized laws and as a result investment requirements are crystallized and eased and economic development advances more quickly.²⁰⁴ Thus, shareholders and third parties feel confident in their transactions and in their decisions when they know that they have broadly the same rights in their dealings with companies.²⁰⁵

2) Differences between national rules demanding compliance with additional terms and conditions with respect to establishment in another Member State, and

3) national rules which (independently from their variety from Member State to Member State) obstruct cross-border establishment of legal persons.²⁰⁶

The Tenth Company Law Directive on Cross-border Mergers²⁰⁷ tries to eliminate obstacles falling within the second category.²⁰⁸ It should be noted that, prior to this Directive, only certain Member States allowed cross-border mergers (both inbound and outbound) and some other Member States did not permit cross-border mergers or imposed onerous conditions for their realization (e.g. winding-up of the acquired company) making the realization of cross-border mergers very difficult or even *de facto*

²⁰³ V. Edwards (n 96) 7. E. Wymeersch (n 106) 3.

²⁰⁴ R. Buxbaum and K. Hopt (n 80) 201. E. Stein (n 21) 429.

²⁰⁵ R. Buxbaum, G. Hertig and others (eds) (n 97) 11.

²⁰⁶ D. A. Wyatt and A. Dashwood (n 46) 865.

²⁰⁷ Directive 2005/56 on cross-border mergers of limited liability companies [2005] OJ L310/1.

²⁰⁸ D. A. Wyatt and A. Dashwood (n 46) 869.

impossible. In the explanatory memorandum of its proposal, the Commission argued that national diversities in the legal framework regulating cross-border mergers applicable to each of the companies planning to merge are such that the companies have to resort to complex and costly legal arrangements and to follow alternative financial techniques. These arrangements often complicate the cross-border merger operation and are not always characterized by transparency and legal certainty. Hence, the costs of cross-border mergers must be rationalized and reduced and Community legislation have to provide legal certainty and to enable as many companies as possible to benefit.²⁰⁹ The Tenth Company Law Directive aims at abolishing any additional requirements for cross-border establishment by providing a suitable legal instrument enabling them to carry out cross-border mergers under the most favourable conditions.²¹⁰

Additionally, the Takeover Bid Directive combats barriers belonging to the third category. Such barriers to cross-border establishment are not caused by the different national provisions at EU level (yet, they could also be the result of these differences). These barriers contained in national rules or in the articles of association of companies result from the fact that the rules in question or practices authorized by such rules are intrinsically capable inhibiting cross-frontier establishment.²¹¹ Sometimes the mere existence of those rules or practices could result in a barrier to cross-frontier establishment of companies. One example of such a takeover barrier which the Takeover Bid Directive tries to abolish is the frustration of a tender offer by the company's board. The Directive requires prior authorization of the shareholders' general meeting before the company's board launches any defensive measures against

²⁰⁹ Proposal for a Directive of the European Parliament and of the Council on cross border mergers of companies with share capital COM (2003) 0703 final.

²¹⁰ Proposal for a Directive of the European Parliament and of the Council on cross border mergers of companies with share capital COM (2003) 0703 final.

²¹¹ D. A. Wyatt and A. Dashwood (n 46) 870.

the bidder. This provision of the Takeover Bid Directive is based on the rationale that the issue of corporate control in a takeover contest should be decided by its shareholders.²¹² The abolition of this kind of obstacle will assist companies in penetrating foreign markets.

Furthermore, the provisions of the Takeover Bid Directive regulating various aspects of disclosure of information aim at the elimination of psychological obstacles, i.e. obstacles of the first category. Article 10 obliges the potential target companies to disclose information which could affect the decision of a potential bidder to launch a bid. Article 6 obliges the bidder to disclose information concerning the bid which is very important for the decision – making of the shareholders (or the board of the company in case of non-implementation of the non-frustration rule) about the bid. The disclosure of information contributes to a great extent to the transparency of the market for corporate control and to the protection of shareholders. The 18th Recital to the Preamble of the Directive states that ‘In order to reinforce the effectiveness of existing provisions concerning the freedom to deal in the securities of companies covered by this Directive and the freedom to exercise voting rights, it is essential that the defensive structures and mechanisms envisaged by such companies be transparent and that they be regularly presented in reports to general meetings of shareholders’. These disclosure provisions of the Directive are mandatory (in comparison with Articles 9, 11 and 12) and set some specific standards for the disclosure of takeover information on EU level. Companies wishing to initiate a takeover and to expand their business activities abroad will find that foreign law on the disclosure of various aspects of takeover bids is more familiar due to harmonization.²¹³ Thus, legal certainty is promoted through the abolition of psychological obstacles resulting from the unfamiliarity with foreign legal

²¹² Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (COM/2002/0534 final) [2003] OJ 45E/1.

²¹³ R. Buxbaum and K. Hopt (n 80) 201.

provisions. Investors seeking a controlling stake in foreign companies would not be discouraged by uncertainty as to the information disclosed by those companies. It should also be noted that disclosure requirements could also fall within the second category of obstacles when offeree or offeror companies have to comply with additional disclosure requirements.²¹⁴

3.3) Categorizing company law directives and methods of harmonization.

Company law directives could be categorized in four generations. First generation directives were adopted when there were only six Member States and the drafting process was under a German political and legal influence. These directives have many detailed and precise provisions²¹⁵ leaving little discretion to Member States as to the method of implementation and lead to more uniformity. The First and Second Company Law Directives are first generation directives.²¹⁶ The second generation directives were prescriptive but to a lesser extent than the first generation directives. They are more flexible offering options and alternative formulae for their implementation and thus they accommodate the different approaches of Member States and the needs of enterprises. This freedom is not a total one because Member States are bound by certain legislative goals and should adopt one of the formulae laid down in the directive. Second generation directives were adopted after the first enlargement when the German influence in the drafting process became less obvious and the legal diversity in the EU increased with the addition of the new Member States. It is the Third and Sixth

²¹⁴ D. A. Wyatt and A. Dashwood (n 46) 869-871.

²¹⁵ A critical discussion with comparisons with the rest of the categories: C. Villiers (n 100) 179.

²¹⁶ C. Villiers (n 101) 29 and 31.

Directives and the Fourth, Seventh and Eighth Directives (Accounts Directives) which fall within the scope of this category (yet the Third and Sixth Directives present many of the characteristics of the first generation directives).²¹⁷ The third generation directives were introduced by the Commission's White Paper on Completion of the Internal Market²¹⁸ and were adopted after the second and third enlargement (when Greece, Spain and Portugal joined the EEC). This White Paper proposed a 'new approach' for directives which should be more general, would clarify the essential requirements and would focus on what is to be achieved rather than how. These directives were adopted under the co-operation process, are relatively short, containing little detail and offering more discretion as to methods of implementation by Member States. The Eleventh and the Twelfth Directives belong to this third generation.²¹⁹ The fourth generation directives came into existence after the accession of Austria, Sweden and Finland and follow the co-decision procedure. These directives could be characterized generally as 'framework' directives. Member States' freedom in choosing the most appropriate method of implementation of these directives is quite wide in comparison with the other generations. Statements of objectives and general principles dominate the content of these directives and Member States are responsible for the adoption of specific national legislation in accordance with these general rules. The Tenth and the Thirteenth Directives follow this pattern of 'framework directives'.²²⁰ It is easily understood that the harmonization of company law evolves towards a minimum of EU centralized legislation and leaves the details and the technical issues to

²¹⁷ C. Villiers (n 101) 29, 36-37 and 224

²¹⁸ COM (85) 310 Final.

²¹⁹ C. Villiers (n 101) 29 and 46.

²²⁰ C. Villiers (n 101) 29, 48-49 and 224.

be decided by the Member States on national level as long the legislative aims are not infringed and the general principles of Article 5 EC Treaty are respected.²²¹

There are various methods of harmonization which are used in the regulation of the internal market. When there were only six Member States, it was quite easy for them to adopt a uniform approach to the regulation of the internal market by the means of Directives (even if the rationale of Directive is not to bring uniformity but harmonization). The 1985 White Paper on the completion of the internal market followed the ruling in *Cassis de Dijon*²²² (in the absence of harmonization, a product lawfully produced in a member State could circulate freely within the internal market and no national restrictions are allowed apart from cases characterized by mandatory requirements in the general interest) and proclaimed a new approach to harmonization directives, abandoning detail and overregulation.²²³ This approach resulted in different harmonization methods being adopted by the European Legislature. Total harmonization allows no derogation in the pre-empted (exhausted by the European Legislature) area except for safeguarded measures or to the extent permitted in the directive.²²⁴ In this method, the system of the directive and the wording of the directive provisions are determinative.²²⁵ Optional harmonization allows market participants to apply national norms or Community norms, some directives allowing the Member State to exercise the option (opting-out).²²⁶ Partial harmonization regulates only one part of

²²¹ C. Villiers (n 101) 29 and 48-49.

²²² Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR-649

²²³ W. Van Gerven 'Harmonization of Private Law: Do we need it?' (2004) 41 CMLRev. 505, 507.

²²⁴ W. Van Gerven (n 223) 508. A. McGee and S. Weatherill 'The Evolution of the Single Market-Harmonization or Liberalization' (1990) 53 MLR 578, 582.

²²⁵ P.J. Slot (n 192) 383.

²²⁶ W. Van Gerven (n 223) 508. Cl. Lempereur (n 123) 244. It was argued that optional harmonization in the area of company law could be proved advantageous to small and medium-sized companies, to companies with differential control and ownership structures and to the majority of the stakeholders. G. Hertig and J. McCahery 'A Legal Options Approach to EC Company Law' (2006) Berkeley Program in Law & Economics Working Paper Series (University of California, Berkeley) No 180. G. Hertig and

the specific area, e.g. provisions regulating cross-border activities only.²²⁷ Minimum harmonization sets minimum rules at EU level, although Member States may individually or jointly provide for more stringent rules.²²⁸ Alternative harmonization provides more than one set of rules and allows Member States to choose among those alternative patterns.²²⁹

As far as the Takeover Directive is concerned, the European legislature has chosen optional harmonization. The Takeover Directive confers options on Member States and at individual company level. Article 12 provide the option to Member States not to require companies to apply the non-frustration (Article 9) and/or breakthrough rule (Article 11). However, where Member States make use of that option, they shall nevertheless grant companies which have their registered offices within their territories the option, which shall be reversible, of applying the non-frustration (Article 9) and/or breakthrough rule (Article 11). The decision of the company shall be taken by the general meeting of shareholders, in accordance with the law of the Member State in which the company has its registered office in accordance with the rules applicable to amendment of the articles of association. The decision shall be communicated to the supervisory authority of the Member State in which the company has its registered office and to all the supervisory authorities of Member States in which its securities are admitted to trading on regulated markets or where such admission has been requested. In addition to that, the Takeover Directive contains a reciprocity clause. Member States may, under the conditions determined by national law, exempt companies which apply

J. McCahery 'Legal Options: Towards Better EC Company Law Regulation' in S. Weatherill (ed) *Better Regulation* (Hart, Oxford 2007) 219

²²⁷ W. Van Gerven (n 223) 508. A. McGee and S. Weatherill (n 224) 587.

²²⁸ P.J. Slot (n 192) 384. P. Rott 'Minimum harmonization for the completion of the internal market? The example of consumer sales law' (2003) 40 CMLRev. 1107, M. Dougan 'Minimum harmonization and the internal market' (2000) 37 CMLRev. 853, Cl. Lempereur (n) 243.

²²⁹ P.J. Slot (n 192) 386, W. Van Gerven (n 223) 508. In the area of company law, the case law of the ECJ had stated that some rules of the Company Law Directives leave room for States to adopt stricter measures and others confer no discretion on Member States (Joined cases C-19/90 and C-20/90 *Karella* [1991] ECR I-02691, Opinion of AG Tesouro *Meilicke* [1992] ECR I-04871 para. 12)

the non-frustration (Article 9) and/or breakthrough rule (Article 11) from applying the non-frustration (Article 9) and/or breakthrough rule (Article 11) if they become the subject of an offer launched by a company which does not apply the same Articles as they do, or by a company controlled, directly or indirectly, by the latter. It is obvious that the core provisions of the Takeover Directive are subjected to this multilevel regime of optionality and reciprocity, because of political compromises in the course of the legislative process. Their harmonizing role has a limited impact on the consolidation of the market for corporate control. Furthermore, the European legislature had chosen partial harmonization in the case of the Cross-Border Mergers Directive because it is obvious that this directive regulates exclusively cross-border mergers (there is another directive, the third company law directive, dedicated exclusively to the regulation of domestic mergers). Article 1 of the Cross-border Mergers Directive states that this Directive shall apply to mergers of limited liability companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, provided at least two of them are governed by the laws of different Member States (hereinafter referred to as cross-border mergers).

3.4) Decisive factors in the harmonization process.

The success of harmonization of European company law depended to a great extent on the area of company law which was planned to be harmonized. As long as Member States tried to harmonize external corporate governance issues (such as protection of third parties, company accounts, legal capital) it was quite easy to reach an agreement which was supposed to affect cross-border commercial transactions between their companies.²³⁰ Nevertheless, when the European legislature focused on the regulation of internal corporate governance, Member States could not reach an agreement on legislative measures such as the fifth directive on public companies and the ninth directive on companies' group nor were they able to agree on directives such as the tenth directive on cross-border mergers and the thirteenth directive on takeover bids after many years of difficult negotiations and political compromises.²³¹ It must be noted that although corporate governance is supposed to regulate listed corporations, it also has a major impact on affairs of and within the entire business associated with that entity, for the benefit of investors.²³² All these latter legislative initiatives were dealing with the relations between shareholders, directors and other parties in internal corporate governance relations.²³³

Member States were reluctant to accept a possible change of their internal corporate governance legislation because such a change would influence the control structures of their markets and would have opened and made more vulnerable their companies to

²³⁰ E. Wymeersch (n 106) 15.

²³¹ E. Wymeersch (n 106) 16.

²³² S.M. Bartman 'Corporate governance: a challenge to company law' (2004) 1 ECL 4.

²³³ E. Wymeersch (n 106)16.

foreign investors and to the global business competition.²³⁴ In the Anglo-Saxon legal systems, it is true that shares of listed corporations are widely held, that no single shareholder (apart from institutional) affects the decisions of the company, that no entrepreneurial shareholder controls the management of the company and that institutional investors exercise greater influence due to the lack of any countervailing power.²³⁵ Shareholder structures in continental Member States are less dispersed than those in UK and the US and show a smaller market control power; this is connected to internal rather than external control devices. The 2003 Action Plan on Modernizing Company Law and Enhancing Corporate Governance appreciates fully the interrelation between internal corporate governance and capital market regulation. The strongest example is the regulation of the EU market for corporate control by the Takeover Bids Directive (yet, in an unsatisfactory way).²³⁶ Additional factors which caused numerous difficulties in the harmonization of internal corporate governance structures are primarily German co-determination (employee participation in company's management through representation on the supervisory board of the company), politically-driven protectionism of Germany against foreign acquisitions and other peculiarities of German company law and corporate governance.²³⁷ Not only the individual Member

²³⁴ E. Wymeersch (n 106) 16.

²³⁵ In UK, this ownership structure resulted in urging UK companies to seek new finance from shareholders by proceeding to a 'rights issue' contributing to further dilution of the holding. E. Wymeersch (n 124) 303. M.J.G.C Raaijmakers (n 124) 235-237. J. Armour and D.A. Skeel 'Who Writes the Rules for Hostile Takeovers, and Why?-The Peculiar Divergence of US and UK Takeover Regulation' [2007] *Georg'nLJ* 1727-1794

²³⁶ COM (2003) 284 (1) P. Leyens supports a more market-based approach to corporate governance at EU level. P. Leyens 'Internal corporate governance in Europe-Towards a more market-based approach' (2007) 4 *KyotoJLP* 17, 19-20. The influence of ownership concentration on the returns to shareholders of the offeree company is discussed by H. Donker and S. Zahir 'Takeovers, corporate control and return to target shareholders' (2008) 1 *IntJCorGov* 106. For a concise analysis of the corporate governance regimes of some Member States, see: C. A. Mallin *Corporate Governance* (OUP, Oxford 2003) 19, 123, 149.

²³⁷ E. Wymeersch (n 106) 16. K. Hopt and P. Leyens 'Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy' (2004) 1 *ECFR* 135-168, R. Buxbaum and K. Hopt (n 80) 259, K. Hopt 'Labor representation on corporate boards: Impacts and problems for corporate governance and economic integration in Europe' in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996)

States but also companies were objecting to specific harmonization initiatives. One example is the Ninth Directive on groups of companies: while all Member States were developing group law in practice, both in the judicial and administrative case law, the large companies were showing clear unwillingness to let this much feared subject be governed by statutory provisions, whether imposed by a European regulator, or even by their more familiar domestic legislator.²³⁸ Sometimes the European Commission after conducting careful impact assessments decided not to proceed to harmonization of new areas of company law. This happened in the cases of the cross-border transfer of the registered office and of proportionality between capital and control in listed companies (commonly referred as to the "one share, one vote" problem)²³⁹ where Commissioner C. McCreevy decided there was no need for action at EU level on these issues.

241, 261. C. Windbichler 'Cheers and Boos for Employee Involvement: Co-Determination as Corporate Governance Conundrum' [2005] EBOR 507, F. Fabricius 'Co-determination in European Company Law' in C.M. Schmitthoff(ed) *The Harmonization of European Company Law* (UKNCCL, London 1973) 101.

²³⁸ E. Wymeersch (n 106) 15-17. E. Werlauff 'Group and Community- The European Court's development of an independent Community law concept of the group and its significance for national company law' (2007) 4 ECL 201, E. Wymeersch (ed.) *Groups of Companies in the EEC: a survey report to the European Commission on the law relating to corporate groups in various Member States* (Walter de Gruyter, Berlin 1993), U. Immenga 'Groups of Companies: Policy Perspectives' in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New York 1994) 174.

²³⁹ Impact assessment on the Directive on the cross-border transfer of registered office (SEC (2007) 1707) and impact assessment on the proportionality between capital and control in listed companies (SEC (2007) 1705).

3.5) The Financial Services Action Plan and the Company Law Action Plan.

In 1999, the European Council approved the Commission's Action Plan for a single financial market (the Financial Services Action Plan)²⁴⁰. A series of policy objectives and specific measures aiming at improving the Single Market for financial services were outlined in this Action Plan adopted by the European Commission. The Action Plan sets three strategic objectives: 1) ensuring a Single Market for wholesale financial services, 2) open and secure retail markets and 3) state-of-the-art prudential rules and supervision.²⁴¹ Among the proposed measures intending to contribute to the completion of a single wholesale financial market were some company law measures with major significance for financial markets. We should not forget that listed companies are the most important players in these wholesale markets and that their corporate governance matters. These proposed measures focused on the creation of a secure and transparent environment for cross-border restructuring. The Financial Services Action plan proposed the European Company Statute, the Takeover Bids Directive, the Directive on cross-border mergers and the Directive on transfers of company headquarters and a Directive imposing a requirement for disclosure of objective and stable criteria for

²⁴⁰Communication of the Commission 'Financial Services: Implementing the Framework for Financial Markets: Action Plan' COM (1999) 232 available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf accessed 16 September 2008.

²⁴¹ Press Release 'Financial services: Commission outlines Action Plan for single financial market' IP/99/327.G. Walker 'European Financial Programme: Content, Structure and Completion' [2004] EBLR 305, 324, A. Sainz de Vicuna 'The legal integration of financial markets of the Euro area' [2001] EBLR 223, 228, 232, 236. N. Moloney 'Law-making Risks in EC Financial Market Regulation after the Financial Services Action Plan' in S. Weatherill (ed) *Better Regulation* (Hart, Oxford 2007) 321. For an analysis of financial services in the internal market before the Community's Action Plan, see: W. Van Gerven and J. Wouters 'Free movement of financial services and the European Contracts Convention' and M. Blair 'Financial Services: the United Kingdom Regulator's Assessment of the 1992 Programme' in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 43 and 125.

authorisation of restructuring in the banking sector.²⁴² The Financial Services Action Plan envisaged a very important role for cross-border mergers and takeover bids in cross-border industrial restructuring. These legal instruments would contribute significantly to the protection of minority shareholders and to a more rationalized organization of corporate legal structures in the Single Market.²⁴³ The 2001 Proposal of a Takeover Bid Directive (recital 13 of the preamble) stated among its main objectives that the proposed directive would prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures. The framework of cross-border corporate restructuring should be characterized by transparency and security. These characteristics are very important for the application of prudential considerations in the case of mergers and takeovers.²⁴⁴ When the relevant supervisory authority is called to implement some prudential conditions in a restructuring process of takeovers and mergers, it should take into account the principles of transparency and non-discrimination.²⁴⁵ The Commission wanted to avoid the possibility of prudential conditions becoming obstacles to cross-border corporate restructuring and required any authorization process to take into account objective, continuous and publicly disclosed standards.²⁴⁶ These standards for the application of prudential considerations to corporate restructuring situations should fully respect the Commission's policy on free movement of capital and freedom of investment.²⁴⁷

²⁴² Press Release 'Financial services: Commission outlines Action Plan for single financial market' IP/99/327.

²⁴³ COM (1999) 232, 9.

²⁴⁴ COM (1999) 232, 9

²⁴⁵ COM (1999) 232, 9

²⁴⁶ COM (1999) 232, 9

²⁴⁷ COM (1999) 232, 9. Communication of the Commission on Certain legal Aspects Concerning Intra-EU Investment. OJ C 220 (1997) 15.

In Spring 2003, the European Commission launched an Action Plan with the title 'Modernizing company law and enhancing corporate governance in the European Union' which proposed twenty-four legislative measures. The Action Plan was developed around three pivotal axes: removing national barriers to foster the internal market, avoiding races to the bottom, and promoting a certain degree of uniformity to reduce the informational costs currently born by investors.²⁴⁸ The European Commission was convinced that market integration demanded its regulatory intervention in the area of company law. These new legislative proposals were supposed to facilitate freedom of establishment, cross-border restructuring and cross-border transactions.²⁴⁹ These initiatives aimed at boosting shareholders' confidence that the corporations they invest in have equivalent corporate governance frameworks. Many voices demand a dynamic reaction of the European legislature after the recent financial scandals (e.g. Enron, Worldcom and Parmalat).²⁵⁰ The Commission also stressed the role of modern technologies in the framework of modern corporate governance and management. It is true that the accession of new Member States in 2004 and 2007 increased diversity in the EU which now has 27 different national company laws and encouraged the European legislature to re-examine the

²⁴⁸ L. Enriques and M. Gatti "The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union", 27 (2006) University of Pennsylvania Journal of International Economic Law 939-998, SSRN Working Papers: < <http://ssrn.com/abstract=879804> > 55. Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward COM (2003)284 final, 6-7, 14.

²⁴⁹ L. Enriques and M. Gatti (n 248) 51.

²⁵⁰ L. Enriques and M. Gatti (n 248) 52. J. Armour and J.A. McCahery 'Introduction: Improving corporate law and modernising securities regulation in Europe' (2003) 3 JCLS 211. The recent banking scandal of British Northern Rock, its connection with the internal market and the role of the Bank of England and the European Central Bank are commented by C. Bamford. C. Bamford 'Northern Rock and the Single Market' (2008) 29 CoLaw 65-66. The reaction of the public to these scandals was stronger in the US than in the EU. For the justification of these different reactions and for an analysis of the extent the Sarbanes-Oxley Act could be used as a guide for corporate reforms in Europe, see: L. Enriques 'Bad apples, bad oranges: A comment from old Europe on post-Enron corporate governance reforms' (2003) 38 WakForLR 911, 912-926. Commissioner F. Bolkestein had stated that prompt action is needed to ensure sustainable public confidence in financial markets. 'Company law and corporate governance: Commission presents Action Plan' (2003) IP/03/716.

Community's *acquis* in the field of company law, to amend already adopted legal instruments and to propose new measures if necessary. This highlights the importance of a principles-based approach able to maintain a high level of legal certainty in intra-Community operations.²⁵¹ The objectives of the Action Plan are twofold: the first goal is to strengthen shareholders' rights and the protection of employees, creditors, and other interested parties; and the second aim which is closely connected with the first one refers to the fostering of the efficiency and competitiveness of business, with special attention to some specific cross-border issues.²⁵² With respect to the first policy objective, the Commission believes that 'maintaining efficient protection of members and third parties will be even more important in the future, in view of the increasing mobility of companies within the EU', which reveals the Commission's fears that corporate mobility and liberalization of company law may have some side-effects like the race to the bottom.²⁵³ As to the second policy objective, in the Commission's view, business efficiency and competitiveness should be promoted: a) through initiatives regulating cross-border business activities (cross-border mergers or transfer of registered office, elimination of cross-border impediments to the exercise of shareholder rights), and b) through a certain degree of harmonization in order to reduce legal uncertainties and to combat psychological obstacles to cross-frontier business plans of corporations.²⁵⁴ It seems that these concerns and thoughts of the Commission are depicted in the regulatory goal of the takeover directive which is primarily to foster

²⁵¹ L. Enriques and M. Gatti (n 248) 52. For principles-based regulatory intervention in the area of business law: J. Black, M. Hopper and C. Band 'Making success of the principles-based regulation' (2007) 1 LFM, S. Schwarcz, 'The "Principles" Paradox', Duke Law School Legal Studies Research Paper Series, Research Paper No. 205, (2008) 1, R. Buxbaum, G. Hertig and others (eds) (n 97) 142 .

²⁵² K. Hopt 'European Company Law and Corporate Governance: Where does the Action Plan of the European Commission Lead ?' (2005) ECGI - Law Working Paper No. 52/2005 <<http://ssrn.com/abstract=863527>> accessed 11 Aug. 2007, 3.

²⁵³ L. Enriques and M. Gatti (n 248) 54. Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward COM (2003)284 final 8

²⁵⁴ L. Enriques and M. Gatti (n 248) 54.

cross-border takeover bids by eliminating legal uncertainties and psychological obstacles in the area of public offers.

The Commission conducted a consultation from December 2005 to March 2006 on future priorities in company law and corporate governance in order to check the extent to which the medium and long term measures under the 2003 Action Plan and the Lisbon Agenda need to be modified, adapted or refocused in order to continue to meet the requirements of the market and to ensure its effectiveness and efficiency. While the 2003 Action Plan focused on the restoration of investor confidence after the corporate scandals, the aim of this consultation was to improve the competitiveness of EU companies and to transpose the principles of the EU Better Regulation approach. The Commission had shown its intentions to recast the entire company law *acquis* and to cut the red tape in its future regulatory initiatives.²⁵⁵

²⁵⁵ D. Weber-Rey 'Effects of the Better Regulation Approach on European Company Law and Corporate Governance' (2007) 3 ECFR 370, 399-400, European Commission 'Consultation and Hearing on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union' <http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf> accessed 27 Sept. 2008.

CHAPTER 4 THE PERMISSIBLE LIMITS OF HARMONIZATION: SUBSIDIARITY ISSUES.

4.1) Introduction.

This chapter deals with subsidiarity. This helps us to see how far the European legislature could go in the regulation of takeovers bids and how it perceives its harmonizing competence in the internal market. The relevant case law will be discussed in detail. This analysis of subsidiarity will try to show various regulatory aspects of takeover regulation at EU level.

4.2) The principle of subsidiarity.

Article 5 EC Treaty contains the principle of subsidiarity.²⁵⁶ The EU glossary²⁵⁷ states that subsidiarity, introduced by the Maastricht Treaty, is intended to ensure that decisions are taken as closely as possible to the citizen and that constant checks are

²⁵⁶ The other principles contained in Article 5 EC Treaty is the principle of attributed competence and the principle of proportionality. For a thorough analysis of the subsidiarity debate at EU level and for some very useful comments and conclusions see: D. A. Wyatt and A. Dashwood (n 46) 97, 367. P. Craig and G. De Burca (n 12) 101 S. Weatherill *Cases and Materials on EU Law* (8th ed., OUP, Oxford 2007) 660, D. A. Wyatt (n 106), S. Douglas-Scott *Constitutional Law of the European Union* (Longman, Essex 2002) 155, N. Emiliou 'Subsidiarity: an effective barrier against the "enterprises of ambition"?' (1992) 17 ELRev. 383, V. Constantinesco 'Who's afraid of Subsidiarity?' (1991) 11 YEL 33.S. Weatherill 'Competence creep and competence control' (2004) 23 YEL 1, J. Pelkmans 'Subsidiarity between Law and Economics' College of Europe Research Papers in Law No 1/2005, D. Halberstam 'Subsidiarity in Comparative Perspective' in V. Amar and M. Tushnet *Comparative Constitutional Law* (forthcoming-OUP, Oxford 2008) <http://eu.pravo.hr/fileadmin/Europsko/dokumenti/Dubrovnik_2008/halberstamamaredit_MT_11-15DH1_CLEAN_2.pdf> accessed 26 Sept. 2008, M. Kumm 'Constitutionalising Subsidiarity in Integrated Markets: The Case of Tobacco Regulation in the European Union' [2006] ELJ 503, R. Van den Bergh 'The subsidiarity principle and the EC competition rules: The costs and benefits of decentralization' in D. Schmidtchen and R. Cooter (eds) *Constitutional Law and Economics of the European Union* (Elgar, Cheltenham 1997) 142, R. Wesseling 'Subsidiarity in Community antitrust law: setting the right agenda' (1997) 22 ELRev 35, N. W Barber 'The limited modesty of subsidiarity' (2008) 11 ELJ 308, U. di Fabio 'The allocation of competences between the European Union and its Member States' and I. Pernice 'Rethinking the methods of dividing and controlling the competences of the Union' in M Andenas and J. Usher (eds) *The Treaty of Nice and Beyond* (Hart, Oxford 2003) 107, 121.

²⁵⁷ EU EUROPA Glossary <http://europa.eu/scadplus/glossary/subsidiarity_en.htm> accessed 11 February 2009.

made as to whether action at Community level is justified in the light of the possibilities available at national, regional or local level. Specifically, it is the principle whereby the Union does not take action (except in the areas which fall within its exclusive competence) unless it is more effective than action taken at national, regional or local level. In the case of the Community's non-exclusive competences, the European legislature should intervene only when collective action would have some appreciable advantage as compared to leaving matters to the Member States acting alone.²⁵⁸ One major problem was that there was no authoritative list of what falls within the EU's exclusive competence and what falls within the shared competence between EU and Member States. Article I-13 of the draft Constitutional Treaty introduced such a categorization for the first time.²⁵⁹ The Edinburgh European Council of December 1992 issued a declaration on the principle of subsidiarity, which lays down the rules for its application. The Treaty of Amsterdam took up the approach that follows from this declaration in a Protocol on the application of the principles of subsidiarity and proportionality annexed to the EC Treaty.²⁶⁰ Two of the things this Protocol introduces are the systematic analysis of the impact of legislative proposals on the principle of subsidiarity and the use, where possible, of less binding Community measures.²⁶¹

²⁵⁸ D. A. Wyatt and A. Dashwood (n 46) 81.

²⁵⁹ D. Chalmers A. Tomkins *European Union Public Law* (CUP, Cambridge 2007) 220.

²⁶⁰ Protocols Annexed by the Treaty of Amsterdam to EC Treaty: Subsidiarity and Proportionality (Protocol No30 1997). D. Wyatt (ed) *Rudden & Wyatt's EU Treaties & Legislation* (9th ed. OUP, Oxford 2004)134. Subsidiarity is a subject matter directly connected to the issue of the quality of Community legislation. Many reports examined quality issues such as the 1992 Sutherland report, the 1995 Molitor report, the 1996 SLIM initiative, the UNICE report and the Koopmans report. One of the most important objectives of quality control is the increase of legitimacy of rule-making and acceptance of the rules by citizens, business and society. A rule-making of good quality ensures the realization of the 'bringing the Union closer to its citizens' declaration. C. Timmermans 'How can one improve the quality of Community legislation?' [1997] CMLRev1229, 1229-1230,1238, W. Voermans 'The Quality of EU Legislation: What Kind of Problem, by What Kind of Standards?(2008) SSRN Working Paper <<http://ssrn.com/abstract=1272620>> accessed 3 Oct. 2008, E. Xanthaki 'The problem of quality in EU legislation: What on earth is really wrong?'[2001] CMLRev 651.

²⁶¹ Europa EU glossary <http://europa.eu/scadplus/glossary/subsidiarity_en.htm> accessed 27 Sept. 2008. For a legal analysis of the historical development of the principle of subsidiarity: D. A. Wyatt 'Subsidiarity and judicial review' in D. O'Keefe (ed) *Judicial Review in European Union Law* (Kluwer, The Hague 2000) 507-513.

Article 9 of the Protocol requires the Commission, in issues of non-exclusive competence, to provide a justification in the accompanying explanatory memorandum. This Protocol also requires the Commission to consult with the European Council, the Council and the European Parliament before any formal proposal and affirms that Community action would be appropriate in conditions where the cross-border situations could not be satisfactorily and effectively regulated by the national legislatures. When there has been no Community action or when national action would be incompatible with the Treaty aims of European integration, Community action and legislative intervention should be considered as appropriate.²⁶² Additionally, both Declaration 23 on the Future of the Union attached to the Nice Treaty and the Laeken Summit which set up the Convention on the Future of Europe stressed the importance of a better and more transparent division of competences in the EU.²⁶³

In recent cases, the ECJ was willing to confirm that the Community institutions have taken due account of the requirements of subsidiarity; nonetheless, the ECJ is reluctant to second-guess their choices about the appropriateness or otherwise of exercising supranational rather than purely domestic competences.²⁶⁴ The ECJ had accepted quite easily that Community legislation would be more efficient than individual national legislation by stating, in *UK v Council*²⁶⁵, that once the Council has found that it is necessary to improve the existing level of protection as regards the health and safety of workers and to harmonize the conditions in this area, achievement of that objective through the imposition of minimum requirements necessarily presupposes Community-wide action. In that case, the ECJ did not pay the required attention to the relevant

²⁶² N. Foster (n 157) 113.

²⁶³ N. Foster (n 157) 115.

²⁶⁴ D. A. Wyatt and A. Dashwood (n 46) 81-82.

²⁶⁵ Case C-84/94 *United Kingdom v Council* [1996] ECRI-5755 para. 47. For a thorough analysis of this case in the light of subsidiarity, see: A. Estella *The EU Principle of Subsidiarity and its Critique* (OUP, Oxford 2002) 142.

Treaty articles authorizing also Member States to take national measures towards the attainment of those goals.²⁶⁶ The ECJ had minimized the requirement of Community institutions to include thorough subsidiarity considerations into the preambles²⁶⁷ of Community legislation. As far as the harmonization of company law and securities regulation is concerned, the legislative practice of Community institutions supports the proposition that this harmonization is either already an integral part of the common market or one of the foundations of Community economic policy.²⁶⁸ If it is shown that a harmonizing instrument of company law is necessary for the development of the common market or that it has a direct impact on the operation of the common market, it is not essential to prove that this legal instrument pursues one or more of the higher objectives of the EC Treaty (Articles 2, 3 EC Treaty).²⁶⁹ Legal harmonization of company law pursues the goals of Article 2 EC Treaty and Article 2 EC Treaty promotes the higher objectives of the EC Treaty; as a matter of fact, no additional justification is required, if this reasoning is adopted.²⁷⁰ Furthermore, the ECJ seems to accept that if a specific competence for the adoption of internal market measures was attributed to the Community legislature, this satisfies also the compliance with the subsidiarity principle (if there is competence to harmonize, harmonization justifies the exercise of this competence).²⁷¹ The conditions of compliance with the principle of subsidiarity become more obscure after the *Deposit Guarantee Directive*²⁷² which said that procedural conditions are fulfilled even where there is no evidence to suppose that

²⁶⁶ D. A. Wyatt and A. Dashwood (n 46) 102.

²⁶⁷ See references to the preambles of various EU Company Law Directives declaring market integration as their aim attainable through harmonization: R. Buxbaum and K. Hopt (n 80) 196.

²⁶⁸ R. Buxbaum and K. Hopt (n 80) 197.

²⁶⁹ R. Buxbaum and K. Hopt (n 80) 197.

²⁷⁰ R. Buxbaum and K. Hopt (n 80) 197.

²⁷¹ D.A. Wyatt 'Subsidiarity' in K. Nicolaidis and S. Weatherill (eds) *Whose Europe? National Models and the Constitution of the European Union* (Conference papers, Oxford 2003) 91-92 <<http://www.competition-law.ox.ac.uk/iecl/pdfs/whoseeurope.pdf>> accessed 7 Oct. 2008. See also Case C-377/98 *Dutch Biotechnology* [2001] ECR I-7079.

²⁷² Case C-233/94 *Germany v European Parliament and Council (Deposit Guarantee Directive)*[1997] ECR I-2405 para. 22-28. For very enlightening comments on this case: A. Estella (n) 148.

the EU legislature actually considered whether proposed legislation complied with subsidiarity and notwithstanding the fact that there is no explicit reference in the proposed legislation to it.²⁷³ Recital 25 of preamble of the Takeover Bid Directive talks about compliance with the principle of subsidiarity and states that since the objectives of the action envisaged, namely to establish minimum guidelines for the conduct of takeover bids and ensure an adequate level of protection for holders of securities throughout the Community, cannot be sufficiently achieved by the Member States because of the need for transparency and legal certainty in the case of cross-border takeovers and acquisitions of control, and can therefore, by reason of the scale and effects of the action, be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 EC Treaty.

4.3) Limits that the principle of subsidiarity places on the harmonization efforts of the Community legislature.

The ECJ has tried to clarify the substantive issue of compliance with the principle of subsidiarity. In the very important cases of *Dutch Biotechnology*²⁷⁴, *BAT*²⁷⁵ and *Alliance for Natural Health*²⁷⁶ (dealing with Community competence under 95 EC Treaty), the ECJ affirmed that the Community measure was serving a market making purpose by eliminating obstacles to trade and distortions of competition within the internal market resulting from the multifarious development of national laws.²⁷⁷

²⁷³ D. Chalmers and A. Tomkins (n 259) 224-225.

²⁷⁴ Case C-377/98 [2001] ECR I-7079.

²⁷⁵ Case C-491/01 [2002] ECR I-11453.

²⁷⁶ Joined Cases C-154/04 and C-155/04 [2005] ECR I-6451.

²⁷⁷ D. A. Wyatt and A. Dashwood (n 46) 102-103. In *Alliance for Natural Health*, the ECJ held that when there are obstacles to trade, or it is likely that such obstacles will emerge in the future, because the Member States have taken, or are about to take, divergent measures with respect to a product or a class of products, which bring about different levels of protection and thereby prevent the product or products concerned from moving freely within the Community, Article 95 EC Treaty authorises the

Community legislative intervention was deemed to be essential because the Member States would not be able to attain individually this objective (the legislative initiatives of Member States so far resulted only in this multifarious development of national laws creating obstacles and distorting competition).²⁷⁸ However, this examination of the substantive part of the subsidiarity principle was not a difficult task for the ECJ because the existence of cross-border trade barriers and distortions of competition arising from legal diversity among Member States is a prerequisite for the very existence of Community competence under Article 95 EC Treaty.²⁷⁹ Hence, it is easily understood that the European legislature had to propose Community legislation in order to eliminate those obstacles or distortions.²⁸⁰

It would be interesting to examine the limits that the principle of subsidiarity places on the harmonization efforts of the Community. The goals of EU integration are decided by the European legislature and Member States could question and challenge mainly the attainment and the method of realization of these objects; it could be alleged that these objects can be attained better at national level, without any EU legislative intervention.²⁸¹ The Community institutions enjoy a wide discretion, framed in a rather open-ended way, in assessing and determining the objectives that could not be sufficiently achieved by the Member States and could, as a result, be better achieved by the Community on the basis of the scale or effects of the proposed Community action.²⁸² The ECJ confirmed this inclination towards wide discretion in *Upjohn Ltd*²⁸³:

Community legislature to intervene by adopting appropriate measures. Joined Cases C-154/04 and C-155/04 [2005] ECR I-6451 para. 32(See also C-434/02 *Arnold André*, [2004] ECR I-11825 para 34, and Case C-210/03 *Swedish Match* [2004] ECR I-11893 para. 33).

²⁷⁸ D. A. Wyatt and A. Dashwood (n 46) 103.

²⁷⁹ D. A. Wyatt and A. Dashwood (n 46) 103.

²⁸⁰ Compliance with the principle of attributed competence could possibly be equated with respect to the principle of subsidiarity. D. A. Wyatt and A. Dashwood (n 46) 103.

²⁸¹ K. Hopt (n 252), 10.

²⁸² D. A. Wyatt (n 261) 513. F. Easterbrook argues that when free movement of economic factors/trade is voluntary the principle of subsidiarity demands national legislation. When free movement is outside the scope of national control or when Member States possess monopoly power being able to export

‘According to the Court's case-law, where a Community authority is called upon, in the performance of its duties, to make complex assessments, it enjoys a wide measure of discretion, the exercise of which is subject to a limited judicial review in the course of which the Community judicature may not substitute its assessment of the facts for the assessment made by the authority concerned. Thus, in such cases, the Community judicature must restrict itself to examining the accuracy of the findings of fact and law made by the authority concerned and to verifying, in particular, that the action taken by that authority is not vitiated by a manifest error or a misuse of powers and that it did not clearly exceed the bounds of its discretion.’

The word ‘discretion’ in this judicial context means the measurement of freedom to make the value-judgements necessary to take the decisions necessary to carry out the task allotted to the institutions instead of the choice of adopting different policy options without excluding totally the latter possibility.²⁸⁴ It seems that the ECJ considers the substantive aspects of subsidiarity as a subject matter tilting towards politics. The ECJ would uphold a breach of the subsidiarity principle in the case of an EU institution manifestly exceeding the limits of the discretion conferred upon it by Article 5 EC Treaty considered in connection to the legal basis for the act in question.²⁸⁵ If harmonization of national laws in the field of takeover bids is thought by the Commission to be a prerequisite for integration in the market for corporate control (being a fracture of the internal market), then it is difficult to imagine how Member States can possibly achieve this without the necessary coordination of national

overcharges or taxes, Community institutions should legislate. Demanding ‘better law’ at Community level is sometimes the result of lobbying or a political decision. Regulatory competition among the various Member States should not be underestimated because it has equal efficiency and power with the competition in markets. F. Easterbrook ‘Federalism and European Business Law’ in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 11.

²⁸³ Case C-120/97 [1999] ECR I-223 para. 34 The ECJ also refers to the following rulings as its well-established case law in this area: Joined Cases 56/64 and 58/64 *Consten and Grundig v Commission* [1966] ECR 299, Case 55/75 *Balkan-Import Export v Hauptzollamt Berlin-Packhof* [1976] ECR 19, para. 8, Case 9/82 *Ohrgaard and Delvaux v Commission* [1983] ECR 2379, para. 14, Case C-225/91 *Matra v Commission* [1993] ECR I-3203, paras. 24 and 25, and Case C-157/96 *National Farmers' Union and Others* [1998] ECR I-2211, para. 39). (cited also by D.A. Wyatt (n 46) 513-514). Moreover, the ECJ confirmed this discretion of European legislature in *Danzer*. Case T-47/02 *Manfred Danzer and Hannelore Danzer v Council of the European Union* [2006] ECR II-1779.

²⁸⁴ D.A. Wyatt (n 261) 514.

²⁸⁵ D.A. Wyatt (n 261) 514.

provisions.²⁸⁶ A European legal framework for takeover bids is not just another set of rules amounting to more regulation but this set of Community rules abolishes barriers among Member States, promotes competition and contributes to a to the development of a market for corporate control in those Member States with no well-established market for corporate control.²⁸⁷

4.4) The new approach towards harmonization: flexibility and simplification.

The European legislature had adopted a more flexible and simplified approach towards the regulation of the internal market. The EU glossary²⁸⁸ states that simplifying legislation means weeding out the superfluous by rigorously applying the principles of necessity and proportionality. The exercise mainly involves the recasting and formal or informal consolidation of legislation. This concept has grown in importance in relation to the internal market since the White Paper on the Completion of the Single Market. It was highlighted by the Edinburgh European Council in 1992. Over the past years a concentrated effort has been made to establish a market giving priority to the four freedoms, but this has meant a wealth of European legislation, simplification of which has now become a priority in order to ensure that Community action is transparent and effective.²⁸⁹ The pilot programme (Simplification of Legislation for the Internal Market — SLIM) covering four specific areas was launched in May 1996 and has been reinforced by a multiannual programme on the simplification and updating of Community legislation adopted by the European Commission in February 2003. In response to the declaration on the quality of the drafting of Community legislation

²⁸⁶ K. Hopt (n 252), 10.

²⁸⁷ K. Hopt (n 252) 6.

²⁸⁸ EU EUROPA Glossary < http://europa.eu/scadplus/glossary/legislation_simplification_en.htm > accessed 11 February 2009.

²⁸⁹ Europa EU glossary <http://europa.eu/scadplus/glossary/legislation_simplification_en.htm> accessed 27 September 2008.

appended to the Final Act of the Intergovernmental Conference (1997), an interinstitutional agreement defining the guidelines for improving the quality of the drafting of legislation was adopted in December 1998. A new interinstitutional agreement which goes beyond drafting quality alone and is entitled "Better Lawmaking" was adopted in December 2003.²⁹⁰ As we mentioned, the 2003 Corporate Governance Action Plan guided the European legislature towards a principle-based approach within the framework of 'Better Lawmaking'. The 2003 Corporate Governance Action Plan does not intend to propose a Pan-European corporate governance code and tries to harmonize a few essential rules with closer coordination between national codes.²⁹¹ Its regulatory approach is far from an 'one-size-fits-all' approach given the many different national corporate governance models.²⁹² Moreover, the Lisbon Agenda includes among its eight key actions the improvement and simplification of the regulatory framework of business operations.²⁹³ In this strand of 'better regulation' approach, the European Commission should not neglect the principle of subsidiarity²⁹⁴; the 2003 Corporate Governance Action Plan requires the

²⁹⁰ Europa EU glossary <http://europa.eu/scadplus/glossary/legislation_simplification_en.htm> accessed 27 September 2008.

²⁹¹ D. Weber-Rey 'Latest Developments in European Corporate Governance in light of Better Regulation Efforts' in S. Weatherill (ed) *Better Regulation* (Hart, Oxford 2007) 253. S. Fazio (n 14) 191-192. Apart from the 2003 Corporate Governance Action Plan, the importance of harmonization of takeover bids was also stressed by the 1999 Financial Services Action Plan. For the implementation of the principle of subsidiarity to financial services, see: D. Mavromati *The Law of Payment Services in the EU* (European Monographs, Kluwer, The Hague 2008) 114-116.

²⁹² D. Weber-Rey (n 291) 253. Legal orders of Member States consist of EU law, harmonized national laws and national laws not under direct influence of harmonization. After the 2004 and 2007 enlargements, when 12 new Member States acceded to the European Union, the range of formally binding EU Law increased together with the variety of interests and national peculiarities. 27 Member States will add greater ideological, political and socio-economic diversity and more views which would have a wider effect on the company lawmaking process. A. Radwan '25 Thoughts on European Company Law in the EU of 25' [2006] EBLR 1169, 1169, 1171, 1179. This legal diversity on EU level is enhanced by the limited subject matter of the company law harmonization programme. C. Villiers (n 101) 226-229. It was also argued that, despite the different national company laws, a common legal pattern with its own distinct features seems to exist. F. Kubler 'A Shifting Paradigm of European Company Law?' [2005] ColJ EurL 219, 219.

²⁹³ D. Weber-Rey (n 291) 253. D. A. Wyatt and A. Dashwood (n 46) 916-918.

²⁹⁴ Better regulation in the EU is closely connected to the question of vertical distribution of powers and, as a matter of fact, to the subsidiarity debate. Commission Report 'Better Lawmaking 2005' COM

Commission to fully respect the subsidiarity and proportionality principles of the Treaty and the diversity of many different approaches to the same questions in the Member States, while at the same time pursuing clear ambitions (strengthening the single market and enhancing the rights of shareholders and third parties).²⁹⁵ It was argued that legal diversity in company laws of Member States and the tools for making it compatible with market integration are just as important an element of the EU policy on company law as harmonization.²⁹⁶ Subsidiarity considerations on a case-by-case basis could lead to the conclusion that national rules are more appropriate in a particular case without producing any obstacles to market integration. This resulting legal diversity with all these different national rules operates in one integrated market resulting sometimes in an optimal regulatory competition.²⁹⁷ This legal diversity originating from the application of the principle of subsidiarity could possibly allow the satisfaction of different preferences, innovative solutions for corporations and better regulatory experimentation in the area of company law.²⁹⁸ G. Hertig and J. A. McCahery supported a minimally harmonized takeover regime enhancing transparency and

(2006) 289. S. Weatherill 'The challenge of better regulation' in S. Weatherill (ed) *Better Regulation* (Hart, Oxford 2007) 2.

²⁹⁵ COM (2003) 284, 4-5. D. Weber-Rey (n 291) 253. K. Hopt argues that a mere recommendation based on 249 EC Treaty, as a soft law legal instrument, would definitely satisfy the subsidiarity objection. However, a recommendation and other voluntary approaches are not always efficient for most areas of company law including the Takeover Bid Directive. This was proved by the fate of the European Code of conduct for security transactions of 1977 with its suggestion that a compulsory takeover bid be introduced, for this was totally ignored by Germany. K. Hopt 'Company Law in the European Union: Harmonization or Subsidiarity', Working Paper Centro di studi e ricerche di diritto comparato e straniero, Saggi, Conference e Seminari 31, (Roma 1998) 10-11. J.J. Kirton and M. Trebilcock, *Hard Choices, Soft Law*, (Ashgate, Aldershot, 2004).

²⁹⁶ S. Grundmann 'The Structure of European Company Law: From Crisis to Boom' (2004) 5 EBOR 602, 602. U. Procaccia and U. Segal 'Thou Shalt Not Sow Thy Vineyard with Divers Seeds? The Case Against Harmonization of Private Law' in K. Hopt and E. Wymeersch (eds) *Capital Markets and Company Law* (OUP, Oxford 2003) 639.

²⁹⁷ S. Grundmann (n 296) 608-609. For a US perspective on regulatory competition: R. Romano *The advantage of competitive federalism for securities regulation* (AEI, Washington 2002). In general, competition within a political system restricts the power of government to attain their regulatory goals or at least to achieve the objectives it sets out to achieve. It could possibly be said that subsidiarity had to do with how markets replace regulation with competition in spite of the best and hard efforts of government. F. Easterbrook 'Federalism and European Business Law' in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 2-3.

²⁹⁸ S. Grundmann (n 296) 616.

shareholder protection and establishing a limit for the ‘race to the bottom’, and endorsed a default arrangement for takeover bids that would allow a firm to choose to be regulated either by the Takeover Bid Directive or by existing Member State law.²⁹⁹ This approach could lead to regulatory competition between national legislatures, innovation in company law, legal arrangements meeting companies’ needs, solution to the matter of compensation of multiple and dual class shareholders, selection of better takeover laws and development of an active cross-border takeover market in EU.³⁰⁰

4.5) Applying the principle of subsidiarity to the regulation of takeover bids at EU level.

One area of the company law harmonization programme which involved discussions on subsidiarity is the harmonization of takeover bids. The Commission had chosen a minimum intervention legal instrument for the regulation of takeover bids and securities regulation in general. In 1977, the Commission issued a non-binding recommendation on a code of conduct for securities trading.³⁰¹ It is obvious that this soft law document respected national competences in the field of securities regulation and left plenty of room to Member States to coordinate their capital market laws. This code contained general and supplementary principles; the most important are the third general principle and the seventeenth supplementary principle requiring equal treatment

²⁹⁹ They are also quite critical towards the proposed EU Company Law reforms under the Company Law Action Plan. They think that many of these harmonizing measures are excessive regulatory intervention, enhance only costly bureaucratic intervention and do not help firms and investors. G. Hertig and J. A. McCahery ‘Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?’ (2003) 4 EBOR 179, 179-180, 205-206.

³⁰⁰ Hertig and J. A. McCahery (n 299) 179-180, 205-206.

³⁰¹ Commission recommendation 77/534/EEC concerning a European code of conduct relating to transactions in transferable securities 1977 OJ L212/37. N. Moloney (n 108) 19. R. Buxbaum and K. Hopt (n 80) 197.

of shareholders through a mandatory bid.³⁰² This optional legal instrument had limited results. The drafting process of the 1989, 1990 and 1996 proposals for a Thirteenth Directive on Takeovers was concerned with issues of subsidiarity. The Commission proposal of 1989 was withdrawn at the Edinburgh Summit, was assessed under the lens of the subsidiarity principle and was relaunched again in 1996. The 1996 proposal was a framework directive, much more streamlined than the previous ones with general principles being used as the guide for proper implementation by the national legislatures, with the original ideas being considerably modified and greatly watered-down in content.³⁰³ The same pattern was followed by the subsequent proposals of 2002 and 2003 and by the final text of the Takeover Bid Directive with the optional provisions, the reciprocity clause and discretion, yet narrow, granted to Member States and national authorities.³⁰⁴ Moreover, the 1996, 2002, 2003 proposals as well as the final text of the adopted directive were imposing only minimum harmonization standards.³⁰⁵ The Commission preferred a more streamlined version, closer to the needs

³⁰² J.L. Hansen 'When less would be more: The EU Takeover Directive in its latest apparition' (2003) 9 ColJEL 275, 276. In relation to the regulation of companies, transnational law distinguishes between hard law deriving from company law, securities regulation or employment law and the soft law of voluntary codes of conduct, corporate governance codes and corporate social responsibility codes. P. Zumbansen 'Transnational Law' in J.M Smits(ed) *Elgar Encyclopedia of Comparative Law* (Elgar, Cheltenham 2008) 742-743.

³⁰³ Many were afraid that in the 1989 and 1990 proposals, there would be a retreat like in the case of the ninth directive harmonising the law on group of companies; notwithstanding this previous experience, there was a new proposal for a Takeover Bid Directive in 1996 taking into account subsidiarity. K. Hopt (n 295) 9-10, N. Moloney (n 108) 18.

³⁰⁴ A framework directive sets the framework for the regulation of a particular matter and leaves the determination of details to Member States. Nevertheless, this characteristic is inherent to the nature of the directive as an instrument for harmonization which is binding only to the legislative goals to be achieved and leaves only discretion to Member States as to the method of implementation into the national legal system. This is understood better if a directive is compared with the regulation. In company law, the result has frequently been much diversity in the harmonized laws of Member States; classic examples are the balance sheet law of the Fourth and Seventh Directives and more recently the Twelfth Directive. K. Hopt (n 295) 9-12. For the implementation process in UK, see: A. Kennon 'The Parliamentary Process for Implementation of Community Financial Market and Company Law' in S. Kenyon-Slade and M. Andenas (eds) , *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell , London 1993) 111.

³⁰⁵ When the European legislature chooses to follow the legislative method of minimum harmonization, only minimum standards are set by the harmonising directive. Member States may preserve national laws which could be stricter or they may choose to pass stricter ones. Minimum harmonization is expressly provided for in the EC Treaty for the areas of labor law, social law and environmental

of market operators for flexibility in these subtle financial transactions. The principles-based approach, supporting ‘substance over form’, and not the rules-based approach is followed by the European legislature in the field of corporate governance.³⁰⁶ The 2003 Corporate Governance Action Plan requires harmonization in the area of company law and corporate governance to be flexible in application, but firm in the principles and concentrate on priorities, be transparent and subject to proper due process and consultation.³⁰⁷

The Takeover Bid Directive sets out to establish minimum guidelines for the conduct of takeover bids involving the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market; it also seeks to provide an adequate level of protection for holders of securities throughout the Community, by establishing a framework of common principles and general requirements which Member States are to implement through more detailed rules in accordance with their national systems and their cultural contexts.³⁰⁸ The first words of the Directive’s Preamble are dedicated to the Article 44 (1) EC Treaty, which aims at the attainment of the freedom of establishment . Preamble (1) of the Directive declares as its legal basis Article 44 (2)(g) EC Treaty and as a result the Directive is classified to the company law harmonization programme(13th Company Law Directive). The purpose of the European Company law harmonization programme is

protection (Article 138, 174 and 176 EC Treaty), but it is also quite possible in other areas and represents actual practice in company and capital markets law. On the one hand, a directive, like the Insider Dealing Directive (Directive 89/592 [1989] OJ L334/30. For a legal analysis, see: B. Rider and M. Ashe ‘The Insider Dealing Directive’ in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 209), expressly allows stricter national provisions. On the other hand, it does not preclude them, as is the case, according to a contested opinion, with the Second Capital Directive. K. Hopt (n 295) 12.

³⁰⁶ D. Weber-Rey (n 291) 250-251. D. Weber-Rey (n 255) 384.

³⁰⁷ COM (2003) 284, 4-5. The ‘benefit of a company’ and other notions surrounding it, together with the pertaining theories, play a decisive role in the legislative choices to be made in the area of company law. J. Dine ‘Companies and Regulations: Theories, Justifications and Policing’ in D. Milman (ed) *Regulating Enterprise-Law and Business Organizations in the UK* (Hart, Oxford 1999) 291, S. Fazio (n 14) 161.

³⁰⁸ Europa website , Activities of the European Union-Internal Market , SCADPLUS : Takeover bids , < <http://europa.eu/scadplus/leg/en/lvb/l26012a.htm> > accessed 21 May 2007.

manifold : increase of transparency , reduction of the cost of cross-border transactions, removal of obstacles to establishment and of appreciable distortions of competition.³⁰⁹

The wording of Article 44 (2)(g) EC Treaty ‘coordinating to the necessary extent’ could be interpreted in different ways . It is argued that that only a minimum level of protection throughout the Community is necessary.³¹⁰ Others demand a more active and intensive intervention of the European legislature expressed by more uniform provisions through harmonization because all members of companies on EU level should have the same rights, which calls for uniform laws.³¹¹ Others believe that harmonization is needed to abolish all remaining obstacles to cross-border establishment and that further harmonization would reduce costs and increase efficiency for doing business within the Community.³¹² The recent EU Company legislation follows a new minimalist approach to harmonisation, which acknowledged diversity in the system and encouraged competition among national legal orders.³¹³

³⁰⁹ G. Wolff ‘The Commission’s Programme for company Law Harmonisation : the Winding Road to a Uniform European Company Law ?’ in S. Kenyon-Slade and M. Andenas (eds) , *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell , London 1993) 19

³¹⁰ G. Wolff (n. 309) 21. Reflexive harmonization provides a basis for the evolutionary selection of rules through mutual learning (experimentation and adaptation) between national-level systems. It is true that reflexive harmonization could have positive results on both national and community level. On national level, it allows rules to be matched to local approaches and, on community level, it allows innovation by maintaining variety within the ‘pool’ of legal solutions to common regulatory problems. S. Deakin ‘Two types of regulatory competition: Competitive federalism versus reflexive harmonization. A Law and Economics perspective on *Centros*’ [1999] *CYELS* 231 232. C. Forstinger argues that reflexive harmonization is the most appropriate method of regulating takeovers because this method uses both centralized legislation of minimum standards to overcome market failures, existing specifically in the area of takeovers, and some degree of self-regulation to obtain discretion for autonomous governance on national level. The aim of reflexive harmonization is to protect legal diversity and to guide the process of evolutionary and participatory adaptation of rules on national level. C. Forstinger *Takeover Law in the EU and USA , A Comparative Analysis* (Kluwer Law International , Hague 2002) 158, 160, Moreover, P. Zumbansen completes the comment of C. Forstinger by saying that the fact that reflexive law considers the co-evolutionary process of minimum harmonization and ongoing processes of self-regulation and adaptation in the Member States is very positive for market integration because ongoing deliberation and mutual education are facilitated. P. Zumbansen ‘European Corporate Law and National Divergences: The case of Takeover Regulation’ (Book Reviews) [2004] *WashUGILStLR* 867, 886.

³¹¹ G. Wolff (n. 309) 21

³¹² G. Wolff (n. 309) 21

³¹³ A. S. Reid ‘The Increasing Europeanisation of Company Law’ (2003) 7 *BLR* 165, 165 When subsidiarity is reflected in economic terms, it is closely related to regulatory competition, i.e the competition of legislators and rule-makers. When the European legislature decides not to intervene and not to harmonize, this decision does not automatically mean less state and less regulation because

Minimum harmonization in company law promotes diverse, national solutions to regulatory problems by providing the necessary flexibility and discretion to Member States to adopt any necessary measures.³¹⁴ One example of this approach is the Takeover Bid Directive with the multi-layered opt-in/opt-out/reciprocity system. Following these harmonization rationales and approaches mentioned above, the European Commission in its 2002 proposal for a Directive on Takeover Bids stressed that:

‘The new proposal pursues the same objectives as *its predecessor*[1996 proposal]: alongside the *general objectives* of *integrating European markets*[i.e. the EU market for corporate control] in line with the Financial Services Action Plan and undertaking harmonisation conducive to *corporate restructuring*, it sets out to strengthen the *legal certainty*[combat psychological obstacles] of cross-border takeover bids in the interests of all concerned and to ensure *protection for minority shareholders* in the course of such transactions. It establishes a *framework*[framework directive] for action by Member States by laying down certain *principles* and a limited number of *general requirements* while allowing Member States to adopt the *detailed implementing rules*[narrow discretion] in accordance with their national practices, provided that the differences are not such as to jeopardise implementation of the directive at Community level.’³¹⁵ [emphasis and comments in brackets added]

The EU legislature had to intervene and to provide a framework for the conduct of takeover bids at EU level, considering that takeovers are an effective method of exercising the right of establishment of companies. It was proved in practice that unharmonized (or sometimes non-existent) national safeguards may make this form of establishment too burdensome or even impossible.³¹⁶ Each Member State could

Member States may have even more regulation in this area and regulatory competition may not exist due to persisting barriers such as language, legal culture, history and politics. K. Hopt (n 252) 21.

³¹⁴ C. Forstinger (n 310) 159.

³¹⁵ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (COM/2002/0534 final) [2003] OJ 45E/1.

³¹⁶ G. Wolff (n 309) 22. Nevertheless, the House of Lords Select Committee and UK Takeover Panel doubted about the appropriateness of a directive on takeover bids, argued that it did not solve any problems that could not be addressed by the national laws and alleged that takeovers should be regulated at national rather than at EU level in compliance always with the principle of subsidiarity. N. Moloney (n 108) 821.

preserve its competence to regulate takeover bids and its own national safeguards but harmonisation deriving from Article 44 (2)(g) EC Treaty is essential to guarantee that the fundamental freedom of corporate establishment is not obstructed by the extent of particular national rules.³¹⁷ Harmonization also ensures that Member States will not regulate takeover bids in a protectionist way inhibiting market access to potential investors from other Member States. As a matter of fact, harmonization should enable companies to do what they could not do otherwise and to exercise the fundamental freedom of establishment given the burden of cumulative or even conflicting national rules .³¹⁸

4.6) Conclusion

Article 3 of the Amsterdam Protocol on subsidiarity characterizes the principle of subsidiarity as a dynamic concept which can be expanded or restricted or discontinued where circumstances so require. Thus, it could be concluded that whichever theoretical or jurisprudential approach and interpretation is followed, the principle of subsidiarity will remain as difficult as ever to tie down.³¹⁹ The overall stance of the ECJ towards the Community competence to intervene and to regulate the internal market could be characterized by a few inconsistencies. On the one hand, the broad interpretation that the ECJ adopted on Treaty articles guaranteeing the fundamental freedoms in the

³¹⁷ G. Wolff (n 309) 22, U.Bernitz 'Special Issue Section on Corporate Governance in Europe in the light of the Takeover Directive' [2004] EBLR 1351, 1351

³¹⁸ G. Wolff (n 309) 22. However, it was argued that takeovers are an area which should be left to self-regulation by market forces due to participation of sophisticated financial players in the market for corporate control. The subsidiarity principle would be complied better if individual Member States regulated exclusively takeovers and then competitive market forces and regulatory competition provide the best solution. Harmonization should refrain from regulating substantive issues of takeovers such as the mandatory bid and the breakthrough rule and should coordinate only the disclosure of information, time-limits and jurisdictional issues. J.L. Hansen (n 302) 295-298.

³¹⁹ N. Foster (n 157) 113.

internal market had widened the scope of legal bases available for the regulation of the internal market. On the other hand, those Treaty provisions aiming at the delimitation of Community competence to regulate the internal market were construed narrowly by the ECJ.³²⁰ This principle should force the Commission to better justify the need for Community action and especially for detailed, intrusive European provisions.³²¹ EU legislative efforts should mainly focus on securing and promoting the coherence of the internal market, which could not be achieved very effectively by the Member States.³²²

³²⁰ D. A. Wyatt 'The Growing Competence of the European Community' [2005] EBLR 483, 487.

³²¹ P. Demaret 'A short walk in the realm of subsidiarity' in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 30. Directives characterized by extreme specificity and containing numerous detailed provisions are the subject matter of a very interesting debate. R. Buxbaum and K. Hopt (n 80) 233-234.

³²² P. Demaret (n 321) 30.

CHAPTER 5

WEAKNESSES AND DIFFICULTIES IN HARMONIZATION EFFORTS IN THE FIELD OF EU COMPANY LAW

5.1) Introduction

This chapter will analyze a range of drawbacks of company law harmonization and how they already affect or are going to affect the regulation of takeover bids on EU level. This is a criticism of the harmonization of various company law standards and their efficiency within the internal market framework and not a criticism of the wide discretion that the European legislature enjoys with regard to its legislative evaluations.

5.2) Implementation of Directives.

Article 44 (1) EC Treaty states that the council shall act by means of directives in order to attain freedom of establishment. Article 249 EC Treaty provides that a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. A directive must be implemented by the national legislature in order to be introduced into the national legal order and to form an operative part of it.³²³ One problem related to the implementation of directives by Member States is the possibility of misinterpretation of the directive's content or of the amount of discretion conferred by the European legislature upon the national legislature.³²⁴ A consequence of this problematic situation is the possibility that a Member State may consider wrongly that its existing national legislation is in conformity with a Directive and not proceed to the required implementation of that Directive.³²⁵ While regulations are always of general

³²³ M. Horspool and M. Humphreys, *European Union Law* (4th edition OUP, Oxford 2006) 77.

³²⁴ M. Horspool and M. Humphreys (n 323) 77.

³²⁵ M. Horspool and M. Humphreys (n 323) 77-78.

application all over the EU, directives are addressed explicitly to specific Member States and bind only those Member States and not the rest (yet, most Directives are addressed to all Member States).³²⁶ According to Article 254 EC Treaty, regulations, as well as directives which are addressed to all Member States, shall be published in the Official Journal of the European Union. They shall enter into force on the date specified in them or, in the absence thereof, on the 20th day following that of their publication. After the ECJ had found that Directives could have vertical direct effect in *van Duyn*³²⁷ it was thought that the difference between regulations and directives could become blurred and perhaps be abandoned.³²⁸ It has also been argued that in order to achieve the uniform and consistent application of EU Law, Directives should be introduced into domestic law without changing their wording.³²⁹

5.3) Criticizing the various techniques of harmonization.

There has been much criticism of the efficacy of various techniques of harmonization.³³⁰ Although the European legislature tends to regulate exhaustively or almost exhaustively some areas of the internal market, optional harmonization and minimum harmonization were chosen quite often in the field of company law.

Optional harmonization allows market participants to apply national norms or Community norms, while some directives allow the Member State to opt out.³³¹ In

³²⁶ M. Horspool and M. Humphreys (n 323) 78.

³²⁷ Case 41/74 *Yvonne van Duyn v Home Office* [1974] ECR 1337

³²⁸ M. Horspool and M. Humphreys (n 323) 78.

³²⁹ M. Horspool and M. Humphreys (n 323) 77-78.

³³⁰ C. Villiers (n 100) 178. For a criticism of the directives regulating sectors of the internal market see: M. B. Kurcz 'Harmonization by means of Directives-never-ending story?' [2001] EBLR, 287. M. B. Kurcz presents various possible scenarios of harmonization of laws in the European Union by means of directives. He discusses the various categories of harmonizing directives (total, partial, optional, alternative, and minimum), criticises possible trade barriers coming from more stringent rules of minimum harmonization and questions the subsequent diversity which could result. Finally, he alleges that hybrid directives combining more than one legal technique of harmonization could serve better the purposes of market integration.

³³¹ W. Van Gerven (n 223) 508. P.J. Slot (n 192) 386, Cl. Lempereur (n 123) 244.

optional harmonization, there are two sets or rules: one for the domestic market and one for intra-community trade.³³² Articles 9 and 11 of the Takeover Bid Directive constitute an example of optional harmonization. The opt-outs of Article 9 and/or 11 of the Takeover Bid Directive and the reciprocity clause of Article 11 are characterized as the main deficiencies of this effort to harmonize the European market for corporate control. Some other examples which contain options are: the fourth and seventh directives³³³, the rules on the acquisition by a company of its own shares in the second directive³³⁴ and the sixth directive³³⁵, wholly optional for Member States which do not already permit division of public companies.³³⁶ These options reveal the defeat of Community initiatives by national idiosyncrasies and interests entrenched by national lobbying. It is also possible that these options create only a superficial equivalence of national standards. Moreover, the possibility that this optional harmonization would affect the content and the scope of the mandatory provision of the harmonizing measure could not be excluded. This has happened with the mandatory bid rule of the Takeover Bid Directive which presents many important deficiencies.³³⁷

³³² M. B. Kurcz (n 330) 295.

³³³ Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts [1983] OJ L193/1. L. Enriques, 'EC Company Law Directives and Regulations: How trivial are they?' (2005) ECGI Working Paper Series in Law No 39/2005 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730388> accessed 17 March 2008, 20 (also published in (2006) 27 *UPaJInt'IEconL* 1-76).

³³⁴ Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L26. Minimum capital and capital maintenance rules in the Second Directive can be described as optional to certain degree. L. Enriques (n 333) 21-22. S. Mengoli, F. Pazzaglia, and E. Sapienza, 'Is It Still Pizza, Spaghetti and Mandolino? Effect of Governance Reforms on Corporate Ownership in Italy' SSRN Working Paper <<http://ssrn.com/abstract=966085>> accessed 9 Sept. 2008. A. Engert 'Life without legal capital: Lessons from American law' (1996) Working Paper Ludwig Maximilians Universitat Munchen <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=882842> accessed 3. Oct. 2008. See also the special volume of the European Company and Financial Law Review: M. Lutter (ed) *Legal Capital in Europe* (De Gruyter, Berlin 2006).

³³⁵ Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies [1982] OJ L378/47.

³³⁶ V. Edwards (n 96) 10.

³³⁷ R. Buxbaum and K. Hopt (n 80) 225-226.

Minimum harmonization results also in similar diversity of company and securities laws, yet at least in this case a central mandatory core of uniform norms should be implemented (only minimum rules essential for the functioning of the internal market are harmonized³³⁸).³³⁹ In practice however even these directives which most resort to this technique are widely recognized as having made a significant contribution to the establishment of improved equivalent rules in important areas such as disclosure of information to investors (e.g. accounting and securities directives³⁴⁰).³⁴¹ It is the case that this minimum harmonization is able to combat psychological obstacles to cross-border establishment of companies by guaranteeing a common framework of minimum protection valid all over the EU.

The choice of the harmonization techniques of options and minimum standards frequently depicts different national approaches to the regulation of certain parts of company law. Harmonization of these divergently regulated areas of company law is only possible through a political compromise which leads unavoidably to optional harmonization.³⁴² Optional harmonization satisfies all the Member States independently of their jurisdictional differences. The alternative to a less than perfect harmonizing directive preserving to a great extent the previous legal diversity would have been no harmonization in that area.³⁴³ This is particularly true in the case of the Takeover Bid Directive, where the negotiations lasted for almost 15 years. Even when a compromise

³³⁸ M. B. Kurcz (n 330) 296.

³³⁹ V. Edwards (n 96) 10.

³⁴⁰ It is not easy to judge the contribution of the first wave of harmonization measures in the field of mandatory disclosure requirements to the development of European capital markets. Institutional investors were reluctant to receive legislative intervention in their playing field regulating disclosure requirements and preferred a legal development coming directly from market forces. At the framework of retail financial markets, however, better disclosure of information, as imposed by EU Law, have played a crucial role in enhancing investor confidence. Nevertheless, there is little concrete support for any claim about the quality of EU disclosure law being a major factor fuelling investor interest in the securities markets in the 1990s. E. Ferran, *Building an EU Securities Market* (CUP, Cambridge 2004) 38. J. Long 'Navigating the Maze: Reviewing the Information Disclosure Requirements in the Financial Services *Acquis*' [2008] EBLR 485, 500.

³⁴¹ V. Edwards (n 96) 10.

³⁴² V. Edwards (n 96) 10.

³⁴³ V. Edwards (n 96) 10.

had been reached on the terms of the draft Takeover Bid Directive, the 2002 tied vote in European Parliament cancelled the results of all those hard efforts. Finally, the adoption of opt-in and opt-out provisions and a reciprocity clause in the Takeover Bid directive seemed unavoidable. Apart from the optionality and reciprocity clauses, there were also various substantive deficiencies in core provisions of the Takeover Bid Directive (e.g. the mandatory bid rule).³⁴⁴ Only this watered-down version of the initial proposed Directive of the European Commission was able to mitigate the concerns of the objecting Member States and the European Parliament.

5.4) Petrification: a side effect of harmonization by means of directives.

Another negative factor in the evolution of company law harmonization is the so-called danger of petrification which accompanies directives, namely the risk that because of the cumbersome legislative process involved, depending on the legal basis chosen, a directive could not be amended and developed easily.³⁴⁵ The 2002 Report of the High Level Group of Company Law Experts criticized directives as being in practice even more inflexible than primary legislation because it is difficult to change the directive and the specific underlying approach. They proposed that the directives should stipulate the general principles and should leave the implementation of more

³⁴⁴ G. Hertig and J. McCahery had developed an opt-in/opt-out default rule approach for EU Company Law within the framework of the European market for corporate control. They are critical of mandatory harmonization of company law because there are few incentives for the European legislature to produce optimal regulations, firms have to bear high transactional costs due to inefficient provisions, transactions are being disrupted and benefits for companies are not high enough. G. Hertig and J. McCahery 'An Agenda for Reform: Company and Takeover Law in Europe' in G. Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004)21, 38.

³⁴⁵ V. Edwards (n 96) 11. M.J.G.C Raaijmakers (n 124) 238, R. Buxbaum, G. Hertig and others (eds) (n 97) 200, S. Fazio (n 14) 94.

detailed provisions to Member States or to market standards.³⁴⁶ Moreover, the 1986 Single European Act introduced the Commission's flexible 'powers of implementation' under Article 202 EC Treaty enabling the Commission to amend technical details (and not substantive matters) of harmonizing directives by way of secondary legislation, without the need to consult the European Parliament.³⁴⁷ 'Petrified' directives could also block later national legislation. This results in the significant restriction of any national legal innovation in the field of company law.³⁴⁸ Article 20 of the Takeover Bid Directive states that five years after the date of transposition of the Takeover Bid Directive (20 May 2006), the Commission shall examine this Directive in the light of the experience acquired in applying it and, if necessary, propose its revision. That examination shall include a survey of the control structures³⁴⁹ and barriers to takeover bids that are not covered by this Directive. To that end, Member States shall provide the Commission annually with information on the takeover bids which have been launched against companies the securities of which are admitted to trading on their regulated markets. That information shall include the nationalities of the companies involved, the results of the offers and any other information relevant to the understanding of how takeover bids operate in practice.

³⁴⁶ P. Burbidge 'Creating high performance boardrooms and workplaces-European corporate governance in the twenty first century' [2003] ELRev. 642, 646. Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe (Brussels, 2002) < http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf > accessed 11 August 2007, 4 ('the Winter Group').

³⁴⁷ V. Edwards (n 96) 11. R. Buxbaum, G. Hertig and others (eds) (n 97) 15, C. Villiers (n 100) 179.

³⁴⁸ R. Buxbaum and K. Hopt (n 80) 241-242. It was suggested that minimum harmonization would leave Member States significant margin to apply their innovative ideas in the area of company law. R. Buxbaum, G. Hertig and others (eds) (n 97) 14.

³⁴⁹ E. Wymeersch 'Investors and Enterprise Structure. A. Report: Eddy Wymeersch' and 'Investors and Enterprise Structure: Discussion' in R. Buxbaum and others (eds) *European Economic and Business Law* (de Gruyter, New York 1996) 325 and 334.

5.5) Different legal concepts among different Member States.

The European legislature confronts very often another problem in the harmonization of national company laws; different legal concepts originating from the different jurisdictions of EU Member States require a common understanding in order to be included in the harmonizing measure.³⁵⁰ Some legal notions may appear to be similar to legal notions in other Member States but in reality this is only a superficial similarity and these notions are completely different in substance. Some legal concepts do not correspond to equivalent legal concepts in other jurisdictions. A directive could seek to regulate an area in which specific concepts are essential to one State's application and understanding of the law but alien and obscure in another jurisdiction.³⁵¹ An example is the introduction into EU Company Law of the concept of the company organ in the law relating to *ultra vires* transactions: a notion used by Roman-Germanic jurisdictions, which is familiar to Napoleonic jurisdictions but which is incompatible to a great extent with England's analysis of company transactions within the framework of agency.³⁵²

This problem is present in the field of takeover regulation. On the one hand, some

³⁵⁰ V. Edwards (n 96) 11-12. P. Wood *Regulation of International Finance* (Law and Practice of International Finance Series, 1st ed. Sweet & Maxwell, London 2007), P. Wood *Maps of World Financial Law* (5th ed. Allen & Overy, London 2005) 17,21, D. C. Donald 'Approaching Comparative Company Law' SSRN Working Paper <<http://ssrn.com/abstract=1092452>> accessed 11 Sept. 2008, M.J.G.C Raaijmakers (n 124) 239, E. Stein (n 21) 87-170. This divergence of national company laws at EU level was attributed to the differences in the general private law (common v. civil law), to the difference in structure between forms of companies (one-tier and two-tier board companies), to national unique regimes of company law (e.g. co-determination), to different groups (managers, workers and financiers) having different positions and enjoying different powers in various Member States, to fragmented harmonization of tax law and to language and cultural differences. M. J. Kroeze and H.M. Vletter-Van Dort 'History and Future of Uniform Company Law in Europe' (2008) 5 ECL 114, 120. C. Villiers asks for a re-evaluation of national company laws. If national company laws were more aligned conceptually and structurally, it might be easier to build a culture of harmony between the company laws of the states. C. Villiers (n 100) 194.

³⁵¹ V. Edwards (n 96) 11-12. Corporate governance issues and notions should not be studied in isolation within only one country. B. R. Cheffins 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 *DukeJCompInt'lL* 5, 5-6. However, harmonization taking into account comparison between existing laws was criticised because it does not satisfy present and future needs of business enterprises. A comparative study beneficial for the harmonization of company law should include an analysis of the actual functioning of the business enterprises, thereby referring to the wider social and 'political' environment and to historical elements. E. Wymeersch (n 124) 322-323. Cl. Lempereur (n 123) 246-247.

³⁵² V. Edwards (n 96) 11-12.

Member States, like the United Kingdom, have long-established regulations in the area of takeover bids (a self-regulatory system in the case of the United Kingdom). Their experience in the development of the relevant legal concepts and in tackling the various regulatory problems is very important. On the other hand, some other Member States (e.g. Germany) introduced mandatory takeover rules only in the 90's. This lack of familiarity and lack of experience could cause problems not so much at the transposition stage but to a greater extent in the everyday application, interpretation and compliance with the national takeover rules implementing the Takeover Bid Directive. Such a takeover rule is the concept of equitable compensation in Article 11 (5) of the Takeover Bid Directive³⁵³. This provision states that where rights are removed on the basis of the breakthrough rule equitable compensation shall be provided for any loss suffered by the holders of those rights. The terms for determining such compensation and the arrangements for its payment shall be set by Member States.

³⁵³ In his Takeover Report, the High Level Group of Company Law Experts ('the Winter Group') was against the introduction of this compensation scheme.

CHAPTER 6

ESTABLISHING AN INTERNAL MARKET FOR COMPANIES: MARKET INTEGRATION IN THE AREA OF EU COMPANY LAW.

6.1) Introduction

After discussing various facets of the regulation of takeover bids and of the harmonization of company law in general and understanding their structure and their deficiencies, it is appropriate to dedicate a chapter to the ultimate goal of the freedom of establishment: the making of an internal market. This will assist in understanding the place where the EU market for corporate control operates, as an element in the internal market. This chapter will seek to show that the market in corporate control forms one indispensable element of the internal market and that the liberalization of takeovers is necessary for the efficient functioning and the completion of the internal market. For this reason, it would be necessary to present concisely the evolution of market integration at EU level and to explain a few regulatory aspects of this continuing process of market integration.

6.2) Barriers to market integration.

There are numerous reasons why differences between the company laws of the Member States could possibly frustrate the integration of the internal market.³⁵⁴ The cornerstone of the EC Treaty is the establishment of an internal market.³⁵⁵ The purpose of the internal market is to abolish obstacles to the free movement of goods, persons, services and capital and to harmonize the laws of Member States to the extent required

³⁵⁴ Article 14 EC Treaty. V. Edwards (n 96) 3

³⁵⁵ V. Edwards (n 96) 3. For the evolution of the various stages of market integration (Economic Constitution) and the close connection and interdependence of politics and law in this process: C. Joerges 'Law, Economics and Politics in the Constitutionalisation of Europe' (2003) 5 CYELS 123.

for the functioning of the internal market.³⁵⁶ The existence of divergent national company laws could have a negative effect on corporate mobility at EU level. If national company laws regulating important areas of creditor and shareholder protection and corporate governance are fundamentally different, this may result in a European ‘Delaware Effect’, urging companies to move into jurisdictions with the laxest laws.³⁵⁷ When a company plans to penetrate a new business environment or to migrate to a new Member State, its decision will not be based only on economic grounds; the company will also consider the regulatory burdens and the substance of the legislation of the new host Member State.³⁵⁸ The main advantage of company law harmonization is that it brings equivalent creditor and shareholder protection and that it encourages cross-border credit and investment, without prejudicial treatment of shareholders and creditors of the companies which have decided to cross the borders.³⁵⁹

Persistent differences in national company laws are responsible for higher transaction

³⁵⁶ Article 3(h) EC Treaty V. Edwards (n 96) 3. In his Opinion in *Alfa Vita Vassilopoulos* (Joined Cases C-158/04 and C-159/04 *Alfa Vita Vassilopoulos AE, formerly Trofo Super-Markets AE and Carrefour Marinopoulos AE v Elliniko Dimosio, Nomarchiaki Aftodioikisi Ioanninon* [2006] ECR I-08135), Advocate General M. Poiares Maduro proposed a common approach to defining a trade barrier across all the freedoms. There are many papers examined the possibility of convergence: see eg E. Spaventa ‘From Gebhard to Carpenter: towards a (non-)economic European Constitution’ (2004) 41 CMLRev 743, P. Oliver and W.H. Roth ‘The internal market and the four freedoms’ (2004) 41 CMLRev 407, J. Snell ‘And then there were two: Products and Citizens in Community Law’ Ch.4 in T. Tridimas and P. Nebbia (eds), *EU Law for the 21st Century*, (Hart Publishing, Oxford 2005), J. Meulman and H. de Waele ‘A retreat from Sager: Servicing or fine-tuning the application of Article 49 EC’ (2006) 33 LIEI 207. J.L. Hansen ‘Full circle: Is there any difference between the freedom of establishment and the freedom to provide services’ in M. Andenas and W.-H. Roth (eds) *Services and Free Movement in EU Law* (OUP, Oxford 2002) 197, M Poiares Maduro ‘Harmony and dissonance in free movement’ (2001) 4 CYELS 315, D. O’Keefe and A. Bavasso ‘Four freedoms, one market and national competence: In search of a dividing line’ in D. O’Keefe (ed) *Judicial Review in European Union Law* (Kluwer, The Hague 2000) 541. The Court has not reconsidered the structure of the law and has not answered the question of whether there should be a convergence in the interpretation of the fundamental freedoms under the EC Treaty. S. Weatherill *Cases and Materials on EU Law* (8th ed., OUP, Oxford 2007) 580. It has also been proposed the introduction of a fifth freedom establishing a competitive market for politics and allowing functional, overlapping and competing jurisdictions (FOCJ). This political approach institutionalizes competition among governmental units at all levels resulting in a development of welfare. Such competition exist now only for national governments. Competition among newly emerging jurisdictions organized along functions instead of territories should also be promoted. B.S. Frey and R. Eichenberger ‘FOCJ: Creating a single European market for governments’ in D. Schmidtchen and R. Cooter (eds) *Constitutional Law and Economics of the European Union* (Elgar, Cheltenham 1997) 195.

³⁵⁷ V. Edwards (n 96) 3.

³⁵⁸ V. Edwards (n 96) 3.

³⁵⁹ V. Edwards (n 96) 3.

costs, because market participants from other Member States have to study carefully the national company law provisions regulating a company before contracting with it or buying its shares. This may hinder cross-border trading and investment.³⁶⁰

6.3) The EU market for corporate control: a segment of the internal market.

The market for corporate control is considered to be a very important part of the internal market, related both to European corporate governance structures and to securities regulation. The market for corporate control leads to the most efficient use of company resources, both on a suppressive basis (board will try to increase the profits of the corporation; otherwise, they could be replaced by a new board) and on a curative basis (takeovers will happen where the board does not perform satisfactorily, and its change would probably bring better results).³⁶¹ The High Level Group of Company Law Experts emphasizes the view that ‘actual and potential takeover bids are an important means to discipline’ management as part of the basis for the Takeover Bid Directive.³⁶² Takeovers constitute the most important part of the market for corporate control but there are more segments of this particular market playing a very important role in EU market integration (such as the establishment of companies, of subsidiaries, of branches, transactions in company assets and other elements of the business enterprise, mergers and assimilated transactions, issue of shares to new

³⁶⁰ L. Enriques, "Company Law Harmonization Reconsidered: What Role for the EC?" (November 2005). ECGI - Law Working Paper No. 53/2005, SSRN Working Papers: < <http://ssrn.com/abstract=850005> > accessed 11 March 2008, 12 (also published in S.M. Bartman (ed.) *European Company Law in Accelerated Progress* (European Company Law Series, Kluwer, AH Alpen aan den Rijn 2006)) L. Enriques characterizes this rationale as ‘unconvincing’.

³⁶¹ B. Sjaafjell ‘The Golden Mean or Dead End? The Takeover Directive in a Shareholder versus Stakeholder Perspective’ in S. Bartman(ed), *European Company Law in Accelerated Progress* (Kluwer Law International, Alphen aan den Rijn 2006) 128.

³⁶² Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, 19. B. Sjaafjell (n 361) 128 (‘the Winter Group’).

shareholders(leading to control change), debt restructuring and shareholder agreements resulting in a control change).³⁶³

6.4) The establishment of a common/internal market.

The establishment and efficient functioning of a common/internal market³⁶⁴ is still the most important goal of the European Community. Although the Treaty does not define exactly the term ‘common market’, some treaty articles make reference to it.³⁶⁵ In the beginning, there was a transitional period which was to prepare progressively for the establishment and the functioning of the common market. (Article 3(1)(h), Article 32(1)-(4), Article 88(1), Article 119(1), Article 120(1), Article 136, Article 211, Article 267, Article 297, Article 308).³⁶⁶ The EC Treaty demands the abolition of all categories of national provisions able to obstruct and affect negatively the establishment of this common market. The stages of integration as proclaimed by Article 2 EC Treaty based on liberal economic thinking presupposes that the creation of a common market and the gradual approximation of national economic policies will result in a larger market for business operations.³⁶⁷ Higher revenues would assist companies in reaching optimal size and becoming more competitive by increasing their productivity.³⁶⁸ An increase of output by efficient and healthy companies would force them to diminish their product prices due to competition; this increases ultimately the purchasing power of

³⁶³ E. Wymeersch (n 124) 301-302.

³⁶⁴ For a very early consideration of the relationship between the common market and English Company Law, see: T. Flanagan, ‘The impact on English Company Law’ in B.A. Wortley (ed) *The Law of the Common Market* (Manchester University Press-Oceana Publications, Manchester 1974) 111.

³⁶⁵ K. Lenaerts and P. Van Nuffel, *Constitutional Law of the European Union* (2nd edition, Sweet & Maxwell, London 2005) 139.

³⁶⁶ K. Lenaerts and P. Van Nuffel (n 365) 139.

³⁶⁷ R. Buxbaum and K. Hopt (n 80) 199.

³⁶⁸ R. Buxbaum and K. Hopt (n 80) 199.

consumers.³⁶⁹ High productivity would also raise workers' wages.³⁷⁰ This market evolution would increase the social product and would attain the objectives of Article 2 EC Treaty.³⁷¹ The role of the European Community is very crucial at this stage due to its power of legislative intervention in case of anomalies in this process of market integration.³⁷² The list of tasks set out in Article 3 EC Treaty and the provisions contained in Part Three of the EC Treaty describe the scope of the common market. Problems in achieving the common market have led to the introduction of the concept of the 'internal market' to supplement that of the common market (Article 14 EC Treaty).³⁷³

Article 3 (1)(a) EC Treaty aiming at the establishment of the common market requires the prohibition, as between Member States, of custom duties and quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect. Moreover, Article 3 (1)(c) states that the basic characteristic of the common/internal market is the abolition in the commercial relations among Member States of obstacles to the free movement of goods, persons, services³⁷⁴ and capital. In *Schul*,³⁷⁵ the ECJ attributed to the common market the aim of the abolition of all obstacles to intra-community trade in order to unify the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market.³⁷⁶ This kind of effort would alleviate any drawbacks of the partitioned

³⁶⁹ R. Buxbaum and K. Hopt (n 80) 199.

³⁷⁰ R. Buxbaum and K. Hopt (n 80) 199.

³⁷¹ R. Buxbaum and K. Hopt (n 80) 199.

³⁷² K. Lenaerts and P. Van Nuffel (n 365) 139.

³⁷³ K. Lenaerts and P. Van Nuffel (n 365) 139.

³⁷⁴ An early consideration of the market integration of investment services: E. Lomnicka 'The internal financial market and investment services' in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 81.

³⁷⁵ Case 15/81 *Gaston Schul Douane Expeditie BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal*. [1982] ECR 01409 para 33.

³⁷⁶ K. Lenaerts and P. Van Nuffel (n 365) 139. For an interesting analysis of harmonization methods to abolish obstacles and of market integration approaches to financial services regulation on EU level, see: E. Lomnicka 'The financial services single market and the interface between Community law and

European markets. In *Polydor*, the ECJ held that its case law on the abolition of trade barriers must be determined on the basis of the European Community's objectives and activities as defined by Article 2 and 3 EC Treaty. The EC Treaty, by establishing a common market and progressively approximating the economic policies and the business environments of the Member States seeks to integrate national markets into a single market having the characteristics of a domestic market.³⁷⁷ The aim of these provisions, introducing the four fundamental freedoms (free movement of goods, services/establishment, workers and capital), is to combat any already existing or future national laws hindering the business activities and the entrepreneurial plans of market participants at EU level. This will result in an efficient allocation of resources and in the establishment of a level-playing field across the Member States, allowing market participants to use better and more efficiently their competitive advantages in this integrated market. As a result, all discrimination on grounds of nationality is also prohibited within the field of application of the Treaty (Article 12 EC Treaty).³⁷⁸ Apart from the promotion of the four fundamental freedoms, the common market emphasizes the importance of free competition. The abolition of trade barriers imposed by the Member States would be useless if undertakings could still frustrate the function of the common market by abusing their dominant position, by forming cartels or by receiving unlawful state aids.³⁷⁹

Domestic law' in A. Arnall and others (eds.) *Continuity and Change in EU Law-Essays in Honour of Sir Francis Jacobs* (OUP, Oxford 2008)261, 267,281.

³⁷⁷ Case 270/80 *Polydor Limited and RSO Records Inc. v Harlequin Records Shops Limited and Simons Records Limited* [1982] ECR 329 para. 16.

³⁷⁸ K. Lenaerts and P. Van Nuffel (n 365) 140. G. Davies *Nationality Discrimination in the European Internal Market* (European Monographs, Kluwer, The Hague 2003).

³⁷⁹ K. Lenaerts and P. Van Nuffel (n 365) 140-141. A. Jones and B. Surfin *EC Competition Law, Text, Cases and Materials* (3rd ed OUP, Oxford 2008), D.G Goyder *EC Competition Law* (4th ed. OUP, Oxford 2003), G. Monti *EC Competition Law* (CUP, Cambridge 2007), M. Furse *Competition Law of the EC and UK* (5th ed. OUP, Oxford 2006). Company law and capital market law have complementary aims: economic concentration and competition law. As regards national company laws on groups of companies and concentration, takeover bids are regulated early in the formation of a group of

A common market could not be established by a mere deregulatory abolition of national provisions constituting trade barriers, of discriminatory laws and of appreciable distortions of competition. EC Law can prohibit national rules that constitute obstacles to cross-border trade either because they are discriminatory or because they restrict market access. Mutual recognition which allows a product lawfully produced in a Member State to circulate freely in the rest of the Member States underpins this approach.³⁸⁰ Nevertheless, many obstacles to free movement in the common market come from differences between national laws such as company law.³⁸¹ While some of these barriers could be eliminated by mutual recognition, some others (which 'survive' due to proper justification according to mandatory requirements of general interest) require legislative intervention by means of directives harmonizing different national standards.³⁸² These differences should be diminished by introducing new harmonized standards for all the Member States. Hence, positive integration was provided by Article 3(1)(h) EC Treaty which required the approximation of the laws of Member States to the extent required for the functioning of the common market.³⁸³ Positive integration was very important for company and banking law because many non-tariff barriers were eliminated through harmonization; the negative integration

companies. Some of these regulations aim at preventing distortion of competition in the market for corporate control and not at blocking concentration. R. Buxbaum and K. Hopt (n 80) 221-223.

³⁸⁰ P. Craig and R. De Burca (n 12) 606. F. Jacobs 'The evolution of European legal order' [2004] CMLRev. 303, 304-305.

³⁸¹ K. Lenaerts and P. Van Nuffel (n 365) 141.

³⁸² P. Craig and R. De Burca (n 12) 606. It is argued that the judicially created principle of mutual recognition is differentiated from the legislative principle of mutual recognition in the financial services market. The judicially formed principle of mutual recognition is not sufficient in guaranteeing the free provision of financial services. Hence, legislative intervention, based on harmonization and the legislative principle of mutual recognition, are needed for the integration of EU financial market. M. Ortino 'The role and functioning of mutual recognition in the European market of financial services' (2007) 56 ICLQ 309, 324.

³⁸³ K. Lenaerts and P. Van Nuffel (n 365) 141. L. Enriques examines empirically the company law directives and case law. He criticizes the fact that negative harmonization (i.e harmonization removing barriers to the four freedoms) is sometimes followed (in case of justified barriers) with positive harmonization because any profits related to the facilitation of freedom of establishment are usually lost in terms of lower flexibility rules. This argument is based on the alleged rigidity of some EU harmonizing rules which also diminish the scope of regulatory competition. L. Enriques (n 360) 2, 9-11.

aiming at the abolition of tariffs, quotas and similar barriers was not enough in these areas of business law.³⁸⁴ In the internal market, harmonization of company laws is required because harmonization would help companies to exercise their right of freedom of movement and establishment in the internal market and would provide more legal transparency and equivalence; thus, this approximation of conditions would enable companies to move within the internal market in a balanced way without causing appreciable distortions of competition.³⁸⁵ The Commission's policy in the field of EU Company Law involves some very difficult decisions which should be contemplated very carefully. The nature, scope and focus of national company laws at EU level were highly fragmented and diversified prior to the introduction of the Commission's harmonization agenda. As far as the protection of shareholders and creditors is concerned, positive harmonization could provide a secure environment for cross-border credit and investment by ensuring that the market access of companies' members and creditors is not prejudiced and impeded.³⁸⁶ Thus, negative harmonization would not provide an adequate level of legal certainty. Negative harmonization should be accompanied by positive harmonization. Positive harmonization may fill the gaps that negative harmonization does not cover due to duly justified barriers or to some residual psychological obstacles to market access. Then, positive harmonizing rules

³⁸⁴ P. Craig 'The Evolution of the Single Market' in C. Barnard and J. Scott (eds) *The Law of the Single European Market* (Hart, Oxford 2002) 2.

³⁸⁵ S. Fazio (n 14) 78. Some academics support the opinion that the internal market has been completed without completion of the harmonization of company law. According to Article 44(2)(g) EC Treaty, harmonization of company law is only required 'to the necessary extent'. Hence, according to this opinion, there is no need for further company law harmonization because the internal market is complete. C. Timmermans 'Harmonization in the Future of Company Law in Europe' in K. Hopt and E. Wymeersch(eds) *Capital Markets and Company Law* (OUP, Oxford 2003) 627-628. This latter opinion alleging that the internal market is completed seems to overestimate the advantages of negative integration through case law. Harmonization of company law is an indispensable part of this market making process whereby legal certainty and equivalent standards are established. It is not easy to see how the various provisions of the Takeover Bid Directive could be established only through case law.

³⁸⁶ S. Fazio (n 14) 79

would be definitely required.³⁸⁷ It should also be stressed that positive harmonization of company law is not an aim in itself but its ultimate objective is the completion of the internal market.³⁸⁸ The contribution of positive integration to the citizens' realization of the advantages of the internal market project was stipulated in *Paul*³⁸⁹ where the ECJ stated that the population should become more strongly conscious of the reality of the common market and that to that end measures should be adopted for the greater liberalization of this specific part of the internal market (this case dealt with tax measures).

The relationship between the harmonization of company law and the establishment of a common market is a very important issue. The harmonization of company law as a method of positive integration aims primarily at the creation and progressive development of a common market. As far as the construction of Article 44(2)(g) EC Treaty is concerned, this provision shall be interpreted according not only to Article 43 and 44(1) EC Treaty, which clearly show that the harmonization of national company law systems forms part of the general programme for the abolition of restrictions on freedom of establishment and the facilitation of market access, but also according to Article 3(h) EC Treaty, which provides that the activities of the Community are to include the approximation of national laws to the extent required for the functioning of the common market. Therefore, all the proposed company law measures based on Article 44(2) EC Treaty should contribute to the effective functioning of the common market. Moreover, the ECJ has talked about the possible limits of the European

³⁸⁷ A. S. Reid (n 313) 165.

³⁸⁸ M.J.G.C Raaijmakers (n 124) 231-232. Positive harmonization could improve the economic efficiency of the internal market in the following ways: doing business under harmonized rules might result in more savings especially for smaller companies which have to give up relatively more resources to cope with an international legal environment than do larger ones, the harmonization would probably result in a review of national regulation, harmonization will strengthen entrepreneurs' confidence in their market access and harmonization would create a level playing field and would prevent the shifts of business and employment. R. Buxbaum, G. Hertig and others (eds) (n 97) 54-55.

³⁸⁹ Case 54/84 *Michael Paul v Hauptzollamt Emmerich* [1985] ECR-915 para.15.

legislature's competence to facilitate freedom of establishment of companies through harmonization means (Directives) seeking to wipe out any national restrictions to cross-border corporate mobility. It has held that the objective of abolishing restrictions on freedom of establishment, which is assigned in very broad terms to the Council and the Commission by Article 44(1) EC Treaty, cannot be confined by the list of Article 44(2) EC Treaty. Article 44(2) EC Treaty merely sets out a non-exhaustive list of measures to be adopted in order to attain that goal of revoking barriers to freedom of establishment, as is inferred by the use in that provision of the words 'in particular'.³⁹⁰ The agenda of the EU institutions could not be limited by the list of Article 44(2) EC Treaty and they can draw up new legislative measures not included in this non-exhaustive list. Hence, the EU institutions are free to organize their policy and to expand their legislative action into new areas which contain potential barriers to freedom of establishment. However, the requirement of contribution to the effective functioning of the common market as stipulated above should be respected anyway by the European legislature. Of course, it should be recalled that this competence in the field of company law harmonization shall comply with the principles of subsidiarity, of attributed competence and of proportionality (Article 5 EC Treaty) as analyzed by the relevant case law.

The Commission adopted in June 1985 the White Paper entitled *Completing the Internal Market*³⁹¹, setting out an extensive programme with a view to eliminating all the remaining barriers. The White Paper classed the barriers in three categories:

³⁹⁰ Case C-97/96 *Daihatsu* [1997] ECR I-6843 paras. 18, 21.

³⁹¹ *Completing the Internal Market: White Paper from the Commission to the European Council* (Milan 28-29 June 1985) COM/85/0310 FINAL. D. A. Wyatt and A. Dashwood (n 46) 914-916. An early consideration of the market integration of investment services: P. Clarotti 'The completion of the internal financial market: current position and outlook' in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 1.

physical, technical and fiscal.³⁹² The Single European Act added Article 8a, 8b and 8c to the EEC Treaty (now Article 14(1) EC Treaty) which obliged the Community to propose measures ‘with the aim of progressively establishing the internal market over a period expiring on 31 December 1992’.³⁹³ In the current consolidated version of the EC Treaty, Article 14 (2) EC Treaty defines the ‘internal market’ as ‘an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty’. Article 14 (1) EC Treaty refers to potential legal bases for the measures listed in the White Paper.³⁹⁴ Article 95 EC Treaty constitutes a key provision for the harmonization of the internal market because it provides the basis to adopt, by qualified majority voting in the Council, the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their goal the establishment and functioning of the internal market.³⁹⁵

³⁹² K. Lenaerts and P. Van Nuffel (n 365) 142.

³⁹³ K. Lenaerts and P. Van Nuffel (n 365) 143. K. Mortelmans ‘The Common Market, the Internal Market and the Single Market, What’s in a market?’ (1998) 38 CMLRev.101, 102-108. M. Clough and N. Forwood ‘The Single European Act and free movement: legal implications of the provisions for the completion of the internal market’ (1986) 11 ELRev 383, T.C. Hartley and others (eds) *The legal foundations of the Single European Market* (OUP, Oxford 1991), L.W. Gormley ‘The internal market: history and evolution’ in N.N. Shuibhne *Regulating the Internal Market* (Elgar, Cheltenham 2006) 19, P. Craig (n 384) 14. For an evaluation of the progress of market integration since the end of the 1992 deadline and an evaluation of the application of internal market law by Member States: S. Weatherill *Cases and Materials on EU Law* (8th ed OUP, Oxford 2007) 299, 304. For a political perspective: C. Hay and A. Menon *European Politics* (OUP, Oxford 2007) 160, R. D. Kelemen and A. Menon ‘The politics of EC Regulation’ in S. Weatherill (ed) *Better Regulation* (Hart, Oxford 2007) 175.

³⁹⁴ K. Lenaerts and P. Van Nuffel (n 365) 143. Article 14 did not generate a *stricto sensu* direct effect, as this would be a step too far for the Member States at the time of the adoption of the Single European Act when this provision was inserted in the Treaty. D. Mavromati (n 291) 17. In *Wijsenbeek* (Case C-378/97 *Wijsenbeek* [1999] ECR I-6207), the ECJ declared that Article 14 EC Treaty aims at the creation of new Community rules for the completion of the internal market and that Article 14 EC Treaty has no independent deregulatory effects. In the absence of harmonization, no obligations for the Member arise based on Article 14 EC Treaty and Article 14 EC Treaty could have no direct effect after the expiry of 1992 deadline. In *Echirolles Distribution* (Case C-9/99 [2000] ECR I-8207), the ECJ adopted a similar view on the direct effect of Article 14 EC Treaty, this time within the framework of free movement of goods. D. Chalmers and others, *European Union Law* (CUP, Cambridge 2006) 467. P. Craig (n 384) 34.

³⁹⁵ K. Lenaerts and P. Van Nuffel (n 365) 143.

6.5) Differences between the common market and the internal market.

The common market and the internal market are different. The main difference between the internal and the common market lays in their respective scopes. The purpose of the internal market is to abolish restrictions to the free movement of goods, persons, services and capital (Article 3 (1)(c) EC Treaty) at EU level and thus has a more limited scope than the common market.³⁹⁶ The White Paper which launched the internal market does not cover competition, agricultural or transport policy.³⁹⁷ As a result, the harmonization measures based on Article 95 will cover only a part of the legislative measures required for the establishment of the common market as proclaimed by Article 3(1)(h).³⁹⁸ With regard to free movement of companies, Article 95 (2) EC Treaty should not be neglected. According to this latter provision, Article 95 EC Treaty shall not apply to the free movement of persons including the freedom of establishment of companies. In fact, the internal market realizes the core of the common market within the meaning of Article 2 EC Treaty by means of a more flexible harmonization procedure, which reveals an evolution of the regulatory techniques and the intentions of the European legislature.³⁹⁹

³⁹⁶ K. Lenaerts and P. Van Nuffel (n 365) 143. L. W. Gormley stresses that a point of particular concern in the ECJ's reasoning is the continuing failure to distinguish between the concept of a common market and the concept of the internal market and to establish some explicit criteria for this diversification. The limits between the four fundamental freedoms and the elimination of distortions of competition have not been clarified. L. W. Gormley 'Competition and Free Movement: Is the Internal Market the Same as a Common Market?' [2002] EBLR 517, 517.

³⁹⁷ K. Lenaerts and P. Van Nuffel (n 364) 143.

³⁹⁸ K. Lenaerts and P. Van Nuffel (n 365) 143.

³⁹⁹ K. Lenaerts and P. Van Nuffel (n 365) 143-144. Advocate General Tesouro states that the notion of internal market is based on that of the common market (Opinion of Advocate General Tesouro Case C-300/89 *Commission of the European Communities v Council of the European Communities (Titanium Dioxide)* [1991] ECR I-2867).

CHAPTER 7

THE RELATIONSHIP BETWEEN THE TREATY PROVISIONS ON FREEDOM OF ESTABLISHMENT OF COMPANIES AND TAKEOVER BIDS.

7.1) Harmonization of Takeover Bids at EU level: a few regulatory considerations.

The foundation of the business regulatory regime is that free markets alone together with the already established sets of rules of contract law, tort law and fiduciary duties will not remedy the various problems and deficiencies of the corporate and financial market so that detailed legislative intervention is necessary (see also the doctrinal battle between regulatory capitalism v/s free market ideology).⁴⁰⁰ It could be argued that, for various reasons, there is satisfactory international consensus on business regulation (at least on the central tenets and principles, e.g. shareholders' protection rationale).⁴⁰¹ The general assumption of commercial laws and company laws of industrialized countries is to find an organizational form suitable to the economic activity of the types of firms conducting business within that market.⁴⁰² Company law should reconcile the various conflicting interests of shareholders, creditors, employees and the public.⁴⁰³

Although takeovers are a private law matter, their regulation has generated legal and

⁴⁰⁰ P. Wood *Law and Practice of International Finance* (Sweet & Maxwell, London 2008) 341. See also G. Visentini and M. Musolino 'The financial system and institutions' in M. van Empel (ed) *Financial Services in Europe* (Wolters Kluwer, AH Alpen aan den Rijn 2008). See also a very interesting recommendation for the establishment of a World Financial Authority: J. Eatwell 'New Issues in International Financial Regulation' in E. Ferran and C. Goodhart (eds) *Regulating Financial Services and Markets in the Twenty First Century* (Hart, Oxford 2001) 235-236.

⁴⁰¹ P. Wood (n 400) 24, M. Siems *Convergence in Shareholder Law* (CUP, Cambridge 2008). It was argued that, in the EU, convergence of corporate governance regimes is a two way process. Continental Member States adopt certain features of the Anglo-American model of corporate governance and the UK incorporates through directives many elements of the continental social model affecting corporate governance structures. P. Burbidge (n 346) 642. For market-driven approximation of corporate governance and a critical discussion: K. Hopt 'Common Principles of Corporate Governance in Europe?' and E. Wymeersch 'Convergence or Divergence in Corporate Governance Patterns in Western Europe?' in J. McCahery and others (eds) *Corporate Governance Regimes* (OUP, Oxford 2002) 176 and 230.

⁴⁰² R. Buxbaum and K. Hopt (n 80) 174.

⁴⁰³ The differences among various national company laws are not the outcome of an ideological conflict, except for the parts of worker participation in the company's management and the representation of the public interest in the firms. R. Buxbaum and K. Hopt (n 80) 174.

economic controversies in Europe because it influences general economic policy, the efficient functioning of large companies, stock-exchange financing and the impact of the shareholders, especially of the institutional investors, on the fate of the company.⁴⁰⁴ On the one hand, it is argued that takeovers are a very positive market mechanism for the welfare of shareholders whereby management is submitted to a disciplinary structure and wealth is reallocated in an efficient way; on the other hand, takeover bids are characterised as a new unacceptable face of capitalism.⁴⁰⁵ The justification for the launch of defensive measures available to a company's board which plans to frustrate a takeover bid depends on one's point of view. One stance towards takeovers claiming their liberalization supports the protection of shareholders' interests; the other stance calling for the permission of defensive measures gives priority to the interests of the employees, of the managers and the company as a whole.⁴⁰⁶ The adoption of defensive tactics could also be determined in accordance with the general interest and the macroeconomic point of view.⁴⁰⁷ Disagreements arise regarding the means of achieving and realizing those tenets, goals and principles. The purposes of business regulation include among others: protection against systemic risk, protection against insolvency of firms, protection of the public and unsophisticated investors, maintaining a level-playing field, prevention of crime, public confidence and abolition of various psychological obstacles, awareness and education of the public and market participants, information transparency and disclosure, delegation of monitoring and enforcement and agency problem.⁴⁰⁸

⁴⁰⁴ E. Wymeersch (n 124) 292.

⁴⁰⁵ E. Wymeersch (n 124) 292-293.

⁴⁰⁶ W.J. Slagter 'Takeovers and the Draft 13th EC-Directive' in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New York 1994) 174.

⁴⁰⁷ W.J. Slagter (n 406) 174.

⁴⁰⁸ P. Wood (n 400) 342-343.

Among those purposes, the most important purpose constituting one of the basic rationales of the Takeover bid Directive is the establishment of a level playing field in the EU market for corporate control. The theory of the level playing field is that companies should bear the same regulatory costs as those in other Member States so that lesser and less intensive regulation in one Member State does not confer an unfair competitive advantage on that Member State's companies and financial entities to the detriment of the stability and efficiency of the EU and global financial system and of the internal market in general.⁴⁰⁹ However, intensive and tough regulation could also result in protectionism rather than equality because new market players would find difficulties in entering to the market and in complying with the strict business regulatory requirements.⁴¹⁰ The Winter group had stressed the lack of a level playing field for takeovers. Moreover, the B. Dauner-Lieb & M. Lamandini Report to the European Parliament on the Commission's new proposal of a directive on company law concerning Takeover Bids had also insisted on the establishment of a level playing field.⁴¹¹ Shareholders from different Member States do not have equivalent opportunities to sell their shares and takeovers could not be launched with the same expectation of success in different Member States.⁴¹² In the EU market for corporate control, investors must be free to put their money into shares and debentures of EU corporations and thus, first to establish themselves in another Member State and secondly, to provide the necessary capital for the development and expansion of those companies.⁴¹³ The Winter group proposed that a level playing field must respect the

⁴⁰⁹ P. Wood *Regulation of International Finance* (Law and Practice of International Finance Series, 1st ed. Sweet & Maxwell, London 2007) 30. For an empirical and comparative approach of the role of takeover bid regulation: E. Wymeersch (n 124) 312-320.

⁴¹⁰ P. Wood (n 409) 30.

⁴¹¹ Dauner-Lieb & M. Lamandini, Report to the European Parliament on the Commission's new proposal of a directive on company law concerning Takeover Bids (Dec. 2002) < http://www.uni-koeln.de/jur-fak/lbrah/pdf_docs/gutachten_daunerlieb_lamandini_en.pdf > accessed 25 Oct. 2008.

⁴¹² J.L. Hansen (n 302) 280.

⁴¹³ C.M. Schmitthoff (n 93) 7.

principles of shareholder decision-making and of proportionality between risk-bearing capital and control.⁴¹⁴

The 2000 Lisbon European Council placed this directive, which forms part of the Financial Services Action Plan⁴¹⁵, among the priorities as regards the integration of European financial markets because it would facilitate pan-European restructuring and so contribute to making Europe the most competitive, knowledge-based economy in the world by 2010.⁴¹⁶ This view is shared by UNICE⁴¹⁷, which has repeatedly stressed the need for a common framework for cross-border takeover bids. The European Parliament recognised that a directive would be useful and important in this field.⁴¹⁸ In these circumstances, the Commission considered it essential to provide a European framework for cross-border takeover bids as part of the Financial Services Action Plan.⁴¹⁹ One important goal of the economic policies of Member States is the assurance of a smooth and efficient flow of capital from savings to investment.⁴²⁰ A prerequisite of this is easy access to securities markets for provision of the necessary capital; efforts were launched by the EU in establishing a properly integrated pan-European financial market with numerous benefits for issuers, (retail and wholesale)

⁴¹⁴ J.L. Hansen (n 302) 280.

⁴¹⁵ COM(1999) 232. The so-called Lisbon Agenda was re-launched by the European Commission in 2005. This 'renewed' endeavor tried to revitalize the EU's economic reform agenda from the 2000 Lisbon Council. There was definitely a need for action as 5 years after its launch, the Lisbon Agenda was not providing the desired benefits for European integration. Communication of the Spring European Council 'Working together for growth and jobs, a new start for the Lisbon strategy' COM (2005) 24, 2, Communication from the Commission to the Council and the European Parliament 'Common actions for growth and employment: The Community Lisbon Programme' COM (2005) 330, 2.D. Weber-Rey (n 291) 249.

⁴¹⁶ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (Explanatory Memorandum, Legislative Financial Statement, Impact Assessment Form) COM (2002) 534 final, OJ [2003] 45E/1, 1. M. Maquil 'The integration of the securities markets in Europe' in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New York 1994) 157. For a critical evaluation of the post-FSAP regulatory landscape: L. Enriques and M. Gatti 'Is There a Uniform EU Securities Law After the Financial Services Action Plan?' (2007) SSRN Working Paper <<http://ssrn.com/abstract=982282>> accessed 9 November 2008.

⁴¹⁷ UNICE (Union of Industrial and Employers' Confederations of Europe).

⁴¹⁸ COM (2002) 534, 1

⁴¹⁹ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (Explanatory Memorandum, Legislative Financial Statement, Impact Assessment Form) COM (2002) 534 final, OJ [2003] 45E/1, 1.

⁴²⁰ E. Ferran (n 340) 1.

investors, the rest of market participants and the national and EU economy economy as a whole.⁴²¹ The Financial Services Action Plan was an attempt by the European Commission to equip the Community better to meet the challenges of monetary union and to capitalise on the potential benefits of an integrated market in financial services constituting a major component of the internal market project.⁴²² We should not forget that the 1985 White Paper on completing the internal market (paragraphs 102-109) places the liberalization of financial services in a key position for the integration of EU capital markets.⁴²³

The Directive has two main objectives: to give a legal framework for takeovers in Europe and to ensure an adequate level of protection for minority shareholders across the EU in the case of a change of company control. Takeover bids and cross-border mergers can contribute to the development and reorganisation of European firms which is a key condition for withstanding international competition and developing a single capital market.⁴²⁴ Takeover bids, before the adoption of the Takeover bid Directive, were subject to very divergent national rules and gave rise to numerous problems when they involved two or more Member States (e.g. as to the law applicable and the competent authorities).⁴²⁵ These uncertainties for market access and the subsequent psychological obstacles to cross-border establishment are not acceptable within the European Union.⁴²⁶ The Takeover bid Directive, together with the general legislative goals of integrating European financial markets and markets of corporate control according to the Financial Services Action Plan and undertaking harmonisation aiming at corporate restructuring, sets out to combat psychological obstacles hindering cross-

⁴²¹ E. Ferran (n 340) 1.

⁴²² E. Ferran (n 340) 1.

⁴²³ R. Buxbaum, G. Hertig and others (eds) (n 97) 7

⁴²⁴ COM (2002) 534, 3.

⁴²⁵ COM (2002) 534, 3. An empirical research about some national takeover bids at the end of 1980s, early in 90s, see: E. Wymeersch (n 124) 292-293.

⁴²⁶ COM (2002) 534, 3.

border takeover bids in the interests of all parties concerned and to ensure protection for minority shareholders⁴²⁷ in the course of such transactions, as is proclaimed by the legal basis for company law harmonization(Article 44(2)(g) EC Treaty: ‘members and others’).⁴²⁸ It establishes a framework for action by Member States by laying down certain principles and a limited number of general requirements while allowing Member States to adopt the detailed implementing rules in accordance with their national practices, provided that the differences are not such as to jeopardise implementation of the directive at Community level. It is a ‘framework’ directive following the structure of the 1996 proposal compared with the 1989 proposal containing many detailed provisions.⁴²⁹

7.2) The Conduct of a Takeover Bid Involves an Exercise of the Right of Establishment.

Freedom of establishment of legal persons is closely related to cross-border acquisitions. Holding or acquiring shares in a company across national frontiers can involve exercise of both of the right of establishment and the right of capital movement where the shareholding gives the investor definite influence over the company’s decisions and allows the investor to determine its activities; where the cross-frontier investment does not give to investor such influence it is known as portfolio investment and falls solely under the Treaty provisions on capital movement.⁴³⁰ The pertinence of

⁴²⁷ With respect to English law on minority shareholders after the Companies Act 2006: V. Joffe, QC and others *Minority Shareholders, Law, Practice and Procedure* (3rd ed., OUP Oxford 2008).

⁴²⁸ COM (2002) 534, 3.

⁴²⁹ COM (2002) 534, 3. An interesting discussion in the period immediately after the release of the 1989 proposal could be found in: R. Buxbaum, G. Hertig and others (eds) (n 97) 375.

⁴³⁰ D. A. Wyatt and A. Dashwood (n. 46) 838. See also Case C-251/98 *Baars* [2000] ECR I paras. 21-22.

company law harmonization to cross-border acquisitions and corporate establishment is that the Treaty basis for such harmonization is the chapter on establishment (Article 44 (2)(g) EC Treaty).⁴³¹ The rationale of company law harmonization is not to harmonize company law for its own sake but to remove obstacles to the cross-frontier activities of individuals and companies.⁴³² On the one hand, mergers and acquisitions fall within the scope of directly applicable Treaty provisions on freedom of establishment and on free movement of capital; on the other hand, the European legislature might harmonize them in compliance with the existing framework of company law harmonization.⁴³³ An individual or company seeking to acquire such a controlling holding conferring influence over a target company would also fall within the scope of the right of establishment and this justifies the adoption of a Directive on Takeover Bids removing any restrictions to cross-border takeover bids.⁴³⁴ The market for corporate control is a part of the internal market and thus its integration is a prerequisite for the integration of the other.

⁴³¹D. A. Wyatt and A. Dashwood (n 46) 838

⁴³²D. A. Wyatt and A. Dashwood (n 46) 838

⁴³³D. A. Wyatt and A. Dashwood (n 46) 838

⁴³⁴D. A. Wyatt and A. Dashwood (n 46) 850. The differences between the incorporation theory and the real seat theory create problems to the European corporate mobility and the exercise of the right of establishment by companies. The significance of this corporate mobility case law will be analyzed below in the next chapter. For that case law, a recommended analysis could be found in: D. A. Wyatt and A. Dashwood (n 46) 839-851, R.R. Drury 'Migrating companies' (1999) 24 (4) ELR 354.

CHAPTER 8

THE SIGNIFICANCE OF THE CORPORATE MOBILITY CASE LAW FOR THE TAKEOVER PROCESS.

8.1) Corporate mobility case law and takeover bids: introductory remarks.

The contribution of the ECJ's case law and of secondary legislation played also an important role in the interpretation of the freedom of establishment and particularly the freedom of establishment of companies. C. Timmermans has commented on EU company law harmonization that 'the internal market has been completed, without completion of the harmonization of company law. That would give the impression that the one does not need the other. So, it seems, the internal market can function without further harmonization of company law'.⁴³⁵ A company will definitely consider the potential costs that will have to be incurred in order to expand its activities to another Member State; if this expansion appears attractive, it may well proceed notwithstanding the lack of any harmonisation which facilitates access to the market of the other (host) Member State.⁴³⁶ However, in the EU market for corporate control, harmonization was deemed to be essential because of wide legal diversity and opposing doctrinal approaches. In some Member States, takeovers and subsequent mergers could not be conducted or could only be conducted very onerously due to the possibility of pre- or post-bid takeover barriers. A company planning to take over a company registered in another Member State and thus to establish itself in this latter Member State would be deprived of this method of establishment. An offeror company could not exercise

⁴³⁵ C. Timmermans (n 385) 627, S.J. Moran 'Establishing Establishment-A Modern Chimera. An Investigation into Securing the Right of Establishment for Companies within the Internal Market of the European Community' (2007) 15 IrSLR 149. For an early in depth overview of the ECJ's case law on companies: T. Tridimas (n 44) 335.

⁴³⁶ S.J. Moran (n 435) 150.

effectively its fundamental right of establishment by taking over a target company registered in another Member State. Therefore, the European legislature should introduce some minimum standards for the exercise of this aspect of the freedom of establishment, i.e. the facilitation of cross-border establishment by means of a takeover. The Takeover Bid Directive (at least in its proposed form) was trying to establish a level playing field by abolishing such distortions in the market of corporate control.

Freedom of establishment aims at removing obstacles to the free circulation of companies at EU level and thus contributes to the creation of the internal market. Removal of obstacles could ensure that companies are recognized in other national legal orders, could assist companies in having the same freedom to act in all Member States (e.g. by launching takeover bids, by acquiring shares and, in general, by participating in the European market for corporate control), could guarantee the possibility of cross-border mergers and could facilitate companies' freedom to move from one state to another, especially by way of transferring their seat.⁴³⁷ As far as the role of case law in this market integration process is concerned, the object of the interpretation of the freedom of establishment by the ECJ and of the harmonising company law is to ensure that companies can exercise efficiently this fundamental freedom to establish themselves in other Member States. This choice of companies to establish themselves in other Member States should be accompanied by the necessary flexibility required by corporate restructuring, should not be disadvantaged due to the cross-border nature of their establishment, and should not incur excessive high costs or burdensome formalities which could potentially result in obstacles (e.g. Dutch legislation in *Inspire Art*).⁴³⁸

⁴³⁷ E. Wymeersch (n 91) 158, 162.

⁴³⁸ E. Wymeersch (n 106) 19.

Takeover bids are another method of corporate restructuring at EU level which falls within the scope of these considerations. It is a corporate financial technique which assists one company (the bidder) in becoming established in another Member State by acquiring the control of another company. This consolidation of corporate businesses at EU level contributes significantly to the creation of economies of scale and to a more efficient allocation of resources. Hence, takeover bids, as a method of cross-border corporate establishment, are closely related to some aspects of the corporate mobility jurisprudence. We will discuss here the relationship between the corporate mobility case law of the ECJ and cross-border takeover bids.

8.2) The impact of *SEVIC* on cross-border mergers and takeover bids.

As will be explained in chapter 10 ('Scene setting: the mechanics and tensions of takeovers'), a takeover bid is a method for achieving a merger. Merger is the absorption of one company by another, the latter retaining its own name and identity and acquiring assets, liabilities franchises and powers of the former, and the absorbed company ceasing to exist as separate business entity. It differs from a consolidation wherein all the corporations terminate their existence and become parties to a new one.⁴³⁹ A merger could be the ultimate and desirable result of a takeover; the decision for a merger between an offeror and an offeree company could be taken by the offeror company after a successful takeover bid. Hence, the effect of *SEVIC*⁴⁴⁰ could be proved very important for Takeover Bids. In this case, a German company (SEVIC) tried to merge with a Luxembourg company (Security Vision SA) with absorption of the latter by the former. As a result, all the assets of Security Vision would be transferred to SEVIC without liquidation and Security Vision would cease to exist. However, the case was

⁴³⁹ H.C. Black (n 82) 891.

⁴⁴⁰ Case C-411/03 *SEVIC Systems AG*. [2005] ECR I-10805. It should be clarified that seat transfers will be discussed only as far as they are related to takeovers and mergers.

brought before the ECJ because German law allowed only domestic mergers and did not permit cross-border mergers. Therefore, SEVIC could not merge with Security Vision SA because cross-border mergers were not permitted in Germany. Many similarities between mergers and takeovers as means of achieving corporate restructuring and modernization on EU level could be found in the opinion of AG Tizzano⁴⁴¹. AG Tizzano alleged that the instrument of merger is a particularly effective means of transforming a company in so far as it makes it possible, within the framework of a single operation, to pursue a particular activity in new forms and without interruption, thereby reducing considerably the complications, delay and costs associated with other forms of company consolidation such as those which entail, for example, the dissolution of a company with liquidation of assets and the subsequent formation of a new company, the transfer of individual assets, and the exchange of title deeds, etc. It is well-known that those benefits and advantages are also characteristics of a takeover bid which aims primarily at corporate restructuring and enhancement of the performance and competitiveness of European companies. The Takeover Bid Directive (at least in its proposed form by the Commission) offers EU companies greater legal certainty for cross-border takeover bids in the interests of all concerned, including their employees, and to protect minority shareholders where control of a company changes hands. Internal Market Commissioner F. Bolkestein characterised the Takeover Bid Directive as an essential step towards the objective of fully integrating European capital markets by 2005 and as a key element in our drive to make Europe the most competitive economy in the world by 2010.⁴⁴²

It is possible to argue that some of the conclusions of the *SEVIC* on cross-border mergers could be applied to a cross-border takeover bid. The ECJ stated that, as the

⁴⁴¹ [2005] ECR I-10805

⁴⁴² IP/02/1402

Advocate General points out in point 30 of his Opinion, the right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators.⁴⁴³ It is possible to draw an analogy with takeover bids which are also characterized by those features of access to the market of another Member State (here market for corporate control and securities markets in general) and to the participation in the economic life of the country (by investing and bidding for another company and possibly controlling this company). Even if takeover bids are considered as just a mean of entering the market of another Member State and of pursuing an economic activity through the acquired company, they still fall within the protective scope of the freedom of establishment. AG Tizzano, in paragraph 29 of his Opinion, reminds us that the ECJ subjected to freedom of establishment of companies not only the national rules relating directly and specifically to the pursuit of the economic activity in question but also all those ‘relating to the various general facilities which are of assistance in the pursuit of those activities’.⁴⁴⁴ Takeover bids could also constitute such various general facilities (corporate financial methods) contributing to the pursue of this economic activity and to the participation, on a stable and continuous basis, in the economic life of another Member State (the offeror company establishes itself in the new Member State through the acquisition of the target company). The ECJ also confirmed the direct effect of Treaty provisions on freedom of establishment by stating that whilst Community harmonisation rules are useful for facilitating cross-

⁴⁴³ Case C-411/03 *SEVIC Systems AG*. [2005] ECR I-10805 para. 18. It is also notable that the ECJ’s approach presents many similarities with the approach followed in *Factortame II* (Case C-221/89 [1991] ECR I-3905) especially the reference to the ‘actual pursuit of an economic activity’. S.J. Moran (n 435) 155.

⁴⁴⁴ Previous case law: Case C-55/94 *Gebhard* [1995] ECR I-4165, para. 25, Case 63/86 *Commission v Italy* [1988] ECR 29, para. 14, and Case 305/87 *Commission v Greece* [1989] ECR 1461, para. 21.

border mergers, the existence of such harmonisation rules cannot be made a precondition for the implementation of the freedom of establishment laid down by Articles 43 EC and 48 EC Treaty.⁴⁴⁵ The same could be alleged for the takeover process as such, outside the framework of its regulation by the Takeover Bid Directive, which falls directly within the protective scope of the freedom of establishment.

In *SEVIC*, the ECJ stated that Articles 43 and 48 EC Treaty preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State. AG Tizzano in his opinion in *SEVIC* stated that Articles 43 and 48 EC Treaty preclude legislation of a Member State such as the German Legislation (*Umwandlungsgesetz*) which does not permit registration in the national register of companies of mergers between companies established in that Member State and companies of other Member States. By permitting cross-border mergers, the ECJ provides an additional incentive for listed companies to get engaged to takeover bids. The companies know that after a successful takeover bid, they will not confront any problems if they plan to merge with the target company which was taken over. The implications of the *SEVIC* case law allow offeror companies to realize their strategic plans of merging with the offeree company. This case law broadens the scope of post-takeover choices and adds another possibility for companies which plan to launch a tender offer: the bidder and the target can merge into a single company and consolidate their respective businesses. In the Takeover Bid Directive and the Cross-

⁴⁴⁵ See, to that effect, Case C-204/90 *Bachmann* [1992] ECR I-249, para. 11.

border Mergers Directive, the goal of the European legislature was to promote the combined use of those two corporate financial instruments in order to result in a more efficient method of corporate restructuring on EU level. The one complements the other and the one is essential for the success of the other.

The ECJ, in *SEVIC*, hold that national legislation must not discriminate between cross-border and domestic mergers. An extension of this reasoning to takeover bids is inevitable because mergers and takeovers constitute the two pillars of the mergers and acquisitions market which is caught by the freedom of establishment.⁴⁴⁶ Discriminatory national rules of a Member State prohibiting or obstructing a company registered in another Member State from launching a cross-border takeover bid for a company registered in that former Member State are definitely precluded in accordance with *SEVIC*.⁴⁴⁷

8.3) The contribution of *Überseering* to a cross-border takeover process.

The financial transaction from which the facts of *Überseering*⁴⁴⁸ originate presented many similarities to a takeover. This case law presents great interest for the examination of some post-takeover situations. *Überseering* was a company incorporated in the Netherlands and having its registered office there. It bought land in Germany and concluded a contract with a company which was supposed to renovate and refurbish its acquired property in Germany. *Überseering* alleged that the

⁴⁴⁶ M. Siems 'SEVIC: Beyond Cross-Border Mergers' (2007) 8 EBOR 307, 315.

⁴⁴⁷ M. Siems (n 446) 315.

⁴⁴⁸ Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919

refurbishment was defective and brought an action against that company before the German courts. The action was dismissed as inadmissible both at first instance and at second instance because after the incorporation of the company in the Netherlands, all the shares of *Überseering* had been acquired by two German nationals, residing in Germany. As a result, this company incorporated and registered in Netherlands had transferred its centre of management/administration and thus its real seat, to Germany. According to German rules of private international law the legal capacity of a company has to be determined by the law at the place of the real seat (in this case German law). As *Überseering* had not implemented German law governing the formation of companies, it had no legal personality and thus no capacity to exercise its right and to appear before a German court. If the company would like to bring a case before a German court, it would have to reincorporate in Germany.⁴⁴⁹ In *Überseering*⁴⁵⁰ the ECJ ruled that where a company formed in accordance with the law of a Member State in which it has its registered office is deemed, under the law of another Member State, to have moved its actual centre of administration to the latter Member State, Articles 43 and 48 EC Treaty preclude the latter Member State from denying the company legal capacity and, consequently, the capacity to bring legal proceedings before its national courts for the purpose of enforcing rights under a contract with a company established in the latter Member State. As far as the compatibility of German conflict of laws rules with freedom of establishment is concerned, the refusal by a host Member State to recognise the legal capacity of a company formed in accordance with the law of another Member State in which it has its registered office on the ground, in particular, that the company moved its actual centre of administration to the host Member State following the acquisition of all its shares by nationals of that State residing there, with the result

⁴⁴⁹ P. Dyrberg (n 14) 531.

⁴⁵⁰ Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919 para. 95.

that the company cannot, in the host Member State, bring legal proceedings to defend rights under a contract unless it is reincorporated under the law of the host Member State, constitutes a restriction on freedom of establishment which is, in principle, incompatible with Articles 43 and 48 EC Treaty (paragraph 82). Moreover, where a company formed in accordance with the law of a Member State in which it has its registered office exercises its freedom of establishment in another Member State, Articles 43 and 48 EC Treaty require the latter Member State to recognise the legal capacity and, consequently, the capacity to be a party to legal proceedings which the company enjoys under the law of its State of incorporation.

Uberseering had the right to invoke freedom of establishment in order to challenge German legislation which did not consider it as a legal person competent to bring a case before a German court.⁴⁵¹ The acquisition of Uberseering's shares and the subsequent *de facto* control over this company fall within the protective scope of freedom of establishment of companies. In this judgment, the ECJ confirmed that *Baars* findings also apply here.⁴⁵² The ECJ characterised, in *Uberseering*, these conclusions of *Baars* as a 'general rule'. In *Baars*, the ECJ stated that a 100% holding in the capital of a company having its seat in another Member State undoubtedly brings such a shareholder within the scope of application of the Treaty provisions on the right of establishment. It is clear from the second paragraph of Article 43 EC Treaty that freedom of establishment includes the right to set up and manage undertakings, in particular companies or firms, in a Member State by a national of another Member State. So, a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the

⁴⁵¹ Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919 para. 76.

⁴⁵² Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919 para. 77.

company's decisions and allows him to determine its activities is exercising his right of establishment.⁴⁵³ Finally, in *Uberseering*, the ECJ held that the German requirement of re-incorporation before a company could bring legal proceedings to defend rights under a contract was a restriction on freedom of establishment.⁴⁵⁴

What if *Uberseering* was a listed company⁴⁵⁵? In this case, the acquisition of shares would be an 'upgraded' capital market transaction, i.e a takeover. The Takeover Bid Directive defines the offeror as 'any *natural* or legal person governed by public or private law making a bid' (emphasis added). Thus, it would be possible an acquisition of a company's listed shares by natural persons who reside in Member State B (as specified by the ECJ's ruling) to qualify for the definition of a takeover bid. Thus, this kind of acquisition of shares fall within the protective scope of the Takeover Bid Directive. However, a takeover bid like this should comply with all the other requirements imposed by the Takeover Bid Directive. The importance of this case law for takeovers lies in the post-bid period. Without this ruling, these natural persons residing in a real seat jurisdiction will be deterred from launching a takeover bid and acquiring the shares of company registered in a jurisdiction which applies the incorporation theory, if they know that the offeree company would not possess any legal rights in their country of residence. Again, this case law encourages takeover bids and share acquisitions by ensuring that the target company will be recognized in the jurisdiction of the bidder. Additionally, the squeeze-out and sell-out rights (Article 15

⁴⁵³ Case C-251/98 *Baars* [2000] ECR I-2787, paras 21-22.

⁴⁵⁴ F. Wooldridge, 'Uberseering: Freedom of Establishment of Companies Affirmed' [2003] EBLR 227, 233.

⁴⁵⁵ A recent case which prohibits the discrimination against listed companies which offer services to a host state is the *Placanica* Case: Articles 43 and 49 EC Treaty must be interpreted as precluding national legislation, which excludes – and, moreover, continues to exclude – from the betting and gaming sector operators in the form of companies whose shares are quoted on the regulated markets. Joined cases C-338/04, C-359/04 and C-360/04, *Criminal proceedings against Massimiliano Placanica (C-338/04), Christian Palazzese (C-359/04) and Angelo Sorricchio (C-360/04)*. [2007] ECR page not yet specified.

and Article 16) of the Takeover Bid Directive could facilitate 100% shareholdings which fall clearly within the scope of freedom of establishment.

Article 11 (2)(b) of the Takeover Bid Directive provides the possibility to the bidder to amend the articles of association and remove the target company's board after acquiring 75% or more of the capital carrying voting rights. Article 11 (2)(b) states that where, following a bid, the offeror holds 75% or more of the capital carrying voting rights, no restrictions on the transfer of securities or on voting rights nor any extraordinary rights of shareholders concerning *the appointment or removal of board members* provided for in the articles of association of the offeree shall apply; multiple-vote securities shall carry only one vote each at the first general meeting of shareholders following closure of the bid, called by the offeror in order to amend the articles of association or *to remove or appoint board members*. To that end, the offeror shall have the right to convene a general meeting of shareholders at short notice, provided that the meeting does not take place within two weeks of notification (emphasis added). This appointment or removal of board members could result in a transfer of a company's centre of administration or its real seat. If the new members of the board were residents in a real seat jurisdiction, it would be necessary to dissolve the company and to re-incorporate in this jurisdiction. *Uberseering* is related to a situation like this. It is easily understood that without the Court's jurisprudence in *Uberseering* this provision of the Takeover Bid Directive could present many operational problems and deficiencies in its application to situations where the new members of the board reside in real seat jurisdictions. The conclusions of *Uberseering* assist not only the company itself in enforcing its rights and in bringing various cases before the national courts but also its shareholders who plan to start litigation. This is a clear expression of the protection of 'members' stipulated by Article 44 (2)(g) EC Treaty. However, the

importance of *Uberseering* in this context is diminished after *Cartesio*, a recent ruling of the ECJ.

This latter conclusion should be considered in the context of the *Cartesio*⁴⁵⁶ ruling in which the ECJ highlighted that, as Community law now stands, Articles 43 and 48 EC Treaty are to be interpreted as not precluding Member State legislation under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.⁴⁵⁷ The ECJ held that a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.⁴⁵⁸ Therefore, in a takeover bid, if this appointment or removal of board members could result in a transfer of a company's centre of administration or its real seat, it would be necessary to dissolve the company and to re-incorporate in this jurisdiction.

⁴⁵⁶ Case C-210/06 *CARTESIO Oktató és Szolgáltató bt.* [2008] not yet reported.

⁴⁵⁷ Case C-210/06 *CARTESIO Oktató és Szolgáltató bt.* [2008] not yet reported para .124.

⁴⁵⁸ Case C-210/06 *CARTESIO Oktató és Szolgáltató bt.* [2008] not yet reported para. 110.

8.4) Application of *Centros* and *Inspire Art* case law to a post-takeover bid situation.

Another corporate mobility case which presents an indirect link to takeover bids in *Centros*⁴⁵⁹. This case law widens the available routes of corporate restructuring and consolidation that companies could track after a successful takeover bid. In that case the ECJ had stated that it is contrary to Articles 43 and 48 EC Treaty for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business where the branch is intended to enable the company in question to carry on its entire business in the Member State in which that branch is to be created, while avoiding the need to form a company there, thus evading application of the rules governing the formation of companies which, in that State, are more restrictive as regards the paying up of a minimum share capital (this case involved differences between minimum capital requirements established by the Second Company Law Directive). Given that the right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty, the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment.⁴⁶⁰ Companies have now a right to take advantage of the most business

⁴⁵⁹ Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

⁴⁶⁰ Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459, paras. 27 and 39. See also: P. Cunha and P. Cadral 'Presumed Innocence': Companies and the exercise of the right of establishment under Community Law' [2000] ELRev. 157, 162, E. Vaccaro 'Transfer of Seat and Freedom of Establishment in European Company Law' [2005] EBLR 1348, 1353, A. Roussos 'Realising the Free Movement of Companies' [2001] EBLR 7, 12, G. Simen Gravir 'Conflict of Laws Rules for Norwegian Companies after the Centros Judgement' [2001] EBLR 146, 149, J. L. Hansen 'A New Look at Centros-From a Danish Point of View' [2002] EBLR 85, 93.

friendly environment in which to establish their companies. The ECJ's decision is quite impressive for its acknowledgement of the rights of natural or legal persons to choose the least restrictive corporate form of those available in the Member States as the vehicle of their cross-border investments and expansions.⁴⁶¹ This case is very useful for an offeror company which decides to choose the most appropriate legal form for the offeree company after a successful takeover bid. After a successful takeover bid, the acquired target company becomes subsidiary⁴⁶² of the offeror company. The offeror company controls now the newly acquired target company and can decide on the form whereby this latter company would continue its business activities. These two companies could preserve their current corporate forms as separate companies or they could merge into a single company. In that case of a subsequent merger, the acquired target company could be possibly transformed into a branch⁴⁶³ of the offeror company. If the offeror company follows the example of *Centros* and decides to carry almost all of their activities through this branch, the Member State of this branch could not restrict this exercise of the right of secondary establishment by not recognising this branch and by refusing its registration.⁴⁶⁴ Member States should respect the right of EU entrepreneurs to choose the corporate form⁴⁶⁵ that they consider more convenient for their conduct of business on cross-border level and to take all the necessary legal steps

⁴⁶¹ See also: D. A. Wyatt and A. Dashwood (n 46) 842. The ECJ also clarified that harmonization was not necessary for this exercise of the right of establishment.

⁴⁶² N. Moloney (n 108) 805.

⁴⁶³ Branch is defined as a division, office, or other unit of business located at a different location from main office or headquarters. H.C. Black (n 82) 170.

⁴⁶⁴ In *Inspire Art* (see next paragraph), the ECJ talked about the prohibition of imposition of additional requirements on the exercise of the right of secondary establishment. The ECJ stated that it is contrary to Articles 43 EC Treaty and 48 EC Treaty for national legislation to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic law in respect of company formation relating to minimum capital and directors' liability.

⁴⁶⁵ Other proposed methods of corporate restructuring and governance which constitute forms of exercising the freedom of establishment are the formulation of a simplified company structure for subsidiaries and joint ventures which is characterised by greater freedom and flexibility in the agreements among parties while no comparable protective attitudes are needed and the creation of a horizontal group. These methods are currently confronting many problems in their realization. E. Wymeersch (n 124) 322-323.

for the realization of this choice. This is just a possible scenario which could take place after a successful takeover bid. However, the offeree company would not have these additional managerial choices of corporate restructuring without *Centros*.

In *Inspire Art*⁴⁶⁶, the ECJ held that harmonisation of the disclosure to be made by branches, as brought about by the Eleventh Company Law Directive 89/666, is exhaustive. Moreover, the ECJ stated that it is contrary to Articles 43 and 48 EC Treaty for national legislation to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the Treaty, save where the existence of an abuse is established on a case-by-case basis. A Member State is certainly entitled to take measures designed to prevent certain of its nationals from attempting, under cover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law. However, the provisions of the Treaty on freedom of establishment are intended specifically to enable

⁴⁶⁶ Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10155. paras 65, 69-70, 72, 143,105, 136-139, 143. Interesting annotations: P.S. Ryan, Case Note Case C-167/01, [2005] ColJEL 187-201.H. Merkt 'European Company Law Reform: Struggling for a More Liberal Approach' (2004) 1 ECFR 3, 20-21, H-J. De Kluiver 'Inspiring a New European Company Law?' (2004) 1 ECFR 121-134, D. Zimmer, Case annotation, [2004] CMLRev. 1127-1140, A. Looijestijn-Clearie 'Have the dikes collapsed? Inspire Act a further break through in the freedom of establishment of companies?' [2004] EBOR p.389-418, H. Hirt 'Freedom of Establishment, International Company Law and the Comparison of the European Company Law Systems after the ECJ's Decision in *Inspire Art Ltd.*' [2004] EBLR 1189-1222, F. Wooldridge 'The Advocate General's Submissions in *Kamer van Koophandel*: Further Emphasis on the Right of Establishment' [2003] EBLR 497-505, A. Schall 'The UK Limited Company Abroad - How Foreign Creditors are Protected after *Inspire Art*(Including a Comparison of UK and German Creditor Protection Rules)' [2005] EBLR 1534-1554.

companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue activities in other Member States through an agency, branch or subsidiary. That being so, the fact that a national of a Member State who wishes to set up a company can choose to do so in the Member State the company-law rules of which seem to him the least restrictive and then set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty. In addition, the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only or principally in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment. This case law confirms that, in the scenario of the previous paragraph, the Member State of the offeree company could not obstruct the offeror company to merge with the offeree company after a successful takeover and, subsequently, to transform the offeree company into its branch and to carry almost all of its activities through this branch.

8.5) Additional standards imposed by capital market law and the importance of corporate mobility case law.

Takeover bids as a financial technique related to both company law and capital market law have an additional significance for the corporate mobility case law of the ECJ. Capital market law could also have a growing regulatory impact on subject matters that

traditionally have been regulated by company law.⁴⁶⁷ National company law in accordance with the corporate mobility case law of the ECJ is responsible for determining the seat of a company incorporated in its jurisdiction. It is possible that capital market law, apart from imposing disclosure requirements, could intervene in the internal corporate governance of companies and could impose additional substantive corporate governance standards for access to capital markets and conduct of business and investments.⁴⁶⁸ These additional requirements imposed by capital market law could not be appropriate for foreign companies which were formed in compliance with a foreign company law. Thus, these foreign companies could find difficulties in accessing some capital markets and benefiting from the flows of those capitals. Capital market law should only draft and impose some general principles of corporate governance which the foreign companies could easily follow by adjusting their corporate structures or should permit foreign companies to derogate.⁴⁶⁹ By allowing capital market law to impose different corporate governance standards to foreign companies, the importance of the ECJ's case law which deduced that company law of a Member State regulates the substantive corporate governance of companies incorporated in that Member State or having moved their registered office to that State, regardless of the jurisdiction they conduct their business in or of the jurisdiction their real seat was moved in, would lose its importance to a great extent.⁴⁷⁰

⁴⁶⁷ J. Winter 'EU Company Law at the Cross-Roads' in G. Ferrarini and others (eds) *Reforming Company and Takeover Law in Europe* (OUP, Oxford 2004) 12-13.

⁴⁶⁸ J. Winter (n 467)12-13.

⁴⁶⁹ J. Winter (n 467)12-13.

⁴⁷⁰ For an extensive analysis of corporate governance structures imposed by capital market law and their consequences, see the following chapter about 'The EU Takeover Bid Directive: an EU Company Law instrument with strong links to EU Capital Markets Law.' J. Winter (n 467) 12-13.

8.6) Conclusion

Both the corporate mobility case law and the Takeover Bid Directive have as their primary aim the promotion of freedom of establishment of companies at EU level. Their starting point is Article 43 EC Treaty. The Takeover Bid Directive is based on Article 44 (2)(g) EC Treaty which tries to attain freedom of establishment (Article 43 EC Treaty) as declared by Article 44 (1) EC Treaty. The corporate mobility case law refers explicitly to the promotion of Article 43 EC Treaty. The corporate mobility case law is crucial for post-takeover situations. The facilitation of corporate mobility and the transfer of the corporate seat by the ECJ's case law could also encourage takeover bids because offeror companies know that they will not find any difficulties in recognising the transfer of an offeree company's seat after a successful takeover bid. This case law provides an additional incentive for takeover bids and contributes to legal certainty and market integration.

CHAPTER 9

THE EU TAKEOVER BID DIRECTIVE: AN EU COMPANY LAW INSTRUMENT WITH STRONG LINKS TO EU CAPITAL MARKETS LAW.

9.1) Company law and capital markets law: an internal market interaction regarding EU Takeover Bids.

Company law and capital market law⁴⁷¹ are two closely related areas of law. This is clear in the case of takeover bids which are financial transactions taking place in a regulated capital market and which involve listed companies. Company law harmonization should also take into account the needs of the capital markets. It could be argued that the harmonization of company law could strengthen capital markets' security, transparency and efficiency because divergent national company law standards (e.g. special classes of publicly traded securities, information asymmetries) have a negative influence on capital markets' transparency.⁴⁷²

Nowadays, capital market law regulates more and more matters of company law. There is a capital market regulatory response to perceived deficiencies in the corporate governance system (e.g. Sarbanes Oxley Act in the U.S.).⁴⁷³ Investors in capital markets started to take into account the internal corporate governance structures of listed companies when contemplating investing in them.⁴⁷⁴ This is the result of the

⁴⁷¹ This covers the interaction between the law and the securities industry. E. Kitch 'Regulation of the Securities Market' in B. Bouckaert and G. De Geest (eds) *Encyclopedia of Law & Economics* (Elgar and the University of Ghent, London 1999) 813. The source of capital market law is found in company law. Capital market law was developed primarily after the 1930's economic crisis. This origin reveals the numerous connections between these two areas of law. R. Buxbaum and K. Hopt (n 80) 189.

⁴⁷² E. Wymeersch (n 91) 158, 173. See also G. Ferrarini 'Introduction' and R. Dale 'The Regulation of Investment Firms in the European Union' in G. Ferrarini (ed) *Prudential Regulation of Banks and Securities Firms* (Kluwer, London 1995) 10 and 27.

⁴⁷³ J. Winter (n 467) 12. For a US perspective on the relationship between company law and capital market law, see: F Cross and R. Prentice *Law and Corporate Finance* (Elgar, Cheltenham 2007)7-21. See also: J. Coffee 'The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' in C. Milhaupt *Global Markets, Domestic Institutions* (ColUP, New York 2003) 437-476.

⁴⁷⁴ J. Winter (n 467) 12. According to the 'Opinion of the European Economic and Social Committee on Financial Integration: The case of European Stock Markets' (own initiative opinion) [2008] OJ C 162/96) the EU institutions should inform the citizens of the EU of the benefits that a harmonized legal

corporate and financial scandals in the global capital markets which were partly caused by poor corporate governance, disclosure and auditor control standards.⁴⁷⁵ This intrusion of capital market law into some areas of company law is very important for encouraging cross-border investments at EU level and integrating the European market for corporate control. This new reach of securities regulation over corporate matters helps EU investors⁴⁷⁶ to base their investment and takeover decisions on a more well-informed basis and to strengthen their trust in EU capital markets. Nevertheless, there is a criticism to be made of this intrusion of capital market law into company law matters when capital market law starts to regulate substantive elements of company law.⁴⁷⁷ It is obvious that there is no difference in substance if a corporate governance standard derives from company law or securities regulation. But from a regulatory perspective there is a difference, particularly because company law and capital market law make different jurisdictional claims.⁴⁷⁸ On the one hand, national company law regulates companies having their real seat or registered office (depending on the adoption of the real seat theory or of the incorporation theory) in that Member State. The place of the business or investment activities is not important for this determination. On the other hand, the main criterion for the implementation of a certain capital market law of a Member State is the active participation of a company in the capital markets of that Member State.⁴⁷⁹ When capital market law of a Member State demands from a foreign company listed in its capital market the adjustment or modification of certain substantive elements of company law, these capital market rules might be incompatible with the foreign company law of that listed company determined by the Member State

framework for dealings in securities would offer them in order to combat the current unwillingness to cross-border capital investments..

⁴⁷⁵ J. Winter (n 467) 12.

⁴⁷⁶ R. Buxbaum and K. Hopt (n 80) 280.

⁴⁷⁷ J. Winter (n 467) 12.

⁴⁷⁸ J. Winter (n 467) 12.

⁴⁷⁹ J. Winter (n 467) 12.

of its seat.⁴⁸⁰ This legislative approach does not contribute to the integration of capital markets because many companies may be deterred from acceding to capital markets which contradict to their ‘home-grown’ corporate governance structures. Capital market regulators should be very careful when they plan to impose any additional company law standards on foreign companies participating in a cross-border takeover bid which takes place in their capital market. National legislatures should always have in mind that takeovers lie in the border between capital market law and company law. An excessive zeal on behalf of national capital market regulators could often conflict with foreign company law. If national capital market regulators are aware in advance of the foreign company law provisions (especially those deriving from harmonization), a possible incompatibility between those two laws could be avoided.

The EU market for corporate control is a part of these regulated capital markets. With regard to its regulation, the EU market for corporate control depends heavily on the legislative choices of company law and on the available corporate governance structures. If a Member State has a certain doctrine on takeovers, it could structure its company law in a certain way whereby company law promotes or inhibits takeover bids. On the one hand, a Member State adopting a positive stance towards takeover bids could use company law in order to liberalize the field of takeovers. On the other hand, if a national legislature does not support takeover bids, it could pass national company law rules allowing companies to adopt certain corporate governance structures hostile to takeover bids. Additionally, the EU legislature could use company law in order to establish a level playing field for takeovers at EU level.⁴⁸¹ Hence, in the company law harmonization programme, there were EU regulatory efforts to establish a level playing field for takeovers at EU level. These efforts of the EU legislature to establish a level

⁴⁸⁰ J. Winter (n 467) 12-13.

⁴⁸¹ E. Wymeersch (n 91) 158, 174.

playing field are also mandated by the protection of ‘members and others’ rationale of Article 44(2)(g) EC Treaty. However, the close relationship between company law and capital market law could sometimes produce a few negative side-effects: more uniform regulation of capital market law reduces the company’s autonomy and margin of assessment, and hence its flexibility to adjust to the needs of the capital markets. Limiting the use of specific types of financial instruments for instance might be prejudicial to financial creativity and appropriate financing conditions.⁴⁸²

9.2) EU regulatory approaches to the harmonization of takeover bids: a consideration in the light of EU company law and EU capital markets law.

While, in many national legal orders, securities regulation completes company law, the European legislature has treated company law and capital market law as separate bodies of law. However, the borders between those two areas of law are often blurred as in the case of takeover bids: although takeovers fall within the scope of capital market law in many jurisdictions, the EU deals with them from the perspective of company law under the title of the Thirteenth Company Law Directive.⁴⁸³ Formally, this directive belongs to the EU Company Harmonization Programme but it regulates a crucial segment of EU capital markets, the EU market for corporate control, and, in many of its provisions, is inspired more by capital market concepts than by company law notions.⁴⁸⁴ The link between the Takeover Bid Directive and capital market law is detected between the interpenetration of capital markets at EU level and the consequent diversification of shareholder bases across the Member State and the need to guarantee

⁴⁸² E. Wymeersch (n 91) 158, 173-174.

⁴⁸³ E. Wymeersch (n 91) 150. G. Wolff (n 309) 21. It is argued that the distinction between capital market law and company law is still a valid distinction. J. Garrido-Garcia (n 85) 762.

⁴⁸⁴ J. Winter (n 467) 12. It is also alleged that the Takeover Bid Directive lies more in the area of capital market law than of company law. R. Buxbaum, G. Hertig and others (eds) (n 97) 408.

equivalent and effective protections for investors as shareholders in the event of a takeover bid.⁴⁸⁵ The market integration rationale underpinning EC securities regulation also applies to company law aspects of takeover regulation.⁴⁸⁶ A liberalized capital market place without legal or structural corporate barriers to takeovers could benefit the competitive position of the European Union.⁴⁸⁷ From a company law perspective the directive is engaged with the external side of corporate governance, i.e. the disciplinary function of the threat of takeover bids and the acquisition of control over a company through a takeover bid.⁴⁸⁸ The reference in the Financial Services Action Plan⁴⁸⁹ to takeover bids makes more indistinct this subtle line between company law and capital market law. Additionally, the fact that the very early 1966 *Segre* Report on the development of a European capital market asked for the removal of the obstacles faced by issuers (among them there are many listed companies) of securities wishing to offer or list securities in another Member States does not distinguish those two areas of law.⁴⁹⁰ Nevertheless, capital market law presents higher regulatory flexibility (due to the use of *Lamfalussy* comitology procedures in the field of securities regulation) and

⁴⁸⁵ N. Moloney (n 108) 806-807.

⁴⁸⁶ N. Moloney (n 108) 811. See also Commission Communication on Financial Services 'Building a Framework for Action' COM (1998) 625, 7. For the integration of financial and capital markets in European Union, see an excellent collection of essays: M Andenas 'Who is going to Supervise Europe's Financial Markets?', J. Dalhuisen 'Towards a Single European Capital Market and a Workable System of Regulation', S. Thomadakis 'Fifteen Regulators for a Single Capital Market: The Project of Regulatory Harmonization in Europe' and R.M. Lastra 'Regulating European Securities Markets: Beyond the *Lamfalussy* Report' in M. Andenas and Y. Avgerinos (eds) *Financial Markets in Europe: Towards a Single Regulator?* (Kluwer, The Hague 2003) xv, 35, 75, 211. M. Blair and N. Phipps 'Regulation of European Markets and Exchanges' in M. Blair and G. Walker (eds) *Financial Markets and Exchanges Law* (OUP, Oxford 2007) 381.

⁴⁸⁷ N. Moloney (n 108) 811. See also ECOSOC Comments on the 1989 Proposal for a 13th Directive on company law concerning takeover and other general bids [1989] OJ C298/56 para. 1(4).

⁴⁸⁸ J. Winter (n 467) 12.

⁴⁸⁹ Communication of the Commission 'Financial Services: Implementing the Framework for Financial Markets: Action Plan' COM (1999) 232, 9 available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf accessed 16 September 2008.

⁴⁹⁰ N. Moloney (n 108) 62-63.

vigor of enforcement (possessing special enforcement instruments and mostly being enforced by a public agencies) than company law.⁴⁹¹

At the beginning of the process of harmonization of capital market law, the EU had followed the same approach as with company law harmonization: detailed and almost identical provisions tried to establish equivalence of safeguards for investors and markets in order to avoid additional onerous controls on access to securities markets and on securities transactions (e.g. prospectus directives).⁴⁹² This approach did not work: authorities in each of the Member States applied their own requirements⁴⁹³, and submitted the securities transactions to a new, although sometimes simplified, vetting procedure.⁴⁹⁴ Then, the European legislature opted for the harmonizing technique of mutual recognition. According to ‘mutual recognition’, securities could be offered to the public without much in the way of additional administrative procedures. This regulatory model presents many drawbacks in practice, because national authorities retain the power to impose justified and proportionate restrictions (*Gebhard* test) such as notification, and additional requirements relating to their local marketing and distribution rules.⁴⁹⁵ This preserves partly the fragmentation of EU primary capital

⁴⁹¹ E. Wymeersch (n 91) 150-151.

⁴⁹² E. Wymeersch (n 106) 19. It is noticed that all capital market directives (except for the Investment Services and the Market Abuse Directives for secondary markets) are based on Article 44(2)(g) EC Treaty. Harmonization of capital market law seems also to be more ‘intensive’ than harmonization of company law which does not intervene into the internal structure of companies. S. Grundmann (n 296) 629-630. R. Buxbaum and K. Hopt (n 80) 202, 218.

⁴⁹³ i.e. legal diversity among national capital market laws. R. Buxbaum and K. Hopt (n 80) 174.

⁴⁹⁴ E. Wymeersch (n 106) 19. It was proposed that priority should be given to capital market law harmonization instead of company law priority because the contribution of the latter to market integration is highly questioned. R. Buxbaum, G. Hertig and others (eds) (n 97) 130, R. Buxbaum and K. Hopt (n 80) 202.

⁴⁹⁵ E. Wymeersch (n 106) 19-20. See also E. Ferran and C. Goodhart ‘Regulating Financial Services and Markets in the Twenty First Century: an Overview’, E. Wymeersch ‘Regulating European Markets: The Harmonization of Securities Regulation in Europe in the New Trading Environment’ and G. Thieffry ‘The Case of European Securities Commission’ in E. Ferran and C. Goodhart (eds) *Regulating Financial Services and Markets in the Twenty First Century* (Hart. Oxford 2001) 13, 190 and 211.

markets and does not assist in their progressive integration⁴⁹⁶. In the securities field, it is amazing to compare the restrictions that are imposed in the primary market, when securities are offered to the public, and the lack of comparable safeguards in the secondary market, when securities are offered for sale on the stock exchange.⁴⁹⁷ Nevertheless, the imposition of those restrictions in the securities transactions of secondary markets could be proved necessary. This last issue is related directly to the takeover process as the effective regulation of those transactions dealing with shares is essential for the transfer of corporate control. These regulated transactions should be characterized by efficiency and protection for the parties. The lack of safeguards in the secondary market could prove detrimental to the market for corporate control because it dissuades bidders from participating in risky acquisitions of shares. Even a satisfactory takeover regime (i.e. the Takeover Bid Directive without the opt-outs and the reciprocity clause) could be endangered by the lack of safeguards in the secondary securities market.

An indirect enforcement mechanism which is quite common in capital markets and which could be proved a valuable incentive for implementing the optional provisions (Article 9 and/or 11) of the Takeover Bid Directive is the ‘comply or explain’ principle. According to this regulatory technique, non-adherents have to declare explicitly whether or not they comply with a stated series of principles or rules and disclose the

⁴⁹⁶ M. Maquil ‘The integration of the securities markets in Europe’ in E. Wymeersch(ed) *Further Perspectives in Financial Integration in Europe* (de Gruyter, Berlin-New York 1994) 157-169.

⁴⁹⁷ E. Wymeersch (n 106) 20. By means of the MiFID (Markets in financial instruments) Directive, the European Union has established a comprehensive regulatory regime for the organised execution of investor transactions by stock markets, other trading systems and investment firms. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1-44. Europa website Markets in financial instruments (MiFID) and investment services < <http://europa.eu/scadplus/leg/en/lvb/l24036e.htm> > accessed 7 March 2008. See also E. Avgouleas ‘The New EC Financial Markets Legislation and the Emerging Regime for Capital Markets’ (2004) 23 YEL 321.

reasons for not complying.⁴⁹⁸ This is well-known in the various corporate governance codes (many of which follow the ideology of the UK's 'Code of Best Practice', the so-called Cadbury Code) where companies must provide detailed and well-founded explanations for their decision not to conform to the requirements of the corporate governance code. The demand from both market organizers (national competent authorities) and listed companies to be able to display a similar instrument of good practice in order to attract investors was driven by the fact that listed companies are being put under pressure to adopt voluntarily rules of good corporate governance, and that, aware of the possible impact-less positive than negative- on investor's interest, they proclaim in their annual accounts the hard efforts they make to comply with these new standards of consistent conduct.⁴⁹⁹ It is obvious that this principle allows the corporate governance code to obtain a moderate obligatory character and, simultaneously, permits different corporate strategies as long as they are justified.⁵⁰⁰ Companies which do not manage to provide sufficient and convincing reasons for their decision to diverge from the corporate governance codes have these facts revealed to the other market participants and to the public in general. However, in practice a usual phenomenon is that those justifications invoked for these differentiations are not always credible and there is no enforcement instrument against those companies that flatly refuse. This potential exposure to market forces (the so-called 'name and shame') will not deter those companies to adopt different corporate governance standards without concrete justifications.⁵⁰¹

⁴⁹⁸ E. Wymeersch (n 91) 156. D. Weber-Rey (n 255) 382-384.

⁴⁹⁹ E. Wymeersch, 'Company Law in the 21st Century' Financial Law Institute, University of Gent Working Paper Series WP 1999/14, 9-10.

⁵⁰⁰ E. Wymeersch (n 91) 156.

⁵⁰¹ E. Wymeersch (n 91) 156.

It is deduced that a similar pressure could be applied to companies which do not implement voluntarily or involuntarily the optional⁵⁰² provisions of the Takeover Bid Directive due to their own decision or due to the Member State's choices. It is possible that this kind of pressure could urge those companies to apply the optional provisions of the Takeover Bid Directive. The Takeover Bid Directive contains a similar provision in Article 10 which demands listed companies to publish detailed information on the structure of their capital including non-listed securities and the different classes of shares, any restrictions on the transfer of securities, any pyramid structures and cross shareholdings, special shareholder rights, any employee share scheme, any restrictions on voting rights any agreements between shareholders which may result in restrictions on the transfer of securities and/or voting rights, the rules governing the appointment and removal of board members, any agreements to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid, any agreements between the company and its board members and employees providing for compensation. This article also requires the publication of this information in the company's annual report as provided for in Article 46 of Directive 78/660/EEC and Article 36 of Directive 83/349/EEC⁵⁰³. Additionally, Article 10 (3)

⁵⁰² Commissioner F. Bolkenstein expressed his disappointment at the optional provisions and the reciprocity clause which watered down the impact of this directive on the EU market for corporate control: 'I am not going to pretend that I am pleased with this agreement. Nor am I going to be hypocritical by pretending that the version of the Directive agreed today represents a step forward for EU competitiveness or for the integration of EU capital markets. The Competitiveness Council says that it wants to be seen to be taking decisions. In all sincerity, I have to say that if the Council continues to take decisions like this one, the European Union will never reach its target of becoming the most competitive economy in the world by 2010. On this issue, we have actually gone a long way in reverse gear since the Council endorsed the previous takeovers Directive in June 2001, with 14 Member States in favour.' Press-Release MEMO/03/245.

⁵⁰³ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies [1978] OJ L222/11, Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts [1983] OJ L 193/1. These directive were amended by the following directives: Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings [2006]

also prescribes that Member States shall ensure, in the case of companies the securities of which are admitted to trading on a regulated market in a Member State, that the board presents an explanatory report to the annual general meeting of shareholders on these matters. The Directive tried to follow this ‘comply or explain’ technique which derives mainly from the field of securities regulation in order to put some pressure on the Member States and the individual companies to adopt the optional provisions of the Directive. The Takeover Bid Directive shows that capital market law is very important for corporate governance because shareholders could affect managers’ behaviour by purchase and sale of their holdings.⁵⁰⁴ This incentive that encourages the application of the optional provisions contributes towards the integration of the European market for corporate control and to the establishment of more uniform and secure takeover regime at EU level.

The Takeover Bid Directive regulates the markets relating to takeover bids for the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market within the meaning of Directive 93/22/EEC⁵⁰⁵ in one or more Member States. However, the Winter Report also refers to an intermediate class, i.e. the ‘open companies’.⁵⁰⁶ These are ‘unlisted’ companies that would have qualified for listing, their securities being freely transferable and dispersed among investors.⁵⁰⁷ Regulations for listed companies do not catch this category of companies and their legal position is quite obscure; the Winter

OJ L 224/1–7 (This directive applies certain short-term changes proposed by the Company Law Action Plan), Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC [2006] OJ L157/87-107.

⁵⁰⁴ S. Grundmann (n296) 630.

⁵⁰⁵ Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (1993) OJ L141/27.

⁵⁰⁶ Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe (Brussels, 2002) < http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf > accessed 11 August 2007, 35(‘the Winter Group’).

⁵⁰⁷ E. Wymeersch (n 91) 172.

Report states that a balance has to be struck without giving further details.⁵⁰⁸ It was proposed that these companies should ask for listing of their securities immediately after offering their securities to the public, or, if they do not voluntarily ask for listing (the case of companies that started as closed companies, but the shares of which were dispersed over time) to choose either trading on a market, or make a bid-or have a shareholder make a bid-for their outstanding shares.⁵⁰⁹ Thus, a sufficient degree of liquidity and disclosure is secured for their shareholders.⁵¹⁰ In that way, the protection of ‘members and others’ proclaimed by Article 44(2)(g) EC Treaty is also promoted because this ambiguous legal status of those companies is not in the best interest of their shareholders. This category of companies should also be regulated by the European legislature in order to diminish legal uncertainties and to ameliorate the status of those companies. It could be alleged that this category of ‘open companies’ fall within the scope of a wide definition of the European market for corporate control even if they are not listed in a regulated capital market. Their securities transactions present many similarities with those of a regulated capital market. These companies constitute an additional vehicle for cross-border investments at EU level which broadens the already existing options of European investors. As a matter of fact, this additional area of cross-border investment deserves the attention of the European legislature.

A major part of self-regulation and independent supervisory control is delegated in many Member States to bodies set up for this purpose that are closely related to the capital markets, yet the government retains responsibility for the supervision of capital markets. Company law and capital market directives (including the Takeover Bid

⁵⁰⁸ E. Wymeersch (n 91) 172-173.

⁵⁰⁹ E. Wymeersch (n 91) 173.

⁵¹⁰ E. Wymeersch (n 91) 173. S. Grundmann categorizes in broad terms modern corporations into private limited companies, public limited companies without capital market orientation and the public limited companies with capital market orientation. The traditional distinction between private and public limited companies is considered to be outdated. S. Grundmann (n 296) 629.

Directive) refer to the national competent authorities appointed for this purpose, and the decisions of those authorities on capital market issues could be reviewed by national (mostly administrative) courts due to their semi-legal status.⁵¹¹ Sometimes, those semi-legal decisions of the national competent authorities could create problems when they are expanded into the field of company law and corporate governance (especially the harmonized part). These decisions are welcome as long as they help listed companies to adjust to securities regulations. Yet, there are problems when these decisions clash with substantive company law and especially with those national company law standards imposed by harmonization.⁵¹² A potential conflict with a purely national rule could be easily resolved by the Member States but a potential conflict with harmonized standards could lead to an infringement of secondary EC law. This possibility of infringement of secondary Community law increases due the separate category of rules on exchange listing enforced usually by the stock exchange, sometimes even after it has been privatized.⁵¹³

Moreover, the impact of electronic data transmission on corporate governance has been stressed. Electronic data transmission is dominant nowadays in capital markets and is approved by securities regulation. These technological changes already influence company life, law and practice and are another result of the imposition of those de facto globalized corporate governance standards. The takeover process could benefit from those technological developments. For example, if financial information is made available in electronic form, the general meetings of shareholders and the board of

⁵¹¹ J.M.M. Maeijer and K.Geens (eds), *Defensive measures against hostile Takeovers in the Common Market* (Martinus Nijhoff publishers and by Graham & Trotman, London 1990) 21. A few examples of those national authorities are: the Commission on the Operations of the Stock Market in France, the Bank Commission in Belgium, the Panel on Takeovers and Mergers in the United Kingdom, the Association for Trade in Securities in the Netherlands, the Hellenic Capital Market Commission in Greece and the Securities and Exchange Commission in Cyprus.

⁵¹² J.M.M. Maeijer and K.Geens (n 511) 21

⁵¹³ E. Wymeersch (n 91) 149-151.

director's meetings could be organized by videoconferencing and the easy identification of shareholders would help them to participate in company life through proxy voting methods.⁵¹⁴ A very interesting innovative approach has also been proposed. This proposal would allow directors to initiate defences, as it is possible under the optional non-frustration rule (Art. 9) of the Takeover Bid Directive, but subject to an ex-post shareholder veto that would, if cast by a majority of record shareholders at any time probably over the internet, subject the company's director's to the more restrictive rules of the Thirteenth Directive.⁵¹⁵

⁵¹⁴ E. Wymeersch (n 499) 11.

⁵¹⁵ C. Kirchner and R.W.Painter, 'Takeover Defences under Delaware Law , the proposed Thirteenth EU Directive and the New German Takeover Law : Comparison and Recommendations for reform' (2002) 50 Am.J.Comp.L 451, 474-476. However, C. Kirchner and R.W.Painter restrict a generalized application of their proposal with a caveat. Because internet voting probably would not involve the same disclosure and procedural safeguards as proxy and in-person voting at a formal meeting, the shareholder-veto procedure suggested here should not replace more formal processes, but should rather be used to determine which rule applies until the shareholders at a formal meeting decide upon a different rule.

CHAPTER 10

SCENE SETTING: THE MECHANICS AND TENSIONS OF TAKEOVERS

A takeover may be defined as a transaction or series of transactions whereby a natural or legal person or group of persons acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company.⁵¹⁶ Where shares are closely held (i.e. by a small number of persons), a takeover will generally be effected by agreement with the holders of the majority of the share capital of the company being acquired. Where the shares are held by the public generally, the takeover may be effected 1) by agreement between the acquirer and the controllers of the acquired company, 2) by purchases of shares on the stock exchange, or by 3) by means of a takeover bid.⁵¹⁷

A “takeover bid” is a method often used to carry out a takeover or merger, and takes the form of an offer to buy all the shares of the company.⁵¹⁸ What happens is that one company, the offeror or bidder or acquiring company buys either all or at least a voting majority, of the shares in another, the offeree or target company (it may pay a cash price or allot shares or other securities in exchange for the shares it acquires).⁵¹⁹ After the takeover, the two companies remain in being, and the offeree company becomes a subsidiary (perhaps a wholly-owned subsidiary) of the other, and it is thereafter controlled by the acquiring company through its majority shareholding and its ability to remove the existing directors and appoint its own nominees in their place.⁵²⁰

Additionally, a takeover bid is a method for achieving a merger. A merger is an amalgamation between companies of similar size in which either the members of the

⁵¹⁶ M.A. Weinberg, M.V. Blank and A.L. Greystoke, *Takeovers and Mergers* (4th ed. Sweet & Maxwell, London 1979) 3.

⁵¹⁷ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 3.

⁵¹⁸ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 3.

⁵¹⁹ L.S. Sealy ‘The Draft Thirteenth Directive on Take-overs’ in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 135.

⁵²⁰ L.S. Sealy (n. 519) 135.

merging companies exchange their shares for shares in a new company or the members of some of the merging companies exchange their shares for shares in another merging company.⁵²¹ The merger is frequently effected by means of a takeover bid by one of the companies for the shares of the other, (or sometimes of a takeover bid by a third company for the shares of both).⁵²² The distinction between a takeover and a merger is that in a takeover the direct or indirect control over the assets of the acquired company passes to the acquirer; in a merger the shareholding in the combined enterprise will be spread between the shareholders of the two companies.⁵²³ In the case of a ‘takeover’, the bid is frequently against the wishes of the management of the offeree company, but in the case of a ‘merger’, the bid is generally by consent of the management of both companies.⁵²⁴ Where a bid is unwelcome, the bidder may improve the terms offered, and will usually write to shareholders outlining the advantages that will follow if the bid is accepted.⁵²⁵ In the meantime, bids from other sources maybe made or the original bidder may withdraw as a result of measures taken by the board of the target company.⁵²⁶ In an unconditional bid the bidder will pay the offered price irrespective of the number of shares acquired, while the bidder of a conditional bid will only pay the price offered if sufficient shares are acquired to provide a controlling interest.⁵²⁷

⁵²¹ E.A. Martin (ed.) *Oxford Dictionary of Law* (5th ed. OUP , Oxford 2003)313, L.S. Sealy (n. 519) 135 -136.

⁵²² M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 4.

⁵²³ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 4.

⁵²⁴ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 4.

⁵²⁵ J. Pallister and A. Isaacs (eds) *Oxford Dictionary of Business* (3rd edition OUP , Oxford 2002) 498.

⁵²⁶ Competing bidders from other sources include ‘white knights’(a person or firm that makes a welcome takeover bid for a company on improved terms to replace an unacceptable and unwelcome bid from a ‘black knight’ . If a company is the target for a takeover bid from a source of which it does not approve or on terms that it does not find attractive, it will often seek a white knight, whom it sees as a more suitable owner for the company , in the hope that a more attractive bid will be made) and ‘grey knights’ (in a takeover battle, a counter bidder whose ultimate intentions are undeclared . The original unwelcome bidder is the black knight, the welcome counter bidder for the target company is the white knight. The grey knight is an ambiguous intervener whose appearance is unwelcome to all) J. Pallister and A. Isaacs (eds) (n. 525) 242, 498, 538.

⁵²⁷ J. Pallister and A. Isaacs (eds) (n. 525) 498.

Takeovers may be broadly classified as horizontal, vertical or conglomerate. This categorization has implications for Competition Law issues. A takeover is horizontal if it involves the joining together of two companies which are producing essentially the same products or services, or products or services which compete directly with each other.⁵²⁸ A takeover is vertical where one of the two companies is an actual or potential supplier of goods or services to the other, so that the two companies are both engaged in the manufacture or provision of the same goods or services but at different stages in the supply route.⁵²⁹ A conglomerate takeover involves the coming together of two in different industries, i.e. the business of the two companies are not related to each other horizontally (in the sense of producing the same or competing products), nor vertically (in the sense of standing towards each other in the relationship of supplier and buyer, or potential supplier and buyer).⁵³⁰ In a 'pure conglomerate' there are no important common factors between the companies in production, marketing, research and development or technology.⁵³¹ Conglomerate takeovers are classified according to the purpose of the dominant party in fully-fledged 'conglomerate' dominant company and a 'financial conglomerate' dominant company but by far the most common form of 'conglomerate' takeover is what used to be called, more simply, diversification.⁵³² This consists of a company, deriving all or the greater part of its revenue from a particular industry, acquiring subsidiaries operating in other industries for one or more of the following reasons: 1) to obtain greater stability of earnings through spreading activities in different industries with different business cycles or to diversify out of a static or dying industry, 2) to employ spare resources whether of capital or management, 3) where there are some common factors, to obtain benefit of economies

⁵²⁸ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 5

⁵²⁹ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 5

⁵³⁰ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 6

⁵³¹ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 6

⁵³² M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 6

of scale , particularly in regard to ‘staff’ functions (such as personnel advertising , accounting and financial) , 4) defensive diversification , designed to make the company too large to be likely to be the object of a takeover or perhaps to make it a less attractive object , 5) to provide an outlet for the ambitions of management , where anti-monopoly laws make further acquisitions (or perhaps even growth) in the company’s own field impracticable .⁵³³

For the takeover bid as a technique to be workable, the applicable company law must make it possible for anyone holding a majority of the voting shares in a company to remove the existing board and appoint new directors to take over its management, and the law must also be such as, if not positively to encourage, at least not actively to obstruct, changes in the control and management of companies in response to market forces.⁵³⁴ It also helps if, in the case of a company whose shares are listed on the Stock Exchange, there are no large blocks of shares held in private hands and not generally traded, and if the shares are held in registered form and lists of the current shareholders and their addresses are publicly available.⁵³⁵

Takeovers are an important external corporate governance mechanism that facilitates effective corporate restructuring.⁵³⁶ An aggressive market in corporate control serves as a disciplinary device for management boards of potential target companies, who would be afraid of losing their posts at the hands of a new acquirer if their company were taken over, thus promoting efficient asset structures.⁵³⁷ However, the separation of ownership and control of the public corporation gives raise to a classical principal-

⁵³³ M.A. Weinberg , M.V. Blank and A.L. Greystoke (n. 516) 6-7. Takeover bids were also classified as control bids vs non-control bids(including investment, withdrawal purposes) and aggressive bids vs agreed bids. E. Wymeersch (n 124) 299-301.

⁵³⁴ L.S. Sealy (n. 519) 136.

⁵³⁵ L.S. Sealy (n. 519) 136.

⁵³⁶ J. Grant ‘Takeovers and the market for corporate control’ in J. Grant (ed.), *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books, London 2005) 4. See also J. Rickford ‘Current Developments in European Law on the restructuring of companies: An Introduction’ [2004] EBLR 1225-1258.

⁵³⁷ P. Leyens ‘A framework for adequate shareholder protection’ (2001) 2 EBLR 42, 43.

agent problem, which can result in the sub-optimal use of capital and a failure to return excess capital to shareholders.⁵³⁸ This problem creates different approaches to corporate control transactions. There are two models of regulation depicting the relevant approaches: in one model directors must not frustrate a public offer, and in the other the directors control access to the shareholders.⁵³⁹ Under the first model the board of the company is not permitted to frustrate the efforts of the bid and to intervene in any other way in the decision – making process of the shareholders, who are the ultimate adjudicators. According to the philosophy of the free enterprise economy the owners of each party to a takeover or merger are the best judges of their own interests.⁵⁴⁰ This first model is implemented in the UK.⁵⁴¹ This model constituted the basis for the proposal and the harmonization efforts of the European Commission, which led ultimately to the Directive 2004/25/EC on Takeover Bids. Under the second model the board of the company has the right (under the corporate statute or because authorized by the general meeting of the shareholders) to frustrate a bid with various defensive measures. This model is encountered in Continental Europe and the U.S..⁵⁴² However, in the U.S., the shareholders can protect their rights by court action if the board of the company frustrates a potential value-enhancing public offer, or if the target company suffers serious and otherwise unjustified loss as a result of the defensive action of the board (let us to say, for serious infringements of the business judgment rule). Hostile takeover bids in Continental Europe are quite rare (only 67 hostile bids in the 15 Member States in the 1990's), due to the historically more permissive attitude towards

⁵³⁸ J. Grant (n. 536) 4, M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 8-13, R.Kraakman and others (eds) *The anatomy of corporate law* (OUP, Oxford 2004) 157-163.

⁵³⁹ R.Kraakman and others (n 538) 163-173.

⁵⁴⁰ M.A. Weinberg, M.V. Blank and A.L. Greystoke (n. 516) 12.

⁵⁴¹ See for an extensive analysis of the UK legal regime G.Stedman, *Takeovers* (Longman Commercial Series, 1st edition Longman, London 1993) and S. Kenyon-Slade, *Mergers and Takeovers in the US and UK / Law and Practice* (1st ed. OUP, Oxford 2004).

⁵⁴² For a comparative study of these takeover regimes see: C. Forstinger (n 310).

technical barriers, such as pre- and post-bid defences, and to structural barriers, related to the way in which companies are owned and financed (e.g. concentrated shareholdings, and distortion of the distribution of voting rights).^{543 544}

The hostile board of the company can choose from a great variety of defensive measures. The ‘poison pill’ is a tactic used by a company that fears an unwanted takeover by ensuring that a successful takeover bid will trigger some event that substantially reduces the value of the company.⁵⁴⁵ It is generally a rights plan that entitles existing shareholders to securities or cash if a hostile bidder takes control, while being redeemable at the option of the board, should a friendly acquirer takes control (such as an issue of securities with a conversion option enabling the bidder’s shares to be bought at a reduced price if the bid is successful).⁵⁴⁶ Other defensive measures which could be deployed by the board of a company resulting in the frustration of the bid are ‘the sale of crown jewels’ or ‘spin-offs’ (selling valuable assets of the company), ‘lock-up options’ (granting preferential options over shares or assets to white knights or other persons), ‘green mail’ (which involves paying the hostile bidder to withdraw its bid), the ‘Pac Man’ defence (which involves launching a bid for the bidder itself) and ‘golden parachutes’ (which involve contractually binding the target company to make large severance payments to incumbent managers in the event of a change of control).^{547 548}

⁵⁴³ J. Grant (n 536) 10.

⁵⁴⁴ For a Political Economy perspective of these models: A. Nilsen ‘Anglo-American v Continental-Nordic Models of Corporate Governance: The political Economy of Takeovers in the European Union’ [2004] EBLR 1353.

⁵⁴⁵ J. Pallister and A. Isaacs (eds) (n. 525) 392.

⁵⁴⁶ D. A. Wyatt and A. Dashwood (n 46) 881.

⁵⁴⁷ D. A. Wyatt and A. Dashwood (n. 46) 881 citing the definitions and descriptions from Kirchner and Painter, ‘Takeover Defences under Delaware Law, the proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for reform’ (2002) 50 Am.J.Comp.L. 452.

⁵⁴⁸ J. Pallister and A. Isaacs (eds) (n. 525) 393.

CHAPTER 11

HISTORICAL BACKGROUND

11.1) The 1989 Proposal.

In the early 1970s the European Commission appointed Professor Robert Pennington to draw up a draft Directive for Takeover Bids. The draft which was presented in 1974, was strongly influenced by the UK Takeover Code.⁵⁴⁹ It was in the UK that national Takeover Regulation first emerged and it was the most shareholders protective in Europe due to several highly publicized takeovers, which provoked demands to improve the situation for target company shareholders. The UK market players (the Bank of England, British Bankers Association, Institute of Chartered Accountants, London Investment Banking Association, Confederation British Industry, Association of British Insurers and National Association of Pension Funds) agreed to regulate themselves and this led to the UK Takeover Code issued in 1968 and the creation of a self-regulatory Body, the Takeover Panel.⁵⁵⁰ These UK bodies and their members decided to develop this self-regulatory regime in order to impose discipline in the market in corporate control by which they are significantly affected.

The characterization of national differences in Public Offers legislation as barriers, and the aim of creating a level playing for takeover bids in Europe, were included in the White Paper on completing the internal market⁵⁵¹. Here, we find the ulterior motives of this harmonization effort and it is, of course, related to the purpose of this thesis, which

⁵⁴⁹ R. Skog, 'The Takeover Directive-an endless Saga?' (2002) 13 EBLR 301, 302.

⁵⁵⁰ R. Skog (n 549) 301. The examination of the UK Takeover Code falls outside the scope of our research. We will refer to the UK Takeover Code only where it inspired the European legislature. For an extensive analysis of the UK Takeover Code see G. Stedman, *Takeovers* (Longman Commercial Series, 1st edition Longman, London 1993) and S. Kenyon-Slade (n 541).

⁵⁵¹ Completing the Internal Market. White Paper from the Commission to the European Council (Milan, 28-29 June 1985). COM (85) 310 final, 14 June 1985.

is to show the contribution of the Takeover Bid Directive to cross border takeover bids. This White Paper clearly declared the link between corporate mobility and the harmonization of takeover bids, in the following extract:

...making better use of certain procedures such as offers of shares to the public for reshaping the pattern of share ownership in enterprises, since the rules currently in force in this sphere vary a great deal from one country to another. Such operations should be made more attractive. This could be done by requiring minimum guarantees, particularly on the information to be given to those concerned, while it would be left to the Member State to devise procedures for monitoring such operations and to designate the authorities to which the powers of supervision were to be assigned. A proposal will be made in 1987 and necessary decisions should be taken by 1989.⁵⁵²

The Commission presented early in 1989 a proposal for a ‘Thirteenth Council Directive on company law concerning takeover and other general bids’.⁵⁵³ The Commission’s suggestions were contained in what was called ‘the Bangemann proposals’.⁵⁵⁴ However, almost nobody was happy with this proposal. First and foremost, Germany objected to encouraging takeovers because it favoured its own takeover system. German companies have for years operated under a voluntary Takeover Code (“The Takeover Code”) of the Borsensachverstaendigenkommission, a private advisory body that the Ministry of Finance established in 1975.⁵⁵⁵ German reactions to a pan-european harmonized takeover regime reflected its own, voluntary, ‘good will,’ takeover system which was far from strict compulsory legislation.⁵⁵⁶ Furthermore, Germany believed that there was no need for a mandatory bid rule, since

⁵⁵² COM (85) 310 final, para. 139.

⁵⁵³ Proposal for a Thirteenth Council Directive on company law concerning takeover and other general bids [1989] OJ C64/8.

⁵⁵⁴ The Directives proposed in the Bangemann proposals included inter alia the 5th Directive, which aimed at restricting the use of deferred voting rights and non-voting shares and the 13th Directive. F. Ipek, ‘Defensive measures under the Directive on Takeover Bids and their effect on the UK and French Takeover Regimes’ [2005] EBLR 341, 342.

⁵⁵⁵ C. Kirchner and R.W. Painter (n 547) 463.

⁵⁵⁶ Germany started drafting a ‘compulsory’ Takeover Code in 2000 and the first German Takeover Code came into effect in 1st January 2002. The difference with UK which had for almost 40 years a self-regulatory but compulsory takeover regime is obvious.

the rights of minority shareholders in Germany are sufficiently protected by the statutory law on groups of companies.⁵⁵⁷ The UK feared that the shift towards a legislative system would create problems for its active self-regulated takeover market with the creation of obstructive litigation and delays.⁵⁵⁸ The main objections of the UK concerned the fact that the takeover rules would be given the force of law, and that there would be more delays due to more frequent litigation, which could put an end to a takeover bid (the English Courts under the then current City Code regime practiced self restraint and discouraged tactical litigation). Moreover, the UK government alleged that the Takeover Panel would also lose its flexibility to adjust the takeover rules and to give rulings on issues arising in the course of a bid.⁵⁵⁹ The British criticism was

⁵⁵⁷ K. Braunohler 'Hostile Takeovers' (2001) 6 EBLR 309, 314 and P. Leyens (n. 537) 55. K. Hopt argues that the provisions of the German law relating to groups of companies are inferior and not equivalent to a mandatory bid rule. K. Hopt (n 295) 18-19. E. Wymeersch (ed.) *Groups of Companies in the EEC: a survey report to the European Commission on the law relating to corporate groups in various Member States* (Walter de Gruyter, Berlin 1993).

⁵⁵⁸ J.S.Knudsen, 'Is the single European Market an Illusion? Obstacles to reform of EU Takeover Regulation' (2005) 11 ELJ 507, 509. See also for a more extensive and well-founded analysis: S. Kenyon-Slade and M. Andenas 'The Proposed Thirteenth Directive on Takeovers: Unravelling the United Kingdom's Self-Regulatory Success?' in S. Kenyon-Slade and M. Andenas (eds), *E.C. Financial Market Regulation and Company Law* (Sweet & Maxwell, London 1993) 149-188. M. O'Neill 'When European integration meets corporate harmonization' (2000) 21 Comp.Law. 173, 175-176. For an early consideration of the Code: A. Johnston *The City Take-Over Code* (OUP, Oxford 1980) and N.S. Poser *International Securities Regulation* (Little Brown & Company, Toronto 1991). Furthermore, see for a comparison between the two systems of regulation, self-regulatory/private regulation and statutory/public regulation, and their analysis (arguments in favour and against each system of regulation): B. Pettet, 'Private versus Public Regulation in the field of Takeovers: The future under the Directive' (2000) 5 EBLR 381. For an extensive critical analysis of the self-regulatory takeover regime of England, one of the most advanced in the world, see: G. De Minico 'A Hard Look at Self-Regulation in the UK' [2006] EBLR 183, P.L. Davies *Gower and Davies' Principles of Modern Company Law* (7th ed Sweet & Maxwell, London 2003) 704, D. Kershaw 'The illusion of importance: Reconsidering the UK's takeover defence prohibition' (2007) 56 ICLQ 267. For an interesting comparison between England's self-regulatory, standards-based system and US more formal, rules-based system: B. E. Rosenzweig 'Private versus public regulation: A comparative analysis of British and American takeover controls' (2007) 18 Duk.J.Comp.Int.L. 213. See also a very interesting article on disputes and litigation in takeover bids: T. I. Ogowewo 'Tactical litigation in takeover contests' [2007] JBL 589-619. For a critical approach to General Principle No 7 of the UK Takeover Code (shareholders should decide the outcome of a takeover bid), which was the basis of the non-frustration rule of the Takeover Bid Directive, see: A. Dignam 'The globalisation of General Principle 7: transforming the market for corporate control in Australia and Europe?' (2008) 28 Legal Studies 96-118.

⁵⁵⁹ V. Edwards, 'The Directive on Takeover Bids, - Not worth the paper it's written on?' (2004) 4 ECFR 416, 420. Securities arbitration is another very flexible method of alternative dispute resolution: S. Ware 'What Makes Securities Arbitration Different from Other Consumer and Employment Arbitration?' (2008) 76 UCinLR, 447, J. Gross and B. Black 'When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration' JDispRes (forthcoming

especially troublesome for the Commission, since the UK Takeover Code had served as a model for the Commission's proposal, and for the various takeover regulations that by then had gradually begun to take shape across across Continental Europe.⁵⁶⁰ Finally, the Commission decided to prepare another draft proposal in order to satisfy the complaining Member States. However, this time the Commission was obliged to take into account the principle of subsidiarity, which came into effect after the ratification of the Maastricht Treaty.

11.2) The 1996 Proposal

The Edinburgh Council included this Directive among the list of Directives which were to be revised in accordance with the principle of subsidiarity adopted earlier that year at Maastricht. In February 1996, the Commission submitted a fresh proposal⁵⁶¹ for a 13th European Parliament and Council Directive concerning takeover bids, which was a much more streamlined version of the previous proposal.⁵⁶² It did not impose detailed requirements, but rather it sought to ensure that there were minimum guidelines for the conduct and transparency of takeover bids.⁵⁶³ The Commission proposed a "framework Directive" contain five so-called general principles that Member States

2008), B. Black and J. Gross 'Making it Up as They Go Along: The Role of Law in Securities Arbitration' [2002] 23 CardLR 991, J. Johnson and E. Brunet 'Substantive Fairness in Securities Arbitration' (2007) 76 UCInCL.

⁵⁶⁰ R. Skog (n 549) 303.

⁵⁶¹ Proposal for a 13th European Parliament and Council Directive concerning Takeover Bids, [1996] OJ C 162/5.

⁵⁶² V. Edwards (n 559) 421, R. Skog 'The Takeover Directive, the 'breakthrough rule' and the Swedish system of dual class common stock' [2004] EBLR 1439, 1440.

⁵⁶³ V. Edwards (n 559) 421. Fourth Recital of the preamble stated: 'a framework consisting of certain common principles and a limited number of general requirements which Member States will be required to implement through more detailed rules according to their national systems and their cultural contexts'.

should follow when drafting national takeover legislation, but few detailed provisions.⁵⁶⁴ Moreover, the discretion of Member States was wider than in the previous proposal, as a result of the general requirements that Member States should adopt rules, but without any recommendations as to their material content.⁵⁶⁵

As far as the objection of the UK was concerned, the self-regulation clause⁵⁶⁶ that was included in the proposal did not satisfy completely the requirements of the UK government because there were still dangers of frequent litigation. In November 1997 the UK Takeover Panel, having obtained an opinion from leading counsel that the proposed Directive failed to satisfy the principles of subsidiarity and proportionality and was accordingly unlawful, called on the Commission to abandon the proposal altogether or replace it with a non-binding recommendation or voluntary code.⁵⁶⁷ Finally, the British concerns were mitigated by the amendment of the relevant provision and the restriction of the role of the representatives of the employees or the employees themselves in the takeover bid process.⁵⁶⁸

Finally, after resolution of a dispute having to do with the jurisdiction of the supervisory authorities and the relevant authorities during the course of a bid, in June the Council adopted a common position⁵⁶⁹ on the proposed Directive. The Council's common position was slightly more detailed than the Commission's 'Framework Directive'.⁵⁷⁰ The common position was approved by the European Parliament with fifteen amendments.⁵⁷¹ The most important amendment, which is also related to promotion of the freedom of establishment, was the amendment of Article 9. The

⁵⁶⁴ R. Skog (n 549) 303.

⁵⁶⁵ R. Skog (n 549) 303.

⁵⁶⁶ Proposal for a 13th European Parliament and Council Directive concerning Takeover Bids, [1996] OJ C 162/5, Article 4(5).

⁵⁶⁷ V. Edwards (n 559) 423.

⁵⁶⁸ V. Edwards (n 559) 423.

⁵⁶⁹ Common Position (EC) No 1/2001 [2001] OJ C 23/1.

⁵⁷⁰ R. Skog (n 549) 304 and V. Edwards (n 559) 425. The common position is analysed in depth in N. Moloney (n 108) 819-840.

⁵⁷¹ V. Edwards (n 559) 425.

neutrality or non-frustration rule contained in this Article demanded prior shareholder approval before the board of the target company took any defensive measures which could frustrate the bid and lead to its failure. This neutrality or non-frustration rule seems well suited to meet the expectations of the legal base of the Directive, Article 44(2)(g) EC Treaty.⁵⁷² This Article aims at the protection of the interests of shareholders by giving them the opportunity to decide upon the bid, and, more generally, to facilitate the right of establishment. The shareholders should be able to decide, without the board's intervention, whether they will finally accept the offer and to manage their ownership rights through their shares.⁵⁷³ Thus takeover activity in Europe is encouraged, and, as a consequence, the freedom of establishment is facilitated. On the other hand, the European Parliament proposed that supervisory authorities should have the power to adopt guidelines permitting boards to take defensive action without consulting shareholders. The amendment was justified by reference to the need to level the playing field for takeovers as between companies incorporated in the United States, where boards may adopt and carry out defensive measures on their own responsibility.⁵⁷⁴ This protectionist approach is contrary to the legislative base and the goals of the Directive. It is against the basic Treaty-based principle of shareholder protection because it deprives shareholders of the opportunity to decide on the merits of the bid and on the disposal of their shares.

The Commission⁵⁷⁵ disagreed with the amended text and so the conciliation process began in April 2001. However, Germany unexpectedly (and unusually after the

⁵⁷² Article 44(2) (g) EC Treaty: 'g) by coordinating to the necessary extent the *safeguards* which , for the *the protection of the interests of members and others* are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent throughout the community' (emphasis added) .

⁵⁷³ There is going to be a specific chapter about the neutrality/non-frustration rule of the Directive. The basic notions of this principle remained unchanged during the drafting procedure.

⁵⁷⁴ V. Edwards (n 559) 425.

⁵⁷⁵ Commission's opinion pursuant to Article 251 (2) (c) COM (2001) 77.

adoption of a common position) changed its position and argued that the Directive should provide for shareholders to be asked at general meetings to grant the board the right for a fixed period to act against a hostile bid without further consultation.⁵⁷⁶ During that fixed period, the shareholders would be deprived of their right to decide. The basic German argument was that the shareholders are not always able to estimate properly the current and future condition of the company and should be protected from hasty assignments of their right to decide about defensive measures. The rest of the Member States criticized the fact that Germany withdrew support from the Common Position. Hence, the Council held to its convictions, but Parliament's conciliation delegation used the conflict to push even harder in conciliation negotiations to allow boards to take frustrating actions with the support of prior authorization.⁵⁷⁷ Finally, on 5 June 2001, the day before the deadline for agreement, failing which the proposed Directive would have lapsed, the Council and Parliament agreed on a compromise whereby Article 9 remained unamended, but Member States could postpone its application for one year after the deadline for implementation of the Directive.⁵⁷⁸ The Directive needed parliamentary approval by a simple majority, and then approval by the Council by a qualified majority, in order to be put into force. However, the proposal was rejected with an unprecedented⁵⁷⁹ tied vote: 273 votes in favour, 273 against and abstentions. The lack of only one vote prevented the harmonization of takeover bids in Europe.

This protectionist approach of Germany⁵⁸⁰ was of course due to domestic interests. The German Government was led to this unexpected change of position due to lobbying

⁵⁷⁶ V. Edwards (n 559) 426.

⁵⁷⁷ R. Skog (n 549) 309.

⁵⁷⁸ V. Edwards (n 559) 426.

⁵⁷⁹ This adjective is used by V. Edwards (n 559) 427.

⁵⁸⁰ National takeover regulatory regimes prior to the implementation of the Directive are out of the scope of our thesis. We are examining some elements of the German legislation in order to see how this

by local industry and labour unions.⁵⁸¹ Representatives of Volkswagen, BASF and other companies, together with labour union representatives, addressed demands for changes to the proposed Directive directly to the German government.⁵⁸² Furthermore, the Rapporteur of the Legal affairs Committee, the source of the amendments and the soul of the parliamentary delegation in the conciliation process, was Klaus-Heiner Lehne, a German Christian Democrat MEP, who represented Dusseldorf, home of Mannesmann, acquired shortly beforehand by Britain's Vodafone, in Germany's first hostile takeover.⁵⁸³ Lehne argued that the draft Directive failed to address the remaining substantial differences between the company laws of different countries, and that these variations would confer unfair advantages in an ensuing struggle for economic power through corporate control.⁵⁸⁴ The reform of German company law by the Control and Transparency Law (KonTraG) of 1998 strengthened the supervisory board, shareholder rights and shareholder equality, but left intra-corporate power relations largely intact.⁵⁸⁵ By rendering German firms more vulnerable to hostile takeovers, the KonTraG galvanized opposition to further liberalization and shareholder-friendly reforms. At this point we have an irony. The initial liberalization brought by the passage of the KonTraG ultimately prevented the further liberalization of takeover law. The law exposed German corporations to greater takeover vulnerability in an emerging European market for corporate control.⁵⁸⁶ The draft Directive did not bar all

protectionism played the main role in the proposed Directive's rejection (what was the effect of the German national legislation to the drafting process?).

⁵⁸¹ V. Edwards (n 559) 426.

⁵⁸² R. Skog (n 549) 308.

⁵⁸³ V. Edwards (n 559) 425.

⁵⁸⁴ J.W. Cioffi, 'Restructuring "Germany Inc.": The Politics of Company and Takeover Law Reform in Germany and the European Union' (2002) 24 *Law and Policy* 356, 384, J.S. Knudsen (n 558) 510.

⁵⁸⁵ J.W. Cioffi (n 584) 355.

⁵⁸⁶ J.W. Cioffi (n 584) 358. J. N. Gordon 'An American Perspective on the New German Anti-takeover Law' (2002) ECGI - Law Working Paper No. 02/2002, Columbia Law and Economics Working Paper No. 209 < <http://ssrn.com/abstract=336420> > accessed 25 October 2007, 4.

the takeover defences.⁵⁸⁷ It contained no one-share one vote principle, as does the KonTraG, it allowed the continued use of golden shares that confer voting control over corporations upon the minority that holds them, and permitted the sort of protective cross-shareholding that German legislation was designed to dismantle.⁵⁸⁸ Thus, German firms could not easily develop a defensive strategy and had fewer defensive measures available in comparison to corporations from countries which allow golden shares, cross-shareholdings and poison-pills. Other Member States' defensive devices (e.g. those of France and Sweden which preserved multiple voting rules) were insulated from the scope of the Directive, but German takeover barriers were within the scope of the Directive and they had to be abolished (the non-frustration rule of the proposed Directive would not allow the prior authorization (before the bid) of the general meeting to the board of the company to be able to launch defensive measures for a fixed period without asking for new permission). There was also the question of trans-Atlantic takeover bids, with the boards of American companies having full discretion to develop defensive tactics. The realization of how vulnerable German Companies might be to foreign takeovers under the proposed Directive was the main reason for the switch in the German opinion. On the one hand, the general meeting of a German company would not be able to authorize in advance of a bid the board of the company to be able to deploy defensive measures, without a new permission from the shareholders. The non-frustration rule of the proposed Directive would prohibit such a tactic and would allow only post-bid approvals for the launch of defensive measures by the board of the offeree company. On the other hand, a French company could still issue ceiling or time lapse shares, and a Scandinavian company⁵⁸⁹ could preserve its system of dual class common stock after the adoption of the proposed Directive. The irony of the battle over

⁵⁸⁷ J.W. Cioffi (n 584) 382.

⁵⁸⁸ J.W. Cioffi (n 584) 382.

⁵⁸⁹ R. Scog (n 562) 1439.

the Takeover Bid Directive was that Germany did not switch its position on the Takeover Directive because it was hostile to economic modernization and liberalization. Rather, it was because domestic reforms had already liberalized the legal structure of corporate governance to a significant degree and other Member States had not undertaken similar steps. Germany abolished multiple-voting rights and enacted the one share, one vote, principle. Furthermore, the German legislation was hostile to cross-shareholdings, because it prohibited the voting of cross-shareholding stakes above a certain percent in supervisory board elections. The majority of the Member States had not abolished these anti-takeover techniques and the proposed Takeover Bid Directive did not catch these defensive tactics. However, the non-frustration rule of the Directive would catch the prior authorization practice for defensive measures that was allowed by German takeover legislation. Hence, the vulnerability of German companies in comparison to companies of other Member States (which could still use defensive measures evading the provisions of the Directive) is obvious. So, it is ‘ironically’ reasonable to talk about ‘liberal’ protectionism and conservatism, which motivated the German opposition. The current version of the Directive was not regarded by the Germany authorities as compatible with the reformed German takeover legislation, which demanded a broader harmonization, which would level the European takeover playing field and would provide equality of arms for takeovers all over Europe.

Proposals after a conciliation process are very rarely rejected by the European Parliament. Political scientists have shown that MEPs typically vote according to party affiliation. However, in the case of the Takeover Bid Directive, most MEPs voted accordingly to their country affiliation.⁵⁹⁰ MEPs stressed three major problems with the Directive. First, many MEPs rejected the principle whereby, in order to take defensive

⁵⁹⁰ J.S. Knudsen (n 558) 511.

measures in the face of a bid, the boards of the offeree company must first obtain the approval of shareholders (Article 9). Secondly, many MEPs found that the Directive insufficiently protected employees working for companies involved in a takeover bid. Lastly, many MEPs argued that the proposal did not abolish multiple voting rights and hence failed to achieve a level playing field. According to German MEPs, a Directive on Takeover Bids “must create a level playing field for takeovers both within the European Union and world-wide.”⁵⁹¹ Domestic resistance, in particular German domestic resistance to the Takeover Directive is best explained as a result of asymmetric vulnerability in the form of domestic corporate governance systems and reforms. In short national differences constituted obstacles to real reform within the context of arguments about how to create a level playing field.⁵⁹²

11.3)The 2002 Proposal

⁵⁹¹ J.S. Knudsen (n 558) 511 and K.Lehne, Rapporteur, ‘Working Document on the proposal for a Directive of the European Parliament and of the Council on Takeover Bids’ , COM (2002) 534-C5-0481/2002-2002/0240 (COD) , Committee on Legal Affairs and the Internal Market.

⁵⁹² J.S. Knudsen (n 558) 524.

The Commission was not willing to abandon the venture of harmonizing takeover bids at European level because this Directive was a key component of the Financial Services Action Plan and was placed by the Lisbon European Council among the main priorities of the integration of EU Financial markets. This view was also shared by UNICE,⁵⁹³ which has consistently stressed the need for a common framework for takeover bids.⁵⁹⁴ The rejected proposal was submitted to a so-called High-Level Group of Company Law Experts, headed by Jaap Winter, with a mandate to address outstanding issues.⁵⁹⁵ Its key proposals in its final Report were that : a) where a takeover offer succeeds at least to the extent of acquiring 75% or more of the risk bearing share capital in the offeree company, the bidder should be entitled to control the constitution and the board of that company accordingly , notwithstanding any constitutional or structural provisions in the company which would prevent the exercise of such control (the breakthrough provisions); b) where a bidder acquires control , the price to be offered under the mandatory bid for the remaining shares should normally be the highest price paid by the bidder during a period of 6 to 12 months up to and including that acquisition of control; and c) where a bidder has acquired in excess of a threshold (to be set at between 90 and 95%) of the shares in the target, he should be entitled to buy out minority holders , and minority shareholders should be able to require that their shares are bought out, at a fair price , presumed to be the offer price where there is a 90% or more acceptance of the offer (‘squeeze-out’ and ‘sell-out’ rights).⁵⁹⁶ The new proposal did not completely follow the recommendations of the Report of the High Level Group

⁵⁹³ Union of Industrial and Employers' Confederations of Europe-Union des Industries de la Communauté Européenne (UNICE).

⁵⁹⁴ F. Wooldridge, ‘The Recent Directive on Takeover – Bids’ [2004] EBLR 147, 148.

⁵⁹⁵ J.S. Knudsen (n 558) 518 The rest of the members were: J.Rickford (UK), J. Simon (France), K.Hopt (Germany), J.M. Garrido Garcia (Spain), J.S. Christensen (Denmark), G. Rossi (Italy).

⁵⁹⁶ V. Edwards (n 559) 428.

of Company Law experts on Takeovers concerning the proposed breakthrough procedure, although it provided for the unenforceability of restrictions on the transfer of securities during the period for acceptance of the bid, and for the unenforceability of restrictions on voting rights when the General meeting decided on any defensive measures.⁵⁹⁷ The proposal of the High Level Group, that the bidder should not be required to offer compensation to the holder of shares carrying disproportionate voting rights, where the bidder reaches the breakthrough threshold after a general takeover bid, and makes use of the breakthrough right, was not accepted.⁵⁹⁸

This proposal preserved the same basic principles of the previous proposal, although the Member States would be permitted to defer implementation of the prohibition of defensive action by the board without prior shareholder approval for up to three years.⁵⁹⁹ According to the Winter Takeover Report, there should also be definitions of 'equitable price' and the introduction of squeeze-out and sell-out rights after bid.⁶⁰⁰ The most important feature was that the board neutrality/non-frustration rule was maintained. Finally, the proposal sought to meet the Parliament's concerns about employee protection by providing for national measures to govern the provision of information and consultation of representatives of the employees of both target and bidder.⁶⁰¹

The European Parliament was again concerned with the inconsistent treatment of multiple voting shares by the proposal (like its predecessor). The Commission's text of the proposed Directive explicitly excluded from the scope of the Directive multiple

⁵⁹⁷ F. Wooldridge (n 594) 147.

⁵⁹⁸ Although this proposal aimed at facilitating the bidder in financing his offer and encouraging aspiring investors to get engaged with takeovers, it was contrary to the constitutional rights of some Member States (a form of confiscation). There were also concerns about its compatibility with the First Protocol to the European Convention on Human Rights and the 'public interest' justification for restrictions. F. Wooldridge (n 594) 148.

⁵⁹⁹ V. Edwards (n 559) 429.

⁶⁰⁰ V. Edwards (n 559) 429.

⁶⁰¹ V. Edwards (n 559) 429.

voting securities.⁶⁰² There would be no level playing field in the European market for corporate control, if a Directive did not abolish all multiple voting rights. This concern of the European Parliament dealt unequally with the voting and share transfer restrictions in Europe by abolishing some of them (e.g. the Scandinavian) and preserving others (e.g. the French). This concern met extreme opposition in Scandinavia because the whole Nordic model of capitalism was based on the multiple voting share system in these countries.⁶⁰³ Multiple voting shares refer to a company's varying classes of stock. The different classes have varying voting rights, dividend payments, or other characteristics. Supporters of the system say that the presence of controlling, unlisted stock somewhat counters any short-term financial focus investors may have. This is because the founders or other investors who hold the controlling shares often see past quarterly earnings. However, many shareholders see dual-class stock as an unfair system that allows a small group of shareholders to retain control while other shareholders provide a majority of the capital.⁶⁰⁴ With the aim of mitigating these concerns, the Greek Presidency proposed two compromises: first, Member States would have to prohibit the use of multiple voting rights but could delay implementation until 2010 to allow companies to make changes to their voting systems; secondly, it was proposed that the Directive should include a clause stating that it did not affect Member States' rights to refuse the transfer of control over a company under their jurisdiction to a company of a country outside the EU.⁶⁰⁵ The first compromise is

⁶⁰² Proposal for a Directive of the European Parliament and of the Council on Takeover Bids COM (2002) 0534 final [2003] OJ C 45E/1 Article 11.

⁶⁰³ J.S. Knudsen (n 558) 519.

⁶⁰⁴ Definition of multiple voting shares at-- , 'Dual-Class Stock' (Financial Glossary , Educational Part, Wall Street Authority) < <http://www.streetauthority.com/terms/d/dual-class-stock.asp> > accessed 25 May 2007. Shearman & Sterling LLP, which conducted the external study commissioned by the European Commission 'Proportionality between ownership and control in EU listed companies: comparative legal study', defined multiple voting rights shares as shares issued by a company giving different voting rights based on an investment of equal value (This study is available at < http://www.ecgi.org/osov/documents/study-exhibit_a_en.pdf >).

⁶⁰⁵ V. Edwards (n 559) 430.

compatible with freedom of establishment and the fostering of European takeover activity because it secures an even transition to a level playing field with the progressive abolition of multiple voting rights. So, everybody would be happy. The Germans and Scandinavians because they could adjust their company law systems to the new regime; the Commission and the Member States which supported this feature of the Directive because a Directive would finally exist; and the European Parliament because at the end after the transitional period a level playing field would be achieved. Furthermore, Finland proposed that multiple voting rights be invalid when shareholders were asked to vote on defensive measures to frustrate a bid but, valid when the bidder was negotiating the purchase of shares in the target.⁶⁰⁶ This proposal was quite vague because in practice it is quite difficult to distinguish between these two periods. In June, Portugal suggested a compromise allowing companies the choice of applying the rules on defensive measures.⁶⁰⁷ Finally, the Italian Presidency adopted the Portuguese idea and proposed that the board neutrality / non-frustration rule and the breakthrough rule be optional but should leave the possibility to individual companies to adopt them if they wished to. Moreover, a reciprocity rule was also proposed, which would allow Member States to permit those companies which applied these provisions to opt out again if they were the target of a bidder which did not itself apply the same takeover provisions. Only these opt in/opt out/reciprocity provisions made possible the adoption of the proposal (27 November 2003) and its approval by the European Parliament (16 December 2003). Member States were obliged to transpose Directive 2004/25/EC of the European Parliament and the Council of 21 April 2004 on takeover bids not later than 20th May 2006.

⁶⁰⁶ V. Edwards (n 559) 430.

⁶⁰⁷ V. Edwards (n 559) 430.

CHAPTER 12
THE MANDATORY BID RULE (ARTICLE 5)

Some of the few obligatory substantial provisions of the Directive for the regulation of takeover bids are the mandatory bid rule (Article 5), the squeeze-out right (Article 15), and the sell-out right (Article 16). The purpose of these provisions is to protect the minority shareholders according to the legislative base of the Directive (Article 44 (2)(g) EC Treaty). However, the Directive provides the possibility of evading the enforcement of these provisions both when transposing the Directive into national law and, after implementation, when the parties to a bid are obliged to launch a mandatory bid. Additionally, the provisions themselves are characterized by many drawbacks, which reveal their weakness in contributing to the protection of the shareholders and subsequently to the freedom of establishment through takeover bids.

12.1) The Deficiencies of the Mandatory Bid Rule.

Article 5 contains detailed rules imposing the requirement of making a mandatory bid at an equitable price whenever a natural or legal person gains control of a listed company. The main problem is that this provision gives a wide discretion to the Member States. This discretion does not have to do with adjustments of the regulation to the Member States' needs and idiosyncrasies but with the waiver or not of the enforcement of the mandatory bid rule in individual cases. Thus, the minimum harmonization technique which is chosen by the Community legislature (Article 3(2)) is inconsistent with these provisions of the Directive, which provide for derogations even from the minimum safeguards of the Directive. The national legislature is not prompted

to adopt further safeguards for minority shareholder protection but is given the possibility to evade the minimum protection standards of the Directive.

First of all, Article 4(5) states:

‘Provided that the general principles laid down in Article 3 (1) are respected, Member States may provide in the rules that they make or introduce pursuant to this Directive for derogations from those rules: (1) by including such derogations in their national rules , in order to take account of circumstances determined at national level and/or (2) by granting their supervisory authorities , where they are competent, powers to waive such national rules, to take account of the circumstances referred to in (1) or in other specific circumstances, in which case a reasoned decision must be required.’

Furthermore, Article 5 (4), which is the specific provision granting the possibility of derogations to the mandatory bid rule, states:

‘...Provided that the general principles laid down in Article 3 (1) are respected, Member States may authorize their supervisory authorities to adjust the price referred to in the first subparagraph in circumstances and in accordance with criteria that are clearly determined. To that end, they may draw up a list of circumstances in which the highest price may be adjusted either upwards or downwards, for example where the highest price was set by agreement between the purchaser and a seller, where the market prices of the securities in question have been manipulated, where market prices in general or certain market prices in particular have been affected by exceptional occurrences, or in order to enable a firm in difficulty to be rescued. They may also determine the criteria to be applied in such cases, for example the average market value over a particular period, the break-up value of the company or other objective valuation criteria generally used in financial analysis. Any decision by a supervisory authority to adjust the equitable price shall be substantiated and made public’.

In other words, Member States may allow their supervisory authorities to decide, case-by-case, that the Mandatory Bid Price should be adjusted or that the Mandatory Bid Rule does not apply at all in certain special circumstances, whether specified by the

national rules or not ('other special cases').⁶⁰⁸ To be sure, unjustified or over-ample use of this power may constitute a breach of Article 3 (1) (a) (protection of minority shareholders in case of control transfer), unless of course some other equivalent form of protection is provided.⁶⁰⁹ Although the Directive provides explicitly for one category of derogation⁶¹⁰(Article 5 (2) – where control has been acquired following a 100% voluntary bid to all the holders of securities for all their holdings), there are possibilities for other categories of derogations granted by the Member States at the implementation stage or by the supervisory authorities and the legislature at the bid stage. These derogations should be interpreted narrowly. This narrow discretion of the Member States and national supervisory authorities to the possible exemption is not only due to the determination of the price by 'circumstances and in accordance to criteria clearly determined' and the relevant national 'list of circumstances' (Article 5 (4) of the Directive). The general principle of Article 3 (1) (a) of the Directive and Article 43 EC Treaty also dictate a narrow national discretion in granting the adjustment. When the national supervisory authority grants a derogation to the mandatory bid rule under Article 5 (4) of the Directive ('the highest price paid for the same securities by the offeror , or by persons acting in concert with him/her , over a period , to be determined by Member States, of not less than six months and not more than 12 before the bid

⁶⁰⁸ L. Enriques, 'The Mandatory Bid Rule in the Takeover Directive : Harmonization Without Foundation ?' (2004) 4 ECFR , 440 , 443.

⁶⁰⁹ L. Enriques (n 608) 443. K. Hopt discusses the issue of 'equivalence' in the framework of the German Company Law (and especially the law relating to groups of companies): He thinks that, within a developed capital market at any rate, a mandatory bid will be functionally superior to a solution based upon the law relating to groups of companies (also mentioned above). K. Hopt (n 295) 18-19. E. Wymeersch (ed.) *Groups of Companies in the EEC: a survey report to the European Commission on the law relating to corporate groups in various Member States* (Walter de Gruyter, Berlin 1993).

⁶¹⁰ A Council and Commission statement entered in the minutes of the Council on the adoption of the Directive expresses the Council and Commissions agreement that national law may provide that , when control has been obtained following a voluntary bid made in accordance with the Directive , addressed to all holders of securities for at least 60% of their holdings , the obligation to launch a mandatory bid laid down in Article 5(1) shall not apply ,on condition that the offer has been approved by the majority of shareholders with voting rights , excluding from calculation securities held by the offeror and by any shareholder who alone or in concert holds more than 10% of the voting rights. F. Wooldridge (n 594) 151.

referred to paragraph 1 shall be regarded as the equitable price'), it has a narrow discretion; a wide discretion would be incompatible with the general principle of Article 3 (1) (a) (adjusting the price downwards without adequate justification does not protect '...the other holders of securities...') of the Directive and the fundamental freedom of establishment (Article 43 EC Treaty-adjusting the price upwards without adequate justification could discourage bidders). Furthermore, the European Commission in its 2002 Proposal⁶¹¹ justifies the derogation provision by the need for flexibility in the financial markets and stresses that Member States shall 'authorize their supervisory authorities to adjust that price in circumstances and according to criteria that are clearly determined, by means of a reasoned decision that is made public'.

The Directive does not specify exactly what share of the capital and voting rights is needed for control; that is left to Member States to decide. It does not even specify a method of calculation.⁶¹² The lack of harmonized control threshold and a price definition does not contribute towards a unified system of minority shareholder protection throughout the European Union. There has been some criticism of the fact that the Directive does not require a cash alternative in all circumstances: although liquid securities (which it may be noted are not defined) may be regarded as almost equally fungible, they are clearly at risk of volatile price movement.^{613 614}

As far as the relation of Article 5 with other provisions of the Directive is concerned, we should pay attention to the relationship between Article 5 and the breakthrough provision (Article 11). The crucial question is: if breakthrough would apply if a bid were to be made, should the potential for breakthrough change the threshold for

⁶¹¹ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids COM (2002) 0534 final [2003] OJ C45E/7.

⁶¹² P. Leyens (n 537) 56.

⁶¹³ V. Edwards (n 559) 434.

⁶¹⁴ For an economic analysis see: J. McCahery and others *The Economics of the Proposed European Takeover Directive* (Research Report, Center for European Policy Studies, Brussels 2003)

determining control on the grounds that if the target is subject to the rule acquisition of control is easier?⁶¹⁵ The better answer is that priority should be given to protecting the minority shareholders over promoting freedom of establishment. The fact that the control threshold is crossed more easily by enforcing the breakthrough rule, triggers more easily the mandatory bid rule, which protects minority shareholders. Thus, the shareholder protection conferred by the mandatory bid rule is promoted by the breakthrough rule. On the other hand, there are arguments that the breakthrough rule and the mandatory bid rule should be treated as irrelevant and that the most important issue is the current de facto exercise of control by the offeror without the breakthrough mechanism.⁶¹⁶

The mandatory bid rule is not fully comprehensive. This makes its implementation and its protective function more difficult. It is possible that the mandatory bid rule's scope will not include some cases of minority shareholder protection. For example there is no reference to the treatment of acquisitions of control of companies controlling a listed company.⁶¹⁷ The minority shareholders of the listed company need protection from the new acquirers of the controlling company, who are also able to control the listed company. Unfortunately, the Directive does not regulate these situations, not even with a general provision. It leaves their regulation to the discretion of each Member State.

The omission of partial bids from the Directive is another negative factor as regards minority shareholder protection. A bidder may seek a stake below the mandatory bid threshold, possible because all he wants is working control, or he may want a larger

⁶¹⁵ J. Rickford, 'The Emerging European Takeover Law From A British Perspective' [2004] EBLR 1379, 1395.

⁶¹⁶ J. Rickford (n 615) 1395.

⁶¹⁷ L. Enriques (n 608) 445.

stake.⁶¹⁸ No mandatory bid requirement will of course follow a bid for a stake below the relevant threshold.⁶¹⁹ So, a potential bidder could design the shares acquisition just below the mandatory bid threshold in a way that he fulfills his plans without having to finance a mandatory bid. These kinds of practices, which are allowed by the Directive, do not contribute at all to minority shareholder protection (because this is a de facto minority). However, the variety of mandatory bid thresholds at EU level, resulting from the Member States' discretion in determining the relevant threshold, could create serious obstacles to anybody trying to design a shares acquisition just below the mandatory bid threshold (in order to evade its implementation) .

The definition of 'securities' in Article 2 (1) (e) is not really helpful in the context of the mandatory bid rule. 'Securities' means transferable securities carrying voting rights in a company. The mandatory bid rule provisions do not apply to non-voting securities. This, in turn, means that some value-decreasing acquisitions may well go through under the proposed regime: in the worst scenario, after the bid (voluntary or mandatory) the new controlling shareholder will be able to abuse his position to the detriment of holders of non-voting shares, to whom the Directive gives no exit-option protection.⁶²⁰ The Directive should have given a more flexible definition of 'securities' to prevent non-voting shareholders being locked into the company after the control change. An exit-option would confer a real protection on this category of shareholders. There is always the danger that the acquirer could abuse his control powers over the trapped non-voting shareholders.

As we already mentioned, Article 44 (2) (g) EC Treaty is the legal basis of the Directive. In the mandatory bid rule, the rationale of 'the protection of the interests of

⁶¹⁸ L. Enriques (n 608) 445. H. Leigh Ffrench 'Pre-offer purchases and partial take-over bids' (1986) 7 CoLaw 66-67.

⁶¹⁹ L. Enriques (n 608) 445.

⁶²⁰ L. Enriques (n 608) 447.

members and others' is expressed in the text of the Directive. Article 5 (1) states: '...such a person is required to make a bid as a means of protecting the minority shareholders of the company.' Preamble paragraph 9 states:

'...protect the holders of securities , in particular those with minority holdings when control of their companies has been acquired' and ' ...ensure such protection by obliging the person who has acquired control of a company to make an offer to all the holders of that company's securities for all of their holdings at an equitable price ...' .

While the mandatory bid rule declares minority shareholder protection as its primary aim, there is a huge debate about the possibility of succeeding in such an aim. There is a broad consensus in the literature that, while obviously ex post (i.e. after a control acquisition materializes) minority shareholders are better off with a mandatory bid rule in place, ex ante, the rule inevitably reduces the number of value increasing control acquisitions.⁶²¹ This is because a mandatory bid rule is discouraging to a potential investor/bidder as a result of the potential cost of making a mandatory offer. If a potential bidder faces the mandatory bid rule, he will consider again thoroughly his decision to launch a bid. Thus, the shareholders might lose the opportunity to sell their shares at a higher premium (the higher premium which could be offered in the absence of a mandatory bid rule). This line of argument contends that it is far from certain that the benefits (either private or not) to minority shareholders from protection against value-decreasing acquisitions, e.g., by looters, are greater than the costs of lost opportunities of value increasing acquisitions, the increased agency costs of reduced market discipline upon incumbent managers and blockholders, and the efficiency loss deriving from the lesser adaptability of the industrial system to environmental changes.⁶²²

⁶²¹ L. Enriques (n 608) 448.

⁶²² L. Enriques (n 608) 448 See also for a comprehensive view of the debate : M.Burkart and F.Panunzi , 'Mandatory Bids , Squeeze-out , Sell-out and the dynamics of the Tender Offer Process in

The minority shareholder protection rationale of the rule is closely related to the equal treatment rationale.⁶²³ Article 3 of the Directive states among the general principles that ‘all holders of the securities of an offeree company of the same class must be afforded equivalent treatment’. The mandatory bid rule is also based on the equal treatment rationale. The equal treatment in question relates mainly to the premium paid for the shares acquired. If the bidder is not obliged to launch a mandatory bid when he reaches the mandatory bid threshold of control, then only the shareholders who sold their shares to the new controller benefit from the premium. The minority shareholders do not benefit from this premium, are trapped in the company with the new controller, and can only sell their depreciated shares at normal stock exchange rates. On the other hand, if the bidder is obliged to launch a mandatory bid, then the shareholders whose shares were used by the bidder in order to acquire control have to share the premium with the minority shareholders.⁶²⁴ As was argued in respect of the minority shareholder protection rationale, the mandatory bid rule results in less takeover activity.⁶²⁵ It is impossible to state ex ante and in general (and even more so for all EC equity markets) whether the premiums would offset the adverse effects of the mandatory bid rule on takeover activity and on managerial discipline.⁶²⁶

G.Ferrarini , K.Hopt , J. Winter and E.Wymersch (eds) , *Reforming Company and Takeover Law in Europe* (1st edition OUP , Oxford 2004) , E.Wymeersch ‘The Mandatory Bid : A Critical View’ in K. Hopt and E.Wymeersch (eds) , *European Takeovers* (1st ed. Butterworths , London 1992) , R. J. Gilson ‘The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment’ (1992) 61 *Fordham L.Rev.*161 , 164 and O.Ehrhardt and E. Nowak, ‘Private Benefits and Minority Shareholder Expropriation – Empirical Evidence from IPOs of German Family-Owned Firms’ (2002) EFA 2003 Annual Conference Paper No. 809 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=423506&high=%20nowak >.

⁶²³ L. Enriques (n 608) 453. For a comment on an interesting dispute before the Takeover Appeal Board, see: G. Morse ‘The Takeover Appeal Board rules on equivalent treatment of shareholders under a Code offer and the existence of different classes of shares: Cumbrian Newspaper Group Ltd case not applied’ (2008) 1 *JBL* 96.

⁶²⁴ This means of course reduced premium for the shareholder whose shares conferred control to the bidder because the bidder must now take into account his new obligation of launching a Mandatory Bid.

⁶²⁵ L. Enriques (n 608) 453.

⁶²⁶ L. Enriques (n 608) 453 and see also R.Kraakman and others (n 538) 187. As we already mentioned, the possibility of a Mandatory Bid discourages a potential bidder from proceeding to his offer.

Nor does the mandatory bid rule contribute to the integration of European equity markets.⁶²⁷ The Explanatory Memorandum of the Commission Proposal⁶²⁸ sets this as the very purpose of the Takeover Bid Directive. This lack of contribution results from the discouraging effect of the mandatory bid rule to potential bidders, which reduces the number of value-increasing takeovers which will take place for the shareholders' benefit. This could be then compared with managerial defensive tactics.⁶²⁹ The situation is aggravated by the permissibility of defensive measures by the board of the company without prior shareholder approval (resulting from the combined operation of Article 9 and 12 of the Directive). The mandatory bid rule, as a further takeover obstacle, may discourage bids. The mere existence of the mandatory bid rule may assist the board of the offeree company in its efforts to frustrate a bid, because there is no need to obtain shareholder approval for this inherent takeover obstacle. Furthermore, the mandatory bid as a defensive measure is not required to be announced at a general meeting of the offeree company and does not need to be included in the publication of the detailed information required by Article 10 of the Directive. It is a 'hidden' defensive measure. The mandatory bid is an additional barrier to takeover activity, and, as a consequence, to market penetration. This is detrimental to the market in corporate control, to freedom of establishment, and to the integration of European equity markets in general.

⁶²⁷ L. Enriques (n 608) 453.

⁶²⁸ Proposal for a European Parliament and Council Directive on Takeover Bids (COM (2002) 534) of 2 October 2002, Explanatory Memorandum, 3.

⁶²⁹ L. Enriques (n 608) 453. It is argued that the Takeover bid Directive does not follow the two basic rationales behind the mandatory bid rule: the protection of minority shareholders and the prevention of value-decreasing public offers. On the one hand, the mandatory bid rule by raising the cost of acquisition is likely to prevent value-increasing transactions. On the other hand, the mandatory bid rule does not prevent the extraction of private benefits and, as a result, does not contribute to the protection of minority shareholders. These legislative choices at EU level are not considered to be a positive and efficient evolution of the EU securities regulation. S. Sepe, 'Private Sale of Corporate Control: Why the European Mandatory Bid Rule is Inefficient' (2007) SSRN Working Paper <<http://ssrn.com/abstract=1086321>> accessed 24 Sept. 2008.

12.2) The ‘Concerted Parties’ Problem

The definition of ‘Concerted Parties’ in the Takeover Bid Directive is another issue which diminishes even more the contribution of the mandatory bid rule to minority shareholder protection, and, subsequently, to freedom of establishment. Article 2 (1) (d) of the Directive defines concerted parties as

‘natural or legal persons who cooperate with the offeror or the offeree on the basis of an agreement , either express or tacit , either oral or written aimed either of acquiring control of the offeree company or at frustrating the successful outcome of a bid. ’

Moreover, the mandatory bid rule (Article 5 (1) of the Directive) includes concerted parties in the acquisition of shares and the crossing of the mandatory bid threshold. However, Article 5 (3) of the Directive again confers wide discretion upon the Member States:

‘The percentage of voting rights which confers control for the purposes of paragraph 1 and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office.’

So, the percentage of voting rights which confers control is defined by the Member States. This percentage of shares defines the acquisition of control according to Article 5 (1) of the Directive. As a matter of fact, the acquisition of control defines the concerted parties (Article 2 (1) (d) of the Directive). Again, this wide discretion of Member States is something very dangerous due to the risk of national protectionism, which is quite usual in the field of European takeovers.

The vagueness of the relevant provision of the Directive and the wide discretion conferred upon Member States could harm the interests of minority shareholders. First, the provision, by referring to a mandatory bid threshold, does not cover the cases of

hidden de facto control by concerted parties. The hidden controller, in order to evade crossing the mandatory bid threshold, can sell his shares to ‘white knights’, e.g. investment banks, under put and call arrangements, who will hold the shares on his behalf. Thus, the hidden controller maintains control with the help of the ‘concerted parties,’ and does not have to finance a mandatory bid in favor of minority shareholders. Moreover, the hidden controller can use call options derivatives and re-acquire the shares at a later stage. This technique was used in two recent Italian takeover cases: SAI/Fondiaria and Banca Antonveneta.⁶³⁰ Second, there is no ‘grandfathering’⁶³¹ provision. If a shareholder or a shareholder consortium had already crossed the mandatory bid voting threshold before the implementation of the Takeover Directive, what would happen as regards a mandatory bid? This was the case in the Beiersdorf takeover by a consortium led by Tschibo.⁶³² The Directive mentions nothing about any parties acting in concert if one of those parties had already crossed the mandatory bid threshold before the implementation of the Takeover Directive. The easier the triggering of the mandatory bid, the better the protection of the minority shareholders, consistently with the legal basis (Article 44 (2) (g) EC Treaty). Hence, if a person had crossed the mandatory bid threshold before the implementation of the Directive, he should be obliged to launch a mandatory bid in favor of minority shareholders. This solution also promotes equality for investors prior to and after the

⁶³⁰ J. Grant ‘Takeover Regulation and the balancing of interests’ and E. Bomans and C. Demoulin ‘Acting in Concert – first conclusions drawn from two recent Takeovers and the Takeover Directive’ in J. Grant (ed.), *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books, London 2005) 45-48 and 92-93. P. Giudici ‘Private Law Enforcement in a Formalist Legal Environment: The Italian Sai-Fondiaria Case’ (2008). ECGI Law Working Paper No. 094/2008 <<http://ssrn.com/abstract=1103985>> accessed 19 Sept. 2008.

⁶³¹ This term was borrowed by J. Grant (n 630) 42.

⁶³² National protectionism of local industries appeared again in the Beiersdorf Case. Procter & Gamble tried to acquire control in Beiersdorf. Tschibo with the support of the City of Hamburg and the Labour Unions led a consortium which finally acquired the control of a company and secured that the local company will not be delocalised and that tax revenues and employment will not be lost. For an analysis of the this Takeover case and its political background see: J. Grant ‘Takeover Regulation and the balancing of interests’ and E. Bomans and C. Demoulin ‘Acting in Concert – first conclusions drawn from two recent Takeovers and the Takeover Directive’ in J. Grant (ed.), *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books, London 2005) 42-45 and 94-95.

implementation of the Directive. The Directive could be more specific and detailed in this respect. Member States might adopt solutions detrimental to the protection of minority shareholders due to national protectionist concerns. It is not right to exclude such important issues of shareholder protection from explicit regulation at European level.

An additional problem of interpretation lies in the definition of the parties acting in concert in the Article 2 (1) (d) of the Directive. Member States should not require that the persons acting in concert effectively exercise their control over the company following the acquisition of shares (which gives them a controlling stake).⁶³³ If parties cooperate jointly to acquire a stake that is defined as a ‘controlling stake’ under the applicable law, it seems irrelevant to verify whether or not these parties are coordinating their conduct with regard to the target company following this acquisition.⁶³⁴ Only this interpretation is compatible with the rationale of minority shareholder protection. The fewer conditions for the triggering of the mandatory bid rule, the better for minority shareholder protection. This approach makes it easier for the concerted parties to be obliged to launch a mandatory bid for the benefit of minority shareholders. Additional requirements, like the pursuit of a common objective beyond the acquisition of the shares, and the coordination of voting rights beyond the acquisition of shares, makes the triggering of the mandatory bid rule more difficult. If a more restrictive interpretation imposing additional conditions is adopted, the danger of circumvention by the concerted parties exists. It may be quite difficult to prove (even if it is obvious in cases like the SAI/Fondiaria case and the Beiersdorf case) that the parties coordinate their action beyond the acquisition of the shares. It is useful to remember that the Takeover Directive provides that persons who jointly acquire shares

⁶³³ E. Bomans and C. Demoulin (n 630) 97.

⁶³⁴ E. Bomans and C. Demoulin (n 630) 99.

with the objective of frustrating the successful outcome of a bid are also considered to be acting in concert, without requiring evidence of any joint future control over the target company.⁶³⁵ When a single buyer acquires a participation in a listed company that is defined as a ‘controlling stake’ under the applicable takeover law, it is not necessary to verify whether this party effectively has the objective of exercising control over the target company.⁶³⁶ Why then should it be necessary for several parties acting in concert? Member States and their national supervisory authorities have no other option but to adopt this less restrictive interpretation, which is consistent with the protection of ‘members’ rationale of the legal basis (Article 44 (2) (g) EC Treaty) of the Directive.

The vagueness of the ‘concerted parties’ definition,’ and the subsequent danger of the Member States exercising their discretion in this regard, may also have implications for shareholder activism. Shareholder activism entails the coordination of the action of shareholders (mainly institutional shareholders) in order to defend their shareholder rights and to push for reforms and corporate governance improvements in a listed company, for instance by filing proposals at a general meeting of shareholders.⁶³⁷ However, they do not seek to acquire control. If such action qualifies as concerted party action, an acquisition of shares by any of its members may lead to all of them having to launch a mandatory bid if it is demonstrated that they hold an aggregate percentage of voting rights that is considered to confer control of a company.⁶³⁸ This stance would discourage institutional investors from investing in shares, and as a consequence would affect negatively the freedom of establishment through its restriction of the market in

⁶³⁵ E. Bomans and C. Demoulin (n 630) 102.

⁶³⁶ E. Bomans and C. Demoulin (n 630) 99.

⁶³⁷ E. Bomans and C. Demoulin (n 630) 100. P. Santella, E. Baffi, C. Drago and D. Lattuca ‘A Comparative Analysis of the Legal Obstacles to Institutional Investor Activism in Europe and in the US’ (2008) SSRN Working Paper <<http://ssrn.com/abstract=1137491>> accessed 23 Sept. 2008.

See also the Introduction in M.A. Weinberg, M.V. Blank and A.L. Greystoke (n 516).

⁶³⁸ E. Bomans and C. Demoulin (n 630) 100.

corporate control. Additionally, this stance is harmful for the shareholders' protection. Shareholders will be afraid of coordinating their action in order to push for corporate governance reforms, due to the possibility of being characterized as concerted parties, and triggering the mandatory bid rule. So, again, we have here an internal conflict as regards the aim of the legal basis of the Directive. The mandatory bid rule is seen as protection for minority shareholders (Article 5 of the Takeover Directive is headed 'Protection of minority shareholders, the Mandatory Bid and the Equitable Price').⁶³⁹ The promotion of corporate governance reforms is also, however something positive for shareholders. There is the danger that this promotion will be curtailed because the coordinated action of the parties could be considered as concerted. As shareholder activism is commonly regarded as benefiting all (minority) shareholders, it is therefore necessary to make sure that a rule aiming at protecting minority shareholders (the mandatory bid rule) does not deprive these minority shareholders from another protection (the possibility to coordinate the exercise of voting rights in order to improve the corporate governance structure of a company without the intention to acquire the control of this company).⁶⁴⁰ These ideas aim at the protection of shareholders but they cannot fully coexist due to the peculiar structure of the mandatory bid rule. The best way of balancing them is the solution in the UK City Code. It is essential to verify whether a shareholder proposal at a general meeting is 'board control – seeking'. If it is 'board control-seeking', then the parties are considered to act in concert, and accordingly should comply with the mandatory bid provisions.⁶⁴¹ The solution of the

⁶³⁹ E. Bomans and C. Demoulin (n 630) 101. See also M. Burkart and F. Panunzi, 'Mandatory Bids, Squeeze-out, Sell-out and the dynamics of the Tender Offer Process in G. Ferrarini, K. Hopt, J. Winter and E. Wymersch (eds), *Reforming Company and Takeover Law in Europe* (1st edition OUP, Oxford 2004).

⁶⁴⁰ E. Bomans and C. Demoulin (n 630) 101.

⁶⁴¹ E. Bomans and C. Demoulin (n 630) 100. See for an extensive analysis of the UK legal regime G. Stedman, *Takeovers* (Longman Commercial Series, 1st edition Longman, London 1993) and S. Kenyon-Slade (n 541). For a comparative study see: C. Forstinger (n 310).

UK City Code should also be transposed to the European level. It fosters the shareholder protection rationale by balancing both the aims referred to above. This solution is based on the heart of shareholder protection: the (minority) shareholders need protection when a group of shareholders does not seek corporate governance reforms but for board control. The (minority) shareholders need protection via the mandatory bid rule, when a control change is imminent. Hence, the legal basis of the Directive would be respected because the minority shareholder rationale would be completely fulfilled.

The lack of a common definition and common criteria in order to know when cooperation can qualify as concerted party action may thus lead to legal uncertainty and to law suits, the outcomes of which would be difficult to predict.⁶⁴² Special procedural issues about parties acting in concert will definitely arise during the course of a cross-border takeover bid. National courts and competent authorities may give different interpretations of when parties to a bid are acting in concert. If a court confirms the existence of a concerted action, considerable time may have elapsed between the time of the change of control and the court decision.⁶⁴³ One may then question whether the court should sanction the concerted party action by imposing a tender offer on all of the outstanding shares, or whether damages are the only possible remedy.⁶⁴⁴ An additional issue is who will be entitled to the damages and how the damages will be calculated.⁶⁴⁵ This legal uncertainty is detrimental to minority shareholder protection. A common and specific definition would reduce the need for uncertainty to be resolved by litigation.. Furthermore, a common and specific definition would facilitate the work of the national judges when, inevitably, cases do come to court.

⁶⁴² E. Bomans and C. Demoulin (n 630) 96.

⁶⁴³ E. Bomans and C. Demoulin (n 630) 96.

⁶⁴⁴ E. Bomans and C. Demoulin (n 630) 96.

⁶⁴⁵ E. Bomans and C. Demoulin (n 630) 96.

The Directive's provision about the parties acting in concert should be examined very carefully at the implementation stage because it offers ample room for evading the mandatory bid rule. This potential evasion is possible due to the national protectionist mentality of Member States in the field of takeover bid laws. The chosen interpretations and solutions ought to focus on minority shareholder protection. Otherwise, the aims of legal basis of the Directive (Article 44 (2) (g) EC Treaty) would not be respected.

12.3) The Squeeze-out and Sell-out Rights (Article 15 and Article 16).

The squeeze-out right is described in Article 15 of the Directive. Article 15 (2) states:

‘Member States shall ensure that an offeror is able to require all the holders of the remaining securities to sell him/her those securities at a fair price’.

The rule is aimed at allowing a bidder to gain 100 per cent of the equity to simplify accounting and administration by removing the need to deal with minority shareholders (which can incur high costs).⁶⁴⁶ The bidder knows in advance that if he reaches the squeeze-out threshold, he will be able to exercise the squeeze-out right in order to apply a more efficient management regime. This encourages potential bidders. Hence, freedom of establishment could be promoted, because this measure aims at the protection of investors. Additionally, the protection of shareholders is also promoted

⁶⁴⁶ J. Grant (n 630) 48. For an overview of the economic rationale and of the legal framework of the squeeze-out right and the sell-out right: C. Van Der Elst and L. Van Den Steen ‘Opportunities in the M&A aftermarket: squeezing out and selling out’ (2006) University of Gent, Financial Law Institute Working Papers WP 2006-12 and . C. Van Der Elst and L. Van Den Steen ‘Squeezing and Selling-out-a Patchwork of Rules in Five European Member States’ (2007) 4 ECL 19-20, 25.

because they will have a second chance after the first bid to sell their shares. However, these potential benefits of the squeeze-out rule are cancelled out by another deficiency of the Directive. The provision in question makes no reference to statutory mergers or delistings, which can be used as de facto means of squeeze-out at higher costs, but lower valuations than the tender offer (like in the Deutsche Telecom and T-Online case).⁶⁴⁷ Statutory mergers may operate to the detriment of the protection of shareholders. The statutory merger process allows the majority shareholders to acquire the shares of the minority shareholders at a lower price than applied to the public offer which was previously rejected by the minority shareholders. This practice seems against the interests of minority shareholders; the minority shareholders do not find the price of the bid attractive but they are obliged to sell their shares at a price lower than the price of this bid. Statutory mergers are triggered at a lower threshold than the normal squeeze-out threshold (e.g. 75% in Germany) and without strict fair pricing provisions (they are usually offering a much lower price than the normal market price of the shares).⁶⁴⁸ The Directive does not explicitly prohibit this kind of technique which results in watering down the protective effects of the squeeze – out rule. Furthermore, the fact that the right of squeeze – out must be exercised only in the class in which the relevant threshold has been reached adds an extra burden to the squeeze-out right (Article 15 (3) of the Directive). The protection of shareholders is reduced because the squeeze out right must be exercised separately for every category of shareholders and not altogether. Again the object of shareholder protection of the legal basis of the Directive is not accomplished.

⁶⁴⁷ J. Grant (n 630) 49.

⁶⁴⁸ J. Grant ‘The European Takeover Directive’ in J. Grant (ed.), *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books, London 2005) 65.

The Takeover Bid Directive requires Member States to institute sell-out rights, based on fair pricing provisions similar to Article 15 on squeeze-out.⁶⁴⁹ More specifically, ‘member States shall ensure that a holder of remaining securities is able to require the offeror to buy his securities at a fair price, under the same circumstances as provided for in Article 15 (2)’. The aim of this provision is to provide an exit to the remaining shareholders and as a consequence to protect them. Otherwise, the remaining shareholders could very easily be abused by the new controller and the only exit would be to sell their depreciated shares at a low price on the market. Nevertheless, this protection is again diluted. The sell-out right is granted according to Article 15 (1) only where a bid is made to all the holders of the offeree company’s securities for all of their securities. This can be either a voluntary bid or mandatory bid.⁶⁵⁰ As seen above, mandatory bids may turn out to be easily avoidable, depending on the choices made by Member States and national supervisory authorities.⁶⁵¹ The exercise of the sell-out right depends on the prior launch of a mandatory bid. The mandatory bid depends on the discretion of the Member States and the national supervisory authorities. Hence, the exercise of the sell-out right depends on this discretion, which renders this right ineffective. The Directive tries to protect the shareholders by conferring this right but simultaneously it cancels this protection by making the mandatory bid rule and, as a consequence, the sell-out right, easily avoidable. The exercise of the sell-out right will depend in each case on the national exceptions to the mandatory bid rule. It is obvious that this does not contribute to shareholder protection. This category of remaining shareholders is quite vulnerable since it has no other effective disengagement possibilities. Furthermore, by setting a sufficiently low price for a voluntary bid for all

⁶⁴⁹ J. Grant (n 630) 50.

⁶⁵⁰ L.Enriques ‘The mandatory bid rule and the sell-out right in the Takeover Directive : harmonisation for its own sake ?’ in J. Grant (ed.) , *European Takeovers : the Art of Acquisition* (1st ed Euromoney Books , London 2005) 123.

⁶⁵¹ L. Enriques (n 650) 124.

the shares, the acquirer may succeed in holding securities representing less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company, thus preventing minority shareholders from exiting the company by way of the sell-out right.⁶⁵² Unfortunately, this circumvention technique is not explicitly banned by the Directive.

Undoubtedly, the value of the one share/one vote principle is revealed at this point.

This principle could prevent the development of this type of circumvention.

⁶⁵² L.Enriques (n 650) 124.

CHAPTER 13

THE NON-FRUSTRATION RULE (ARTICLE 9), THE BREAKTHROUGH RULE (ARTICLE 11) AND THE RECIPROCITY RULE (ARTICLE 12).

These three rules constitute the core regulation of the takeover bid process. The first two rules (Articles 9 and 11) regulate the behavior of the management of the target company during the pre- and post bid period. The intended contribution of these Articles is watered down due to a complicated opt-in/opt-out system which renders their application optional. The reciprocity rule adds another component to this optionality regime. The reciprocity rule is nothing more than simply another opportunity to opt-out. We will try to analyze this intricate system of substantive provisions coupled with a multi-layer mechanism of opt-ins and opt-outs by explaining the basic provisions and identifying their defects.

13.1) The Non-Frustration/Board Neutrality Rule (Article 9).

The board neutrality or non-frustration rule envisages the UK model of the regulation of takeovers at European level. S. Bartman argues that the ‘non-frustration’ term rather than the ‘board neutrality term’ is correct because the management of the company is not so much required to observe a neutral attitude towards a bid, but rather forbidden to frustrate the bid before the general meeting of shareholders has had the opportunity to express an opinion on it.⁶⁵³ Additionally, the board of the bidder, according to Article 9 (5) of the Directive, shall draw up and make public a document setting out its opinion

⁶⁵³ S. Bartman , ‘Analysis and consequences of the EC Directive on takeover bids’ (2004) 1 ECL, 5 , 5.

of the bid. Hence, the meaning of the word ‘neutral’ is not suitable, if the board of the target expresses its hostility or friendliness in the report without of course taking any forbidden frustrating measures.

Article 9 (2) of the Directive states that the prior authorization of the general meeting of shareholders is required before any action on behalf of the target’s board, which could result in the frustration of the bid. The Directive clarifies that in the two-tier board structures ‘board’ should mean both the management and the supervisory board (Article 9 (6)). The Takeover Directive rests on the principle that a takeover bid is made to the shareholders and, consequently it is up to the shareholders to decide on defensive measures.⁶⁵⁴ The Explanatory Memorandum of the Commission’s 2002 Proposal says:

‘Where control of the offeree company is at stake, it is important to ensure that its fate is decided by its shareholders. The authorization of the general meeting must therefore be given explicitly with a view to responding to a specific bid ...’,⁶⁵⁵

Thus, the non- frustration rule is a way of protecting the interests of shareholders and fulfilling the aims of the legal basis of Article 44 (2) (g) EC Treaty. The board of the Company is only permitted to seek for alternative bids in order to offer a wider and competitive range of choices to the shareholders of the company.⁶⁵⁶ Furthermore, the Directive states that:

‘Such authorization shall be mandatory at least from the time the board of the offeree company receives the information referred to in the first sentence of Article 6(1) concerning the bid and until the result of the bid is made public or the bid lapses . Member States may require that such authorization be obtained

⁶⁵⁴ R. Skog (n 549) 307.

⁶⁵⁵ COM (2002) 534 Final 8, D. A. Wyatt and A. Dashwood (n 25) 870.

⁶⁵⁶ However , there are strong arguments against the protective scope of the competitive bids. We would focus on this issue, below in the subsection about the problems of the non-frustration rule.

at an earlier stage, for example as soon as the board of the offeree company becomes aware that the bid is imminent.’

This subparagraph of the Directive tries to prevent the phenomenon of market manipulation and insider dealing because during this period the circulation of some specific information is quite sensitive. This is also in conformity with the European legislation on market abuse.⁶⁵⁷ Furthermore, the general principle of Article 3(d) prohibits the creation of false markets and artificial fluctuations in the market prices of the company’s shares. It is obvious that all these provisions aim at protecting the shareholders from reductions in the prices of their shares as a result of unlawful activity.

Additionally, paragraph 2 of Article 9 mentions as a particular way of inhibiting permanently a bid the issuance of new shares. This defensive measure is expressly stated by the Community legislature because it can result in a permanent and irreversible barrier to the attempts of the bidder. The new shares dilute the stake of the bidder and it would be impossible to ever reach the desired control level of the company’s equity. This restriction also includes securities that confer the pre-emption right to subscribe to such securities, like convertible bonds and warrants. According to the second company law Directive⁶⁵⁸, increases in capital are responsibilities of the general meeting. Nevertheless, according to Article 25 (1) and (2) of the same Directive, the general meeting can delegate this power for up to five years to the board of the company. It is this delegated right to increase capital that the board of directors is

⁶⁵⁷ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16.

⁶⁵⁸ Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the EC Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital with a view to making such safeguards equivalent [1977] OJ L26/1.

to be deprived of under Article 9 of the Takeover Bid Directive, from the moment that the offeror has publicized his intention to make a public offer.⁶⁵⁹ The general meeting, which will decide on the authorization of defensive measures, is free to authorize the issue of new shares, since the shareholders are sole judges of the need for defensive measures. In Member States where delegation of the right to increase capital deprives the general meeting of its right to do so, it is clear that Article 9 of the Takeover Directive enables the general meeting to regain this power.⁶⁶⁰ The shareholders' pre-emption rights should be fully respected.⁶⁶¹ Hence, all the existing shareholders must be allowed to subscribe to the securities issued by the board.⁶⁶² The controlling shareholders and the bidder would normally subscribe to the new shares. However, it is not certain that the minority shareholders will exercise their pre-emption rights and that is what the board of the company hopes.⁶⁶³ The board hopes the minority shareholders will not exercise their pre-emption rights and that this capital increase will function as a potential defensive measure (watering down control). The stake of the bidder would be diluted because it is not certain that all the new-issued shares corresponding to the pre-emption right of the minority shareholders will be bought by the bidder (some of them might be bought by other stakeholders, thus watering down the percentage of the bidder). What about an issue of shares that was decided upon before the launch of the bid? Should it be carried out during the bid period? Here we have the safeguard of Article 9 (3), pursuant to which the general meeting of shareholders must approve

⁶⁵⁹ J.M.M. Maeijer and K.Geens (n 511) 9.

⁶⁶⁰ J.M.M. Maeijer and K.Geens (n 511) 9.

⁶⁶¹ However, it is also alleged that the board can withdraw the pre-emption rights. However, this interpretation constitutes a defensive measure because it can impede permanently the bidder from obtaining control. Only after the bid has been made public, the general meeting can authorize a capital increase together with a withdrawal of pre-emption rights. This allegation could be found in J.M.M. Maeijer and K.Geens (eds) (n 511) 10-11.

⁶⁶² F. Ipekeli (n 554) 347.

⁶⁶³ P. Lambrecht 'The 13th Directive on Takeover Bids – Formation and Principles' in Ferrarini et al (eds) *Capital Markets in the Age of Euro –Cross Border Transactions , Listed Companies and Regulation* (Kluwer Law International , London 2002) 460.

actions that do not form part of the normal course of the company's business. In that way, if the board of the company has confidential information about a future bid, it will not be able to entrench its position by deciding to issue shares, and executing the decision later on when the bid is made public. Shareholders' approval will be required.

Furthermore, in addition to Article 9 (3), Recital 16 of the Preamble is also relevant here:

'In order to prevent operations which could frustrate a bid , the powers of the board of an offeree company to engage in operations of an exceptional nature should be limited , without unduly hindering the offeree company in carrying on its normal business activities .'

This provision obliges us to adopt the interpretation at national level that the issue of new shares during the bid period is uncontestedly a defensive measure. However, this provision is not restricted solely to the issue of new shares. It also covers many other hidden defensive measures, which would be presented by the board as part of the normal course of business. The underlying idea is to prevent the board from realizing material changes of the position of the target, such as the sale of substantial assets or the acquisition of a new subsidiary.⁶⁶⁴

I believe that it is a good idea to cite here once again the various different defensive measures that can be used by the board to frustrate a bid. The available arsenal of the board stresses the importance of a strict non-frustration rule. Post-bid defences⁶⁶⁵ include: poison pills, pac-man defences, spin-offs (crown jewels), white knight/squire, anti-trust litigation, strategic acquisitions, share buy-backs, and special dividends.

The protection of shareholders by giving them the opportunity to decide, without being subject to detrimental delays, on the merits of a bid, is offered by Article 9(4) of the Directive. The general meeting which will decide if the board will be allowed to

⁶⁶⁴ V. Edwards (n 559) 436.

⁶⁶⁵ Definitions of these defences are to be found at the end of chapter 10 ('Scene setting: the mechanics and tensions of takeovers').

enact defensive measures should be called at short notice, provided that the meeting does not take place within two weeks of notifications' being given.

The only 'frustrating' action that the board is permitted to do is to try to exercise a psychological pressure and influence on the shareholders through the document which should include its opinion on the bid and the reasons on which it is based (Article 9 (5) of the Directive). The required justification of the board's opinion deters the board from disguising its personal interests and presenting them as stakeholders' interests. According to the text of the Directive, this disclosed document should include the views of the board on the effects of the implementation of the bid on all the company's interests, and specifically employment, and on the offeror's strategic plans for the offeree company, and their likely repercussions on employment, and the locations of the company's places of business.

It is admitted that Article 9 alone fulfills the expectations of the Commission and the Winter Group Report on Takeovers. There are a couple of points in this provision that raise issues for the protection of shareholders. However, the Article which creates the biggest problem is Article 12. This Article makes the implementation of Article 9 optional at Member State and company level. It seems as if Article 12 erases Article 9, and the only thing that we see as a result is a shadow on the paper, which is hardly legible.

13.2) The Deficiencies of the Non-Frustration Rule (Article 9)

The main problem of the non-frustration rule, as we mentioned, lies in Article 12, which leaves the implementation of Article 9 (and 11) to the discretion of the Member States and individual companies. Hence, the proclaimed aims of facilitating corporate

restructuring and corporate mobility at EU level are not fulfilled because boards could still retain their power to frustrate a bid and discourage investors. Furthermore, there is vagueness in what belongs to the normal course of the company's business. This could create cross-border problems when each Member state will try to give its own different definition.

The Directive also does not stipulate when exactly the period during which the board is forbidden to act begins. It is possible that this discretion may lead to different periods in different Member States. Moreover, there are objections to the argument that a competing bid enhances the position of shareholders and contributes to the protection of their interests.

The Directive allows pre-bid authority to be used only if the pre-approved decision

‘forms part of the normal course of the company's business and whose implementation will not result in the frustration of the bid’ (Article 9 (3))⁶⁶⁶

It is difficult to assess, however, whether or not a decision taken prior to the bid forms part of the normal course of the company's business.⁶⁶⁷ This depends on the interpretation that each Member State gives to the term ‘normal course of the company's business.’ Some Member States, according to their company law traditions, may include various defensive measures under the definition of ‘normal course of company business’ (for example, in France, this definition covers the issue of new shares and the repurchase by the company of its own shares-effective defensive measures). This lack of a unified approach could be detrimental to the interests of shareholders because creeping defensive measures could ruin their role as ultimate

⁶⁶⁶ F. Ipekeli (n 554) 347.

⁶⁶⁷ F. Ipekeli (n 554) 348.

adjudicators of the bid.⁶⁶⁸ However, this authorization provision for every pre-bid action that does not form part of the normal course of the company's business could work against the interests of shareholders instead of promoting them. This is because of resulting procedural delays. If the general meeting had approved a transaction (e.g. the sale of an asset at a profitable price) that does not form part of the normal course of the company's business, prior to the launch of the bid, and it had to approve it again after the launch of the bid, then the unavoidable delays of the second general meeting could be detrimental to the interests of shareholders. This may prove unfortunate, for in some cases, the continuance of a pre-existing transaction or arrangement could be beneficial, and the very need for a further shareholder approval could cause a delay which could result in the loss of a value-enhancing opportunity.⁶⁶⁹ It should be noted that the 1989 proposal had a wider range by providing for 'transactions which do not have a character of current operations concluded under normal conditions'. This language was, however, dropped from the 1990 amended version of the Directive, which should be seen as a retreat from the original position.⁶⁷⁰

The non-frustration rule is enacted from the time board received the information about the bid and lasts until the result of the bid is made public or the bid lapses (Article 9 (2) (2)). Member States may require this authorization for defensive measures under the non-frustration rule to be obtained at an 'earlier stage' for example 'as soon as the board of the offeree company becomes aware that the bid is imminent'. The lack of mandatory definition is likely to lead to a non-level playing field.⁶⁷¹ A strict national definition that prohibits defensive action by the board from the time it has verified information that the bid is imminent complies with the rationale of the non-frustration

⁶⁶⁸ V. Edwards also argues that Article 9 (3) is not wholly clear. V. Edwards (n 559) 436.

⁶⁶⁹ F. Ipekeli (n 554) 348.

⁶⁷⁰ F. Ipekeli (n 554) 348.

⁶⁷¹ F. Ipekeli (n 554) 348.

rule. According to the text of the Directive, it is possible for a Member State to allow the board to take defensive measures, from the time the board receives information about an imminent bid, until the bid is formally disclosed and publicized. This period could be enough for a hostile board to organize a first wave of frustrating measures. So there are going to be some Member States where the boards are having an additional (small but crucial) time advantage. The rules for the takeover regime would not be the same and some targets would be more vulnerable than others. This would of course have effects on the level of protection of shareholders.

The only action that the board is allowed to take during the bid period is to seek alternative bids. The potential alternative bidder is called a 'white knight.' This exception from the non-frustration rule is allowed because it enhances shareholders' opportunities, by putting their shares up for auction. An alternative bid should also not be considered to be a defensive measure at all, because it embodies a second choice for shareholders, which does not affect the conditions of the first bid at all.⁶⁷² Nevertheless, seeking an alternative bid could be detrimental to the shareholders' interests. After the launch of a takeover bid, shareholders face collective action problems, which might tempt them to accept the offer even though this is not in their collective best interest (the so called pressure to accept the bid).⁶⁷³ Competing bids could be coercive, so that they could compel shareholders to accept the second bid although the bid launched at first is to be considered as more attractive.⁶⁷⁴ The collective action problem derives

⁶⁷² F.Mucciarelli 'White knights and black knights. Does the search for competitive bids always benefit the shareholders of 'target' companies?' (2006) Working Paper <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=910220> accessed 21 November 2006 p. 8-9 (for another version of this paper: F. Mucciarelli 'White Knights and Black Knights-Does the search for competitive bids always benefit the shareholders of 'target companies'?' (2006) 4 ECFR 408-425).

⁶⁷³ F.Mucciarelli (n 672) 3. L. Bebchuk 'The pressure to tender: an analysis and a proposed remedy' (1987) 12 *DelJCL* 911, L. Bebchuk 'Toward undistorted choice and equal treatment in corporate takeovers' (1985) 98 *HLR* 1693.

⁶⁷⁴ F.Mucciarelli (n 672) 3. There is an extensive analysis with numerical examples analyzing the different combinations of higher and lower prices in two competing bids in the article of F.Mucciarelli (n 672) 5-12.

from the fact that shareholders do not know about the decisions of the rest of the shareholders. This unavoidable lack of coordination of decision-making creates in shareholders the fear that they will lose the bid price and they will be left with under-priced minority shares. The mandatory bid rule mitigates the problem in some cases of two-tier or partial competing bids but not wholly (not for example in 100% public offers-these cases are exempted from the mandatory bid rule).⁶⁷⁵ Shareholders compare the risk of holding minority undervalued shares, in the event of the bid being successful, with the price of the offer; hence the optimal ex ante strategy is to sell their shares to the bidder. It is obvious that the pressure to accept the bid does not always lead to the most value-enhancing choice. The shareholders cannot assess properly all the available bids, because they only take into account their potential post-bid situation as weak minority shareholders with under-valued shares. This exception of seeking an alternative bid does not distinguish coercive⁶⁷⁶ competing bids from non coercive ones: the Directive does not distinguish white knights from black knights.⁶⁷⁷ If the competing bid sought by the board is coercive it is neither in the best interest of shareholders, nor does it represent a simple market alternative; therefore a coercive defensive bid does not fit either of the rationales underpinning the white knight exception.⁶⁷⁸ A coercive alternative bid therefore should be considered as a defensive measure. The white knight exception includes only non-coercive alternative bids. Each case of alternative bid

⁶⁷⁵ See above the first two paragraphs of subchapter 1 of chapter 12 ('The Deficiencies of the Mandatory Bid Rule').

⁶⁷⁶ Coercive competing bids are bids which create a pressure to the shareholders to accept them. In most cases the coercive competing bids are less attractive (with lower price) than the other bids. The 'coerciveness' is due to the fact that shareholders are obliged to accept this less profitable 'coercive' bid and reject the other more profitable public offers. The shareholders are led to this value-decreasing choice because they do not want to become minority shareholders with undervalued shares, if the less attractive bid is successful. The shareholders prefer to sell their shares at a lower price rather than to find themselves 'trapped' as minority shareholders. Hence, they think that they will be secured from becoming minority shareholders, if they accept the less attractive bid. The less attractive takeover bid is coercive because it leaves no other choice to the shareholders other than accepting this bid and rejecting all others.

⁶⁷⁷ F.Mucciarelli (n 672) 13.

⁶⁷⁸ F.Mucciarelli (n 672) 13.

should be examined separately. This approach towards the white knight exception should be adopted because the Directive does not allow only those alternative bids which are at a higher price than the first bid.⁶⁷⁹ In the latter case, the shares really are put up for auction. This is only the case as regards 100% voluntary bids to all holders of securities for all their holdings, because in all the other cases the bidder is obliged to launch a mandatory bid, when he reaches the relevant control threshold (Article 5 (2) of the Takeover Bid Directive). Thus, the minority shareholders are protected due to the existence of the mandatory bid provision, and the fact that the price of the mandatory bid should not be less than the highest price paid for the same securities by the offeror during a specific period before the mandatory bid. This approach is compatible with the shareholders' protection rationale because they are protected from this pressure to accept the bid. Otherwise, the board of the company could use this exception in order to guide the shareholder, through the pressure to sell his shares, to the offer of a bidder that they approve (and of course found) or to the failure of the takeover in general.

The non-frustration rule (as well as the breakthrough rule) exists only because of the compromise of Article 12. Member States can opt-out of Article 9 and 11.⁶⁸⁰ Paragraph 1 of Article 12 states that Member States may reserve the right not require target companies to apply Article 9 (2) and / or Article 11. However, according to the second paragraph of the same Article, where Member States opt-out of Article 9 and 11

‘they shall nevertheless grant companies which have their registered offices within their territories the option, which shall be reversible, of applying Article 9(2) and (3) and/or Article 11, without prejudice to Article 11 (7).’

⁶⁷⁹ This ‘higher price’ solution is proposed by F.Mucciarelli (n 672) 12.

⁶⁸⁰ Below, we will refer more extensively to the breakthrough rule and its opt-out.

The decision of the company to opt-for either or both Articles should be taken by the general meeting and the applicable procedural rules are those for the amendment of the articles of association.

If the Directive had been adopted in its 2001 form, the non-frustration rule would have been obligatory. This optionality system was adopted mainly due to German objections in order to secure the passage of the Directive in the European Parliament. The non-frustration/ board neutrality rule is essential for the promotion of freedom of establishment at European level. The boards of target companies would not be able to ruin the efforts of a potential investor to gain control of their companies. The less barriers the board of a company can deploy, the more takeover bids will be successful. The offeror company, by launching a successful bid and establishing itself in another Member State through the target company, that it now controls, manages to penetrate new national markets. The market making function of a non-frustration rule is obvious; this rule assists a company from one Member State obtain a controlling stake in a company in another Member State, leading to market integration. Additionally, reasons of equality argue in favour of the non-frustration rule, as it is unfair for some Member States to protect their companies by allowing defensive measures, while the companies of some other Member States are made more vulnerable to takeovers due to the prohibition of defensive measures. Furthermore, the EC Treaty places corporate mobility among the main objects of European integration (Articles 2, 3(c), 14 (2), 43 especially (2), 44 (2) (f), (g), 48).

The non-frustration rule respects the interests of shareholders by conferring on them the right to decide on the merits of the bid. The counter-argument, to the effect that the board of the company uses defensive measures in favor of the protection of shareholders from value-decreasing takeover bids, is not convincing. This is due to the

danger that the board is trying to entrench its own position by protecting the personal interests of its members, and avoiding its replacement in case of a successful bid. It is also argued that although the non-frustration rule is quite wide, in order to prevent all the kinds of conduct impeding a takeover bid, it does not mean that all conduct incompatible with Article 9 of the Directive would also be incompatible with the right of establishment of a bidder⁶⁸¹ For example a prior authorization of the general meeting to the board, in advance of any bid being made, to adopt certain defensive measures to protect shareholders from inadequate offers, infringes Article 9 (2), but may serve the shareholders' interests because it increases the ability of the target company to negotiate a higher premium.⁶⁸² This kind of measure cannot be regarded as a restriction on the right of establishment because it is a non-discriminatory activity by or on behalf of market operators to improve their market position vis-à-vis their competitors or their suppliers or customers and not discriminatory conduct on the part of market operators and activities which restricts the access to the market of other market operators.⁶⁸³ In literature there is a long debate about which system of corporate governance regulates better the conduct of takeovers at European level.⁶⁸⁴ Furthermore, there are arguments about what the stance of the board should be during a takeover from the law and economics perspective.⁶⁸⁵ However, the European Commission has taken all these arguments into account and believes that the British model with a non-frustration rule should be transposed to European level. The Council has the same opinion as it

⁶⁸¹ D. A. Wyatt and A. Dashwood (n 46) 883-884.

⁶⁸² D. A. Wyatt and A. Dashwood (n 46) 884.

⁶⁸³ D. A. Wyatt and A. Dashwood (n 46) 884.

⁶⁸⁴ See for example: J. Payne(ed.) ,*Takeovers in English and German Law* (Hart Publishing , Oxford and Portland,Oregon 2002) , M. Gatti 'Optionality arrangements and reciprocity in the Takeover Directive' in J. Grant (ed.), *European Takeovers : the Art of Acquisition* (1st ed Euromoney Books, London 2005) 107-108 and R. Kraakman and others (n 538) 157-191.

⁶⁸⁵ G. Bittlingmayer , 'The Market for Corporate Control (Including Takeovers)' Online Encyclopedia of Law and Economics p.725-771 < <http://encyclo.findlaw.com/5640book.pdf> > accessed 21 February 2007.

included the regulation of European takeover bids among the priorities of the Lisbon Agenda for the integration of European Capital Market.

Since the non-frustration rule is considered to be an important device for increasing takeover activity, the fact that their adoption will depend upon choices by national legislatures puts into question whether the ultimate outcome of the Takeover bid Directive will indeed be the promotion of a vibrant and efficient market for corporate control.⁶⁸⁶ Unfortunately, the existence of the opt-out system does not result in a uniform approach at European level, which would foster corporate mobility and the protection of shareholders. When the aim of European regulation is the protection of the weaker players of the game (i.e. shareholders), the European legislature should adopt a common structure for all Member States with effective safeguards and not allow excessive national discretion. In the field of European company law, harmonization should respect to a certain degree the national structures of company law (some minimum safeguards must always exist). Nevertheless, this is not so in the case of the Takeover Directive. Allowing opt-outs from the basic provisions of the Directive is not a sign of respect for national legal idiosyncrasies. It is rather a retreat for the market integration objects of harmonization to the national aims of protectionism.

However, the Directive obliges opting-out Member States (Article 12 (2)) to allow their companies to implement Articles 9 and/or 11 of the Directive, if they so wish. If a company of an opting-out Member State decides to opt-in, it can opt-out again. Only the general meeting of the company can take these decisions ‘in accordance with the rules applicable to the amendments of the articles of association’. This implementation possibility for the companies of opting-out Member States mitigates the overall negative effect on European integration of the opt-out system. A Member State which

⁶⁸⁶ M. Gatti (n 684) 103.

opts out of these articles must enact special legislation that allows the willing companies to implement the rules. Hence, in a Member State which does not implement the non-frustration and /or the breakthrough rule, there is going to be legislation for the implementation of these rules in voluntary cases. Two categories of listed companies will emerge within opting out Member States, namely opted-in companies applying the Directive and opted-out companies, which are merely subject to national legislation regarding takeovers.⁶⁸⁷ The companies of opting-out Member States could have an incentive to opt in. As was the case with creditworthiness and corporate governance, this will also give rise to a system of (national and international) comparison and rating on the market.⁶⁸⁸ ⁶⁸⁹ The opted-in and opted-out status may subsequently lead to a certain ranking on the securities market, similar to the degree of creditworthiness.⁶⁹⁰ Many companies which need liquidity will try to present themselves as open to potential investors on the European and Global Capital Markets. The disclosure obligation under the Directive with regard to the internal control structure (Article 10), and the current protection regime (Article 11 (4)), are of great importance here.⁶⁹¹ If any significant differences in prices occur between opted-in companies and opted-out companies, which are otherwise very similar companies, the latter will sooner or later find themselves under pressure to apply the voluntary regime as well.⁶⁹² This will lead to a boost in the market for corporate control because listed companies will be discouraged from applying defensive measures. This element meets the need for

⁶⁸⁷ S.M. Bartman (n 653) 6.

⁶⁸⁸ S.M. Bartman (n 653) 6.

⁶⁸⁹ The Rating Agencies play an important role in providing an incentive for companies to implement these optional provisions. The Rating Agencies assess the creditworthiness of governments and corporations as well as particular issues of securities as a guide to investors, e.g. AAA for the best risks and D for firms which have either defaulted or are expected to default. The most important rating agencies are US (Standard and Poor's, Moody's Investor Service, Fitch Investor Service, Dominion). See P. Wood, Handout – Introduction to the course of Global Comparative Financial Law, Degree of Magister Juris, University of Oxford, Acad. Year 2005-06, p.9.

⁶⁹⁰ S.Bartman, 'Crack the OOC-code!' (2006) 3 ECL 162, 163.

⁶⁹¹ S.M. Bartman (n 653) 6.

⁶⁹² S.M. Bartman (n 653) 7.

empiricism in the field of European company law.⁶⁹³ Takeover legislation will be harmonized from the bottom up.⁶⁹⁴

13.3) The Breakthrough Rule (Article 11)

The High Level Group of Company Law Experts set two basic principles. The first principle is that of shareholder decision making, which is reflected in the general principle of Article 3 (1) (c), and the non-frustration rule of Article 9 of the Directive. This principle is directly related to the shareholder protection rationale. The second principle is the proportionality principle. According to this principle, the degree of risk/reward which the shareholders take should determine the degree of control to be exercised by shareholders. Thus the greater the shareholders' stake in the company in terms of his exposure to the company's success or failure, through his holding in the risk-capital or general cash-flow rights, the greater his voice should be in determining the manner of its control.⁶⁹⁵ This principle is expressed in the breakthrough rule. It aims at the facilitation of takeover activity, and requires that where contractual and property rights are exercised in ways which inhibit 'legitimate' bids, these rights should be broken through.⁶⁹⁶ Thus the breakthrough provision embodies an enhanced, idealized, or paternalistically imposed, freedom of shareholders based on a defined optimal redistribution of rights.⁶⁹⁷ This could also be called a 'one share-one vote' principle.

⁶⁹³ D. A. Wyatt and A. Dashwood and others (n 46) 874-875.

⁶⁹⁴ S. Bartman (n 690) 163.

⁶⁹⁵ J. Rickford (n 615) 1385.

⁶⁹⁶ J. Rickford 'Takeovers in Europe-shareholders decisions and open markets- a UK perspective' in J. Grant (ed.), *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books, London 2005) 67.

⁶⁹⁷ J. Rickford (n 696) 67.

Here we come again to the necessary balancing of partially conflicting rationales: the shareholder' protection rationale and the takeover promotion rationale. Article 11 of the Directive lays down that any restrictions on the transfer of securities or voting rights provided for in the articles of association of the offeree company, or in contractual agreements between the offeree company and the holders of its securities, or in contractual agreements between holders of the offeree company's securities, shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid (paragraphs 2 and 3). The Directive covers only contractual agreements entered into after the adoption of the Directive. The Directive expressly states that 'Multiple-vote securities shall carry only one vote each at the general meeting of shareholders which decides on any defensive measures in accordance with the Article 9'. Restrictions on the transfer of securities or on voting rights and any extraordinary rights of shareholders concerning the appointment or removal of board members are prohibited, if the bidder obtains 75% or more of the voting capital of the target company (paragraph 4). The one share –one vote principle is implemented and multiple voting rights are declared inactive 'at the first general meeting of shareholders following closure of the bid, called by the offeror in order to amend the articles of association or to remove or appoint board members' (paragraph 4). The bidder has the right to convene a special post-breakthrough meeting in order to strengthen his controlling position in the target company (paragraph 4). However, the Directive itself provides for two exceptions to the breakthrough rule. First, the breakthrough rule does not apply when restrictions on voting rights are compensated for by 'specific pecuniary advantages' (paragraph 6). Secondly, the rule does not apply to legal 'Golden Shares' hold by Member States.⁶⁹⁸

After objections from the European Parliament, and contrary to the suggestions of the

⁶⁹⁸ See para. 7, ' where Member States hold securities in the offeree company which confer special rights on the Member States which are compatible with the Treaty , or to special rights provided for in national law which are compatible with the Treaty or to cooperatives'

High Level Group of Company Law Experts, there is a provision in the Directive concerning equitable compensation. This compensation should be conferred when loss is suffered by the holders of special rights which are broken through (paragraph 5).

13.4) The Deficiencies of the Breakthrough Rule (Article 11)

The breakthrough rule is deficient in two respects: as regards the substance of the rule, and as regards the optional character of Article 11.⁶⁹⁹ Both deficiencies are a result of the political compromise to which the Directive owes its existence. The objects of the proportionality principle are not fulfilled, and as a result takeover activity in Europe is not encouraged. Hence, obstacles to the freedom of establishment of legal persons still remain. As we already mentioned above, the breakthrough rule facilitates the activities of bidders by overriding disproportionate corporate structures. It prohibits any pre-bid defensive structures, which could be deployed by the board in order to make it impossible for the bidder to finally obtain control. This facilitation of the activities of bidders should mean that takeover activity in Europe will increase and cross-border mobility and establishment of companies will be promoted. However, the deficiencies referred to above frustrate to a great extent the accomplishment of this aim.

We will start our examination of the deficiencies of the breakthrough rule by analyzing the textual, substantive problems of that rule. The prohibition of restrictions on the transfer of securities provided for in the articles of association of the offeree

⁶⁹⁹ J. Rickford (n 615) 1389-1390.

company is perhaps redundant. It is already a requirement of listing that shares should be freely negotiable.⁷⁰⁰ Additionally, the prohibition of such restrictions contained in agreements between shareholders may be thought to be too wide, since it risks catching normal market arrangements, such as pre-emption and option rights, sale agreements with deferred settlement, and indeed irrevocable undertakings to accept a takeover offer (which usually incorporate a restriction on sale of the shares concerned to a third party).⁷⁰¹ The text of the Directive in this point is quite wide and catches normal financial transactions which are pro or at least neutral to takeover activity. This is possibly something negative for the integration and advance of European capital markets because sophisticated financial instruments will not be available to market players during takeover bids. One objection could be raised to irrevocable undertakings to accept a bid. This could probably prevent the launching of a competitive bid with better terms for the shareholders. However, irrevocable undertakings are usual in friendly bids when the offeror and the offeree company agree to the takeover; or in hostile takeovers when the irrevocable undertaking with the final winner follows a takeover bid contest with offerors competing with each other under fair terms. The Directive could be more detailed in this point by excluding financial structures which are takeover friendly or at least neutral.

One widely used category of voting agreement between the shareholders of a target company, which is broken through by the rule in Article 11, is the syndical agreement. Under syndical agreements, a number of shareholders reach agreement to fix their voting pattern in advance in order to pool voting power in the company.⁷⁰² In this way a company is created within a company: the minority in the syndicate will vote at the

⁷⁰⁰V. Edwards (n 559) 437.

⁷⁰¹V. Edwards (n 559) 437.

⁷⁰²J.M.M. Maeijer and K.Geens (eds) (n 511) 19-20.

company's general meeting in favour of the wishes of the majority in the syndicate.⁷⁰³ Moreover, the shareholders could be completely insulated from the exercise of their voting rights by the use of irrevocable proxies with which the members of the syndicate are represented at the general meeting by a person who casts all of the votes for the majority view in the syndicate.⁷⁰⁴ This restricts excessively the freedom of shareholders to decide on the merits of the takeover bid. Thus, both principles laid down by the High Level Group of Company Law Experts are infringed by syndicated agreements coupled with irrevocable proxies : shareholder decision-making and proportionality.

There are arguments that a limitation of voting rights, either in the articles of association or in contractual agreements, does not infringe the principle of 'one share one vote', as it does not affect the voting rights of shares but rather of the shareholder.⁷⁰⁵ It is the shareholder who may not cast more than a given percentage of the total number of shares. This percentage is usually not based on the total number of votes that an individual can cast, but on the total number of votes that all shareholders can cast.⁷⁰⁶ This argument is not convincing. It is against the merits of the proportionality principle of the Report of the High Level Group of Company Law Experts, which constituted the justification of the breakthrough rule. The degree of control that shareholders exercise over the company should be proportionate to the degree of risk/reward which they take. It is obvious that in practice the limitation of voting rights has the result of infringing the 'one share-one vote principle', because the maximum percentage is usually the same for all shareholders, regardless of the number of shares they possess. From the point of view of pure voting power, it is accordingly

⁷⁰³ J.M.M. Maeijer and K.Geens (eds) (n 511) 19-20.

⁷⁰⁴ J.M.M. Maeijer and K.Geens (eds) (n 511) 20.

⁷⁰⁵ J.M.M. Maeijer and K.Geens (eds) (n 511) 17.

⁷⁰⁶ J.M.M. Maeijer and K.Geens (eds) (n 511) 17.

pointless to own more shares than the number of shares one may cast.⁷⁰⁷ The application of the breakthrough rule also helps in the avoidance of circumvention techniques and the subsequent legislation which combats them. There would be no need any more for the prohibition of men of straw or pseudonyms among whom a large shareholder can always spread his shares in order to avoid the legislation on limitations of voting-rights. The breakthrough rule simplifies the situation by disarming the limitations on voting-rights and the anti-infringement legislation.

The breakthrough rule is called 'mini-breakthrough' because it allows the breakthrough of some, but not all the restrictions infringing the proportionality principle.⁷⁰⁸ I think that it is necessary to examine which categories of securities survive the implementation of the breakthrough rule. It is obvious that there are many exceptions from the breakthrough rule due to its narrow scope. The categories of securities outside the scope of the breakthrough rule constitute obstacles for any potential bidder.

The first problem is created because of the text of the Directive itself. Article 2 (1) (g) defines multiple-voting securities as 'securities included in a distinct and separate class and carrying more than one vote each'. Ceiling or time lapse voting securities are not caught by the breakthrough rule. These shares are fully enfranchised after a specific holding period and are not caught because while the voting rights will vary from time to time, according to the contingency of the duration of a holding, they remain of the same class.⁷⁰⁹ This kind of share is very common in France. The defensive aim of this kind of share is to discourage any potential bidder by ensuring that the offeror acquiring such a share obtains a diluted control right unless he is able to wait for up to four years for the

⁷⁰⁷ J.M.M. Maeijer and K.Geens (eds) (n 511) 18.

⁷⁰⁸ J. Rickford (n 615) 1389.

⁷⁰⁹ J. Rickford (n 696) 69.

shares to be fully enfranchised.⁷¹⁰ The requirement that shares comprise part of a distinct and separate class excludes an important category of shares from the scope of the breakthrough rule. The scope of the breakthrough rule should be determined by the aim of negating the potential of certain shares to inhibit the takeover process and not by formalities like the requirement for different classes of shares. The breakthrough rule aims at preventing recourse to any pre-bid system of shares, which violates the proportionality principle, regardless of the class of the shares. It is unfortunate that the European Commission, the defender of freedom of establishment and corporate mobility, confirms this exception from the breakthrough rule.⁷¹¹ Nevertheless, multiple voting shares in separate class are undoubtedly caught by the breakthrough rule. This kind of share is often found in Scandinavian Member States and sometimes in the UK. Thus, we have the side-effect that multiple voting shares, which have exactly the same result of obstructing the course of the bid, are treated differently only because they belong to different classes. Furthermore, this creates inequality and does not level the playing field among the EU countries. France managed to exclude this French structure from the breakthrough rule without even opting out of the relevant provision. The argument that the harmonization of European company law should respect the idiosyncrasies of national company law and provide flexibility at the implementation stage, is not convincing in this case. It is clear that the Directive tolerates defensive structures available in some Member States (French ceiling shares), while prohibiting defences available in other Member States (Scandinavian dual class shares), which could not advocate effectively their national interests in the Council. This exception also provides the incentive for companies, where national company law allows such changes, to move from dual to single class share structures while retaining

⁷¹⁰ J. Rickford (n 696) 69.

⁷¹¹ Commission Proposal of 2 Oct. 2002 and Explanatory Memorandum [2003] OJ C45E/9.

disproportionate voting rights. The market for corporate control and the freedom of establishment cannot not benefit from this diversified approach of the breakthrough rule to pre-bid defenses.

Another category of shares which evades the application of the breakthrough rule is that of non-voting shares. If non-voting shares are to be in conformity with the proportionality principle, they should be appropriately enfranchised to carry their proper weight at both meetings, both in the hands of the offeror and in the hands of others, whether sympathetic to the offeror or not.⁷¹² However, the Directive does not support such an approach. It is hard to regard the absence of a vote as ‘a restriction on voting’ to be overridden under 11 (3).⁷¹³ First, Article 2 (1) (g) of the Directive defines as ‘securities’ only those carrying ‘voting rights in a company’. Hence, the breakthrough rule cannot be applied to non-voting shares due to the strict definition of Article 2 (1) (g) of the Directive. Secondly, the breakthrough rule does not catch non-voting shares because there is no provision to indicate how many votes non-voting shares should get if of a different class from voting shares.⁷¹⁴ Thus non-voting securities are not enfranchised in the in the hands of the offeror in the post-breakthrough meeting, nor can the offeror, or others sympathetic to the offer, exercise votes in relation to such shares in the meeting called to authorize defensive measures.⁷¹⁵ A company which renders itself bid-proof by keeping voting shares in the hands of the board and its supporters and issuing non-voting equity to others is not vulnerable to breakthrough in that respect.⁷¹⁶ This deteriorates the position of the bidder in his efforts to obtain control of the target company. It is perhaps not excessive to

⁷¹² J. Rickford (n 615) 1391.

⁷¹³ J. Rickford (n 615) 1391.

⁷¹⁴ J. Rickford (n 94) 1391.

⁷¹⁵ J. Rickford (n 696) 70.

⁷¹⁶ J. Rickford (n 696) 70.

suggest that non-voting shares could thwart permanently the takeover of a target company.

Furthermore, in the Member States where the issuance of non-voting shares will be prohibited, alternatives with the same effect are sought inevitably.⁷¹⁷ One alternative technique having the same result as non-voting shares involves certificates for shares or non-voting depository receipts for shares. The shares are transferred to an independent administration office, which manages the shares and exercises the voting rights in the interests of the company. The shareholders receive a certificate in return for their shares and retain the proprietary rights arising from the shares.⁷¹⁸ This financial technique is usual in the Netherlands, France and Belgium.⁷¹⁹ Under this financial instrument, the shareholder is alienated from his voting rights. The success of the bid is uncertain because it depends on the intentions of an administrative body. This negative effect is mitigated by the fact that the administrative body should be independent and it should take into account when exercising the voting rights the interests of the company as a whole. However, this is at odds with the general principle of shareholder decision making (Article 3 (1) (c)), which was also advocated by the Report of the High Level Group of Company Law Experts. This technique is hostile to takeover bids but the situation could be aggravated if the target company is obliged to buy back the non-voting profit certificates at a somewhat higher price (common in Belgium).⁷²⁰ This additional feature adds a further impediment to the takeover process. Another alternative to non-voting shares is securities that are not shares but carry equity risk, through a right to participate in profits (such ‘enjoyment rights’ are common in

⁷¹⁷ J.M.M. Maeijer and K.Geens (eds) (n 511) 15.

⁷¹⁸ J.M.M. Maeijer and K.Geens (eds) (n 511) 15.

⁷¹⁹ See an analysis of the national legislation at this point in J.M.M. Maeijer and K.Geens (eds) (n 511) 15.

⁷²⁰ J.M.M. Maeijer and K.Geens (eds) (n 511) 16.

Germany).⁷²¹ The breakthrough rule undoubtedly does not catch these company instruments which are not even shares. From all these examples it appears that there exist numerous means of avoiding or circumventing a national prohibition on non-voting shares. Boards can still entrench their positions even in cases where the Member State tries to limit the exceptions to the breakthrough rule by prohibiting non-voting shares. I believe that these loopholes exist because the Directive does not designate the scope of the breakthrough rule by the effect of certain types of shares (i.e. the frustration of the bid) but by a specific requirement (i.e. to which category of shares it belongs). As we mentioned above, this is probably due to political opportunism in the legislative process where some Member States managed to exempt their national company share structures and others did not.

Another deficiency of the breakthrough rule is that it does not cover some categories of very effective pre-bid defences. Pyramid structures are not caught by the breakthrough rule. Pyramids are a form of corporate control structure whereby a company holds shares in another company which in turn holds shares in another one.⁷²² Control of the corporation at the top of the pyramid combines with the stakes all the way down to achieve outright control of the chain.⁷²³ Collectively these are ‘tunnelling’ devices, inter-company dealings whose terms benefit the controlling shareholder at the top of the pyramid, often at the expense of minority shareholders.⁷²⁴ Thus the voting rights of the shareholders at the company at the bottom of the pyramid are diluted. The proportionality principle is distorted because the controlling shareholder at the top of the pyramid can gain voting control of the company at the bottom of the pyramid by having disproportionately low cash flow rights. The High Level Group recommended

⁷²¹J. Rickford (n 615) 1379.

⁷²²J. Grant (n 536) 15.

⁷²³J. Grant (n 536) 15.

⁷²⁴J. Grant (n 536) 15.

dealing with pyramids separately by not allowing stock exchange listing for holding companies whose sole activity was to hold shares in another listed company.⁷²⁵ This measure was not adopted by the Takeover Bid Directive but it is possible it will be adopted in future legislation relating to securities and stock market regulation.

Furthermore, the breakthrough rule does not apply to cross-shareholdings. Cross-shareholdings are defensive arrangements whereby two companies buy stakes in each other and senior managers/owners sit on each others boards and vote their shares together defensively.⁷²⁶ ‘Double-headed’ companies constitute an advanced form of cross-shareholdings. These corporate associations adopt a double corporate form but ensure that takeovers must be of both companies. This may be done by linking shareholdings in one company to shareholdings in the other, or coordinated, and sometimes entrenched, control may be assured by conferring cross-rights of board nomination and special, often preference, share structures.⁷²⁷ I think that there should be a provision in the Directive stating that cross-shareholdings are covered by the breakthrough rule. This is because cross-shareholdings infringe both principles advocated by the High Level Group of Company Law Experts: the proportionality and shareholder decision-making principles. The fact that one company interferes so closely with the takeover of the other company is negative for the shareholders of the target company because a third party weakens their voting rights. It is also obviously negative for the bidder, who must bid for both companies, and not only for one of them, due to these sophisticated corporate links. This helps neither the integration of the market for corporate control nor the creation of economies of scale. Bidders should be able to bid for the companies of their preference and should not be pressed to bid for additional

⁷²⁵ J. Winter ‘The Good , the bad and ugly of the European Takeover Directive’ in J. Grant (ed.) , *European Takeovers: the Art of Acquisition* (1st ed Euromoney Books , London 2005) 27

⁷²⁶ J. Grant (n 536) 15.

⁷²⁷ J. Rickford (n 615) 1392.

corporate bodies. This pressure can lead to unsatisfactory results: failure of the bid because of this defensive structure, withdrawal of a bid due to incapability to finance a bid for both connected companies, or a value-decreasing situation because of the takeover of two companies one of which the bidder does not really want. As a result, the freedom of establishment through a vibrant market for corporate control is not promoted, and again there are available ways of avoiding the minimum shareholder protection safeguards of the Directive. However, the possible cross-rights of board nomination in 'double-headed companies' are probably caught by the current form of the breakthrough rule because they can be regarded as extraordinary rights within the meaning of Article 11 (4). The only obligation is that, according to Article 10 (1) (c)), pyramid structures and cross-shareholdings must be included in the information which must be disclosed pursuant to this Article. This disclosure of information, concerning these defensive structures of pyramids and cross-shareholdings, could be crucial for the creditworthiness and ranking of the companies.

It also seems that the corporate structure of partnerships limited by shares is caught by the Directive (particularly common in France, Italy, and Germany). Such partnerships function with a small number of unlimited liability partners exerting control, while outside shareholders provide the majority of the capital, but have little influence over the strategic direction of the business.⁷²⁸ If the unlimited liability partners are favoured by a statutory or contractual restriction on voting rights or the transfer of shares, then this lack of proportionality will be broken through. The fact that the liability of controllers is unlimited does not play any role in the application of the breakthrough rule. The unlimited liability of some shareholders can not be considered as a pecuniary advantage under Article 11 (5), which grants an exception to the breakthrough rule. The

⁷²⁸ J. Grant (n 536) 16.

shareholders should have the right to participate in decision-making on matter affecting the strategic direction of the business, i.e. the takeover bid process.

An additional exclusion of preference shares from the breakthrough rule is found in Article 11 (6), which states that the breakthrough rule does not apply to ‘securities where restrictions on voting rights are compensated for by specific pecuniary advantages’. It seems that a company continues to be bid-proofed by issuing equity with a dividend preference, however small, and, though this is more doubtful, that acceptances of an offer for such preferential equity will not count towards the breakthrough threshold.⁷²⁹ This provision is not really helpful to the bidder and does not contribute to the opening of the market in corporate control. The board can easily create a group of shareholders within the company by offering a small extra dividend, which will be excluded from the application of the breakthrough rule. However, this restriction of the breakthrough rule is compensated by the additional ‘pecuniary advantage’ and is not necessarily something negative for shareholders. This ‘pecuniary advantage’, this extra dividend, could be a real temptation for shareholders. Thus, the acceptance of the bid will mainly depend on the comparison between the extra dividend and the premium that the bidder offers. Our only concern is that the boards of companies can again easily evade the breakthrough rule by taking advantage of this loophole in the Directive. This technique is not very costly for the company and is not a negative feature in the disclosure documents of the company (quite the opposite, it is something positive because it shows that the company reward shareholders with high dividends). However, it adds a further obstacle to takeover bids by restricting the breakthrough rule.

⁷²⁹ J. Rickford (n 615) 1392.

Additionally, the Article 11 (4) prohibits the exercise of extraordinary rights of shareholders at the general meeting for the amendment of the articles of association or the removal or appointment of members of the board, following the acquisition of 75% or more of the capital carrying voting rights.⁷³⁰ These private ‘golden shares’ involve distortions of the proportionality principle, which are not related to direct restrictions on voting rights. The voting rights of the rest of the shareholders are distorted indirectly. Although the shareholders do not lose their rights to cast their votes, these are watered down due to the decisive role of these extraordinary rights in the appointment or removal of board members. Hence, it is obvious that the application of the proportionality principle is also undermined. It is useful to make reference to these extraordinary, priority shares. In companies with this category of shares, the exercise of some rights by the general meeting remains valid only if approved by the priority shareholders. Moreover, the general meeting may only exercise its rights upon the proposal of the priority shareholders.⁷³¹ This kind of shares is found in several continental Europe countries. This kind of extraordinary shares is provided for by the articles of association of a target company and Article 11 (4) does not exhaustively state as the only category of extraordinary shares the appointment or removal of board members. Thus, we could conclude that all privileges conferred by the articles of association which distort the proportionality principle are broken through.

Another issue that is related indirectly to the breakthrough rule and distortion of the proportionality principle is that of proxies at general meetings. The lack of interest on the part of small shareholders in attending general meetings has led to the growth of a tradition in a number of Community Member States whereby largely banks and

⁷³⁰ This provision states that the extraordinary rights shall concern ‘the appointment or removal of board Members provided for in the articles of association of the offeree company’ (delegation rights).

⁷³¹ J.M.M. Maeijer and K.Geens (eds) (n 511) 18.

financial institutions request proxies in order to be able to exercise a major influence at the general meeting.⁷³² It is inevitable that conflicts of interest should arise: the banks are creditors, shareholders and agents at the same time.⁷³³ When giving a proxy, the question is whether the manner of casting it must be carefully defined or whether blank proxy votes are admissible.⁷³⁴ The Directive is silent on the issue of proxies, leaving it to national regulation. The divergence of proxy legislation is wide among the different jurisdictions (Roman-Germanic v. Common Law v. Napoleonic). It would be positive for the market in corporate control, if there were common safeguards for proxies at European level. Furthermore, proxies depend on the institutional role of banks in this Domain, which is more usual in the capital markets of some Member States (e.g. Germany), than in others. However, this could create problems in cross-border takeovers, where the securities of the company are listed on more than one stock exchange, in different Member States. The solution to this problem is given by Article 4 (2) (e), which designates the applicable law, providing that proxies should be considered a company law matter which is regulated by the applicable rules of the Member State in which the offeree company has its registered office. A bank or financial institution with proxies can control the takeover process. The companies concerned are unconquerable fortresses as long as this is the wish of the banks or financial institutions holding proxies, and once a raider has convinced these banks or financial institutions, no power on earth can save the companies.⁷³⁵ The independence of banks or financial institutions from the influence of the board of the company is not unquestionable. Hence, the board of the target company may influence the decision of the bank or financial institution whether to accept the public offer or not. Furthermore,

⁷³² J.M.M. Maeijer and K.Geens (eds) (n 511) 18.

⁷³³ J.M.M. Maeijer and K.Geens (eds) (n 511) 18.

⁷³⁴ J.M.M. Maeijer and K.Geens (eds) (n 511) 19.

⁷³⁵ J.M.M. Maeijer and K.Geens (eds) (n 511) 19.

the conflicts of interest mentioned above could also distract (especially) the banks from the best decision for the shareholders. This is not always good for the interests of represented shareholders. The Directive could provide safeguards that the banks or financial institutions act always on behalf of the interests of the shareholders whom they represent in the takeover battle, by for example prohibiting banks from collecting proxies if they hold other stakes in the company. Fortunately, the American tradition of ‘proxy-solicitation and fighting’, under which the management gets professionals to gather proxies for itself has hardly caught on in Europe at all. However, the danger that lawyers and financiers could always make use of these techniques requires precautionary regulation in this area.

The dual jurisdiction cases (i.e when ‘...the target company’s securities are not admitted to trading on a regulated market in the Member State in which the company has its registered office...’⁷³⁶) also present problems of interpretation as far as the breakthrough rule is concerned.⁷³⁷ Article 4 (2) (e) determines the jurisdiction in these dual jurisdiction cases: ‘...matters relating to the consideration offered in case of a bid, in particular the price, and matters relating to the bid procedure, in particular the information on the offeror’s decision to make a bid, the contents of the offer document and the disclosure of the bid, shall be dealt with in accordance with the Rules of the Member State’ of listing and

‘[i]n matters relating to the information to be provided to the employees of the offeree company and in matters relating to company law , in particular the percentage of voting rights which confers control and any derogation from the obligation to launch a bid , as well as the conditions under which the board of the offeree company may undertake any action which might result in the frustration of the bid , the applicable rules and the competent authority shall be

⁷³⁶Article 2 (2) (b) (c) of the Directive on Takeover Bids.

⁷³⁷For a general view on the private international law issues of the EU Takeover Bid Directive see: M.M. Siems, ‘The Rules on Conflict of Laws in the European Takeover Directive’ (2004) 4 ECFR 458- 476.

those of the Member State in which the offeree company has its registered office' .

It is quite clear that compensation issues fall within the jurisdiction of the Member State of listing because they are related to the price and they are disclosed in the offer document.⁷³⁸ However, the situation is vaguer for the issues of the 75% threshold for the post-bid general meeting and the categories of broken through restrictions. J. Rickford argues that these issues are analogous to the percentage of voting rights required for control for mandatory bid purposes, or the conditions under which management may take action to frustrate the bid, and is therefore a matter for the law of the target company's Member State of incorporation.⁷³⁹ On the other hand, it could also be alleged that the law applicable to these issues is the law of the Member State of listing, because these are 'matters relating to the bid procedure'⁷⁴⁰ as a whole. The Directive does not clarify exactly the applicable law in these dual jurisdiction cases. Jurisdiction in cases of overlapping legal orders needs to be defined explicitly because the takeover bid process requires speed, transparency and legal certainty. The private international law issues of the breakthrough rule shall not be designated on a case-by-case construction and they demand concrete answers.

The provision of Article 11 (5) concerning equitable compensation creates many problems of interpretation. The holders of the broken through rights are entitled to equitable compensation. Recital 19 of the preamble states that:

'where the holders of securities have suffered losses as a result of the removal of rights, equitable compensation should be provided for in accordance with the technical arrangements laid down by Member States'.

⁷³⁸ J. Rickford (n 696) 74.

⁷³⁹ J. Rickford (n 696) 74.

⁷⁴⁰ Article 4 (2) (e) of the Takeover Bid Directive.

Leaving aside the question whether there is a (temporary) suspension of rights rather than a (permanent) removal of rights, the Directive does not give a clue to who will be obliged to pay the compensation: is it the offeror or the offeree company? Or does it depend on the circumstances of the case?⁷⁴¹ The Report of the High Level Group of Company Law Experts (p.35) rejects the idea that the bidder would always have to pay compensation to shareholders with special rights and proposes that this should happen only in exceptional cases.⁷⁴² This proposal of the Report was based on the rationale that compensation should not constitute an obstacle to the efforts of the offeror to take over the target company. Payment of compensation would be a further condition to be fulfilled by the offeror. However, this proposal of the Report would seem to be contrary to the constitutional provisions in many Member States and also to infringe the First Protocol to the European Convention on Human Rights.⁷⁴³

The 'equitable compensation' provision also creates 'how' and 'when' questions, apart from 'who' questions. How is this compensation to be assessed? Is it to reflect the private benefits of company's insiders or outsiders achievable by exercising block power?⁷⁴⁴ The answer to the quantum question is crucial for the application of the general principle of Article 3 (1) (e) which states that 'an offeror must announce a bid only after ensuring that he/she can fulfill in full any cash consideration ... and after taking all reasonable measures to secure the implementation of any other type of consideration'. A concrete method of quantification of compensation is essential for the bidder in order to secure capital and to finance the bid. Only then, the bidder complies with the general principle of Article 3 (1) (e), and with the information disclosure requirements. Article 6 (3) (e), states explicitly that the offer document shall include the

⁷⁴¹ S.M. Bartman (n 653) 8.

⁷⁴² S.M. Bartman (n 653) 8.

⁷⁴³ F. Wooldridge (n 594) 148.

⁷⁴⁴ J. Rickford (n 615) 1392.

compensation under Article 11 ‘with particulars of the way in which the compensation is to be paid and the method employed in determining it’. By knowing the method of calculation of the compensation, the bidder can program better his actions. This is also good for shareholder decision-making because shareholders can estimate their compensation. The fact that the quantification method is delegated to the Member States may create some inequalities. Shareholders may receive different levels of compensation for broken through shares of equal value in similar takeover cases, according to the adopted method of calculation. This inequality is also revealed in cases where the broken through shares are listed on more than one stock exchange; compensation for the broken through shares of the same company will be different solely because the company exercises its right of establishment and free movement of capital by expanding itself to new national markets. Protection of shareholders requires a unified approach to the calculation of compensation, which would level the playing field at EU level.⁷⁴⁵ Unfortunately the Directive does not provide this. Furthermore, another practical question, which has to be answered carefully by the national legislature, has to do with how the level of compensation can be made the subject of a contractual offer.⁷⁴⁶ Where an offer is addressed to shareholders whose rights might be broken through, and such shareholders accept the offer, no issue of equitable compensation for them can arise.⁷⁴⁷ On the other hand, where such an offer is made, the costs of compensating the shareholders whose rights are to be broken through will depend on how many of them accept the offer.⁷⁴⁸ In such a case, the bidder again cannot know with certainty the amount of capital that will be required for the bid. As a

⁷⁴⁵ Bartman in his article suggests that national ‘legislators should adopt an extremely reticent attitude’ while implementing the compensation provision because ‘such an obligation to compensate should not keep the offeror from acquiring decisive control via the breakthrough rule’. S.M. Bartman (n 653) 8.

⁷⁴⁶ J. Rickford (n 615) 1394.

⁷⁴⁷ J. Rickford (n 615) 1394.

⁷⁴⁸ J. Rickford (n 615) 1394.

consequence, it is impossible for the bidder to comply with the Article 6(3)(e) and the general principle of Article 3(1)(e). The internal contradiction of the compensation provision is once more confirmed. The requirements of Article 6(3)(e) and the general Principle of Article 3(1)(e) cannot be met until announcement of the result of the bid.

There are also problems about the timing of the fixing of such compensation.⁷⁴⁹ Because of the difficulties of quantifying the compensation the Member States are likely to set up some mechanism of arbitration, appraisal or adjudication.⁷⁵⁰ When will these processes take place: before, after or during the takeover bid? The reply is extremely important because delays are inherent in these processes of quantification. If these processes take place before or during the public offer period, the delays will probably ruin the takeover bid. We should not forget that the companies subject to the Directive are listed and their share prices are open to stock market fluctuations. A pending quantification process may have a detrimental effect on the price of the shares of the listed company. The ultimate losers from this delay would probably be the shareholders who will not have an alternative to acceptance of the offer as otherwise they would only be left with depreciated shares. This is also negative for the bidder as the board gains time to organize its defences, e.g., by finding a ‘white knight’.

If the companies of a Member State, which decided to opt out of Article 11, opt back⁷⁵¹ in to the breakthrough rule, the compensation provision of Article 11 is affected by this voluntary implementation of the breakthrough rule. Article 12(2) states that the decision for this voluntary application of Article 11 shall be taken by the general meeting of shareholders ‘in accordance with the rules applicable to amendment of the articles of association’. This voluntary implementation of the breakthrough rule requires adjustments and changes of the special rights attached to special classes of

⁷⁴⁹J. Rickford (n 696) 72.

⁷⁵⁰J. Rickford (n 696) 72.

⁷⁵¹ Article 12 (2) of the Takeover Bid Directive.

shares. These kinds of shares will be primarily subjected to the breakthrough rule as violations of the proportionality principle. However, companies' articles of association may require special majorities of the class affected to authorize such alterations of their rights.⁷⁵² Hence, in the case of optional implementation, special resolutions of meetings of the classes affected will be required, and if these are carried, then there is no longer a case for equitable compensation in respect of the rights waived or modified (in view of the existence of consent).⁷⁵³ However, there is an objection to this rationale from the point of view of promotion of freedom of establishment through the facilitation of takeovers and the efforts of the bidder to acquire control. The Directive is intended to facilitate mergers by creating favourable conditions for bidders and the imposition of an additional resolution over and above the standard resolution required for altering the articles of association is an impermissible additional requirement.⁷⁵⁴ The Directive requires that all rights holders should be allowed equitable compensation and the solution proposed may not be equitable for minority dissentients in class meetings.⁷⁵⁵⁷⁵⁶ This leaves outside of the protective scope of the compensation provision the shareholders who disagreed in the special class meeting. Furthermore, the protective scope of the equitable compensation provision does not cover the breakthrough of rights which are not class rights of shareholders. Parties to agreements with rights restricting the transfer of shares will not necessarily be shareholders and their rights are normal contractual ones, rather than rights under the articles.⁷⁵⁷ Those parties are also entitled to protection and compensation because their rights have substantially the same

⁷⁵² J. Rickford (n 696) 73.

⁷⁵³ J. Rickford (n 696) 73.

⁷⁵⁴ J. Rickford (n 696) 73.

⁷⁵⁵ J. Rickford (n 696) 73.

⁷⁵⁶ J. Rickford also mentions two counter-arguments to these objections. Nevertheless, the danger that the two-fold rationale of the Directive (promotion of European takeover activity through the facilitation of the bidders' effort but with parallel respect to the shareholders' interests) could not be sufficiently fulfilled urges the national legislature to take seriously into account those concerns. J. Rickford (n 696) 73-74.

⁷⁵⁷ J. Rickford (n 696) 74.

legal effect of restricting the transfer of shares with the shareholders' rights. Those stakeholders will have to bring their claim for compensation before the regular national courts and they will not probably have the right of recourse to the special adjudication process established for shareholders with broken through shares. The drawback is that these parties will lose the flexibility and speed of this special procedure of compensation quantification and they will only have recourse to the normal slow judicial process. National legislation should confer the same procedural advantages (flexibility and speed) on both categories which have their rights broken through, both shareholders and stakeholders. I think that the Directive should provide compensation safeguards not only for shareholders, but also for this special category of stakeholders with rights subject to break through. It is to be inferred that the national legislature should be very careful at the implementation stage not to infringe the basic rationales of the takeover regulatory regime (promotion of European takeover activity through the facilitation of the bidders' effort but with parallel respect to the shareholders' interests). The application of the equitable compensation provisions through a voluntary opt-in to Article 11 reveals the internal contradictions, conflicts and weaknesses of the text of the Directive. It is obvious that the source of these specific compensation problems lays in the optional nature of Articles 9 and 11.

The most important deficiency of the breakthrough is an 'external' one and derives from Article 12. The potential beneficial effects of the breakthrough rule have been muted by the fact that Member States are allowed to opt out of the rule.⁷⁵⁸ Between a defective breakthrough, with the deficiencies and weaknesses mentioned above, and an optional defective breakthrough rule, I think that we should choose the former. An optional breakthrough rule permits the deployment of pre-bid defences, which will

⁷⁵⁸ F. Ipekeli (n 554) 345.

probably impede permanently the takeover of the company. This does not really protect the interests of shareholders, who should, according to the principles of the Takeover Report, be the ultimate decision-makers on takeover issues. A non-optional breakthrough rule is really able to protect the interests of shareholders by giving them the power to decide on the merits of the bid and to facilitate the bidder in his acquisition efforts by prohibiting pre-bid defensive tactics. We could also argue that a non-optional breakthrough rule could perform these tasks, even if the breakthrough rule, as in its current form, is not comprehensive, allowing many defensive structures to evade the application of the rule, and even if it is watered down by inconsistencies and ambiguities. It is quite obvious that a mandatory defective breakthrough rule is better than an optional defective breakthrough rule because at least we have a rule! The effects of the optionality regime, analyzed above in the non-frustration rule context⁷⁵⁹, apply to the breakthrough rule context too.

The breakthrough rule does not establish a level playing field for takeover bids at European level for two reasons. The first is that the rule is optional both for Member States and companies (Article 12). The second is that when the rule is implemented on either a mandatory or voluntary basis, there are still many share and corporate structures that evade its application and there are many ways of interpreting certain facets of Article 11⁷⁶⁰ that could lead to inconsistencies. Thus, the breakthrough rule, in addition to its many deficiencies, is optional. Both of the reasons for the lack of the level playing field are due to the political nature of this area of European company law which is characterized by protectionist and mercantilist ideas. S. Bartman alleges that courts should interpret the scope of application of the Directive as widely as possible

⁷⁵⁹ See above: Chapter 13, subchapter 2 'The deficiencies of the non-frustration Rule'.

⁷⁶⁰ Substantive deficiencies of Article 11 .Some of these issues analyzed above are: syndical agreements, ceiling or time lapse voting shares, non-voting shares, pyramid share structures, cross-shareholdings, preference shares, proxies, extraordinary rights, multi-jurisdictional cases, equitable compensation.

when judging protection devices that may not be covered by the Directive when read literally.⁷⁶¹ However, we should not neglect the fact that the Takeover Bid Directive is a political compromise, which tries to balance completely different mentalities of takeover regulation. The deficiencies and the opt-in/out system of the Directive create a faulty incentive. It is true that many Member States will implement the breakthrough rule not because they intend to promote the freedom of establishment but because they know in advance that their national corporate and financial structures infringing the proportionality principle are not caught by the breakthrough rule.

13.5) The Reciprocity Rule (Article 12)

The reciprocity rule is found in Article 12 (3):

‘Member States may, under the conditions determined by national law, exempt companies which apply 9(2) and (3) and/or Article 11 from applying Article 9(2) and (3) and/or Article 11 if they become the subject of an offer launched by a company which does not apply the same Articles as they do, or by a company controlled, directly or indirectly, by the latter, pursuant to Article 1 of Directive 83/349/EEC’.

⁷⁶¹ S. Bartman ‘The EC Directive on Takeover Bids: Opting in as a token of good corporate governance’ in S. Bartman (ed.) *European company Law in Accelerated Progress* (Kluwer Law International, Hague 2006) 3.

Hence, the reciprocity rule is nothing more than a possibility granted to the companies by their Member States. Paragraph 5 of the same Article gives us the procedural conditions for the application of the reciprocity rule when it is granted by a Member State:

‘Any measure applied in accordance with paragraph 3 shall be subject to the authorization of the general meeting of shareholders of the offeree company, which must be granted no earlier than 18 months before the bid was made public in accordance with Article 6(1)’ .

Hence, the decision-making process for the application of the reciprocity rule has two levels: a legislative application by Member States, and, subsequently, an individual application by the relevant companies. Furthermore, paragraph 21 of the preamble states:

‘...Without prejudice to international agreements to which the European Community is a party, Member States should be allowed not to require companies which apply those provisions in accordance with the optional arrangements to apply them when they become the subject of offers launched by companies which do not apply the same provisions, as a consequence of the use of those optional arrangements.’

There are serious concerns whether this discriminatory effect of the reciprocity rule is acceptable under the rules providing freedom of establishment under the EC Treaty.⁷⁶²

The use of reciprocity rules is not uncommon in (secondary) EC Law. Two examples of this regulatory technique are: the reciprocity rules applied vis-a-vis third countries as regards banking legislation in order to ensure equal market access and national treatment (Directive 2000/12/EC on the taking up and pursuit of the business of credit institutions) and the reciprocity rule of the EC Gas Directive (Directive 98/30/EC concerning common rules for the internal market in natural gas) aiming at the protection of gas suppliers in Member States that opted to liberalize more quickly than

⁷⁶²J. Winter (n 725) 28.

required under the Directive against unfair competition from gas suppliers in Member States that had not yet opened up their domestic markets.⁷⁶³ In these examples the reciprocity rule is quite transparent. However, the reciprocity rule of the Takeover Bid Directive is very unclear due to the lack of a fixed and invariable basis. The provisions in respect of which the company is allowed to reciprocate are not always the same, as this depends on the method of application of the first two paragraphs of Article 12 by the offeree and the offeror company. The multiple levels of the reciprocity rule and the opt-out/in provisions can create some quite complicated situations and subsequent interpretative dilemmas, which are closely related to the promotion or not of the freedom of establishment.

These Articles give rise to problems of interpretation. It is quite difficult to choose between the possible interpretations because they lead us not only to inconsistencies but also to even absurd and perverse results. The first problem of construction has to do with whether or not the reciprocity rule applies to companies that are subjected involuntarily to the Articles 9 and/or 11 due to the initial opt-in decisions of the Member States. There is no doubt from the text that it may be conferred on the target companies which have been exempted from Articles 9 and/or 11 by the relevant Member State implementing provision under Article 12 (1), but have chosen to opt-back in under Article 12 (2) (in other words companies applying voluntarily these provisions ('.. companies which apply Articles 9(2) and (3) and /or 11 an offer launched by a company which does not apply the same Articles as they do ...' and '... companies which apply these provisions in accordance with the optional arrangements a company which does not apply the same provisions as a consequence of the use of these optional arrangements')). This approach is tilted in favour of confining the

⁷⁶³ P. Werdmuller 'Compatibility of the EU Takeover Bid Directive reciprocity rule with EU Free Movement Rules' (2006) 3 BLR 64, 65.

right to invoke reciprocity to companies voluntarily subject to Articles 9 and/or 11.⁷⁶⁴

The adoption of the interpretation that supports the application of the reciprocity rule only to companies voluntarily subjected to the two key provisions of the Directive (Articles 9 and/or 11) is justified by legal basis of the Directive (Article 44 (2)(g) EC Treaty). This interpretation means that the reciprocity rule will be available to fewer companies, as a whole category of companies (companies involuntarily subject to them) is exempted from it. Hence, the non-frustration or/and the breakthrough rules will catch a larger percentage of companies, because the reciprocity rule will not be available to companies involuntarily subject to the two key-provisions of the Directive. This is something quite positive for corporate mobility and the cross-border establishment of legal persons because the European market for corporate control will be hindered by fewer pre- and post-bid takeover defences. Furthermore, this is quite beneficial for shareholder protection, because the decision-making balance on takeover issues tilts towards the shareholders. This interpretation is more conducive to freedom of establishment, which constitutes the legal basis of the Directive, than the alternative construction. On the other hand, the interpretation allowing the application of the reciprocity rule by companies involuntarily subjected to the key-provisions (in addition to those voluntarily subjected to those provisions) does not really contribute to the attainment of the freedom of establishment goals because it widens the scope of the

⁷⁶⁴ J. Rickford characterizes these different interpretations as the 'strict' one and the 'liberal' one. He supports the interpretation of the reciprocity rule which catches the companies involuntarily subject to Article 9 and/or 11. This 'liberal' interpretation is based, as he admits by himself, on 'a more stretched use of language, particularly bearing in mind that the Article 12 regime is an exception and reciprocity an exception to the exception, normally requiring strict construction'. The 'more liberal' view is taken by J. Simon, above, 'OPA: Divine surprise ou Faux semblant? EUREDIA 2003/3 p.329, 340 (with slight hesitation) and S. Maul and A. Koulouridas 'The Takeover Bids Directive' (2004) 5 *GermLJ* 4, 12 (without discussion). I think that the textual arguments of the 'strict method' are more convincing and the strict method contributes more substantially to the freedom of establishment as it promotes the Takeover activity by prohibiting defensive measures through the application of Article 9 and 11. The strict interpretation limits the number of companies which make use of the reciprocity and opt-out possibilities of Article 9 and 11 by excluding the companies voluntarily subject to these two key provisions. Hence, more companies will comply with the key provisions of the Directive. J. Rickford (n 696) 76-77. M. Lamandini 'Takeover Bids and 'Italian' Reciprocity' (2008) 5 *ECL* 56.-57.

reasons permitting the evasion of Articles 9/11 of the Directive. Thus, encouragement of takeover activity and shareholder protection are not really facilitated. However, the adoption of the former interpretation (reciprocity available only to companies applying voluntarily the key provisions of the Directive) instead of one that allows the invocation of the reciprocity rule by companies obligatorily or voluntarily subject to it, leads us to an absurd and strange result. The decision by a Member State to apply Articles 9 and/or 11 to all its companies precludes it from conferring on them a reciprocity power which it could confer if it did not take that arguably stricter and more desirable position.⁷⁶⁵ This would be an incentive for Member States to opt out of those Articles because only then companies could secure the benefit of reciprocity by voluntarily adopting them.⁷⁶⁶ So, one interpretation (application of the reciprocity rule only to companies subjected voluntarily to Articles 9/11) is conducive to freedom of establishment, but urges Member States not to implement Articles 9/11 in order to grant this privilege to their companies. The other interpretation (the application of the reciprocity rule both to companies subjected voluntarily and involuntarily to Articles 9/11) does not really contribute to freedom of establishment, but gives Member States an incentive to opt in to the two basic provisions of the Directive. The irrationality is quite obvious, revealing the disadvantages of the reciprocity rule combined with the opt-in/out system.

Our second problem of interpretation is closely related to the practical effect of the reciprocity rule. If a target company⁷⁶⁷ applies Articles 9 and 11, and the offeror applies Article 11 but not Article 9 or Article 9 but not 11, we have the following constructions. On the one hand, the Articles applied by the bidder are not ‘the same’ as those applied by the target (textual approach argument) and so the target can opt out of

⁷⁶⁵ J. Rickford (n 696) 76-77.

⁷⁶⁶ J. Rickford (n 696) 76-77.

⁷⁶⁷ For reasons of simplification, we would examine the application of these Articles by the companies independently of the fact that this application could be obligatory or voluntary. This would also allow us to avoid the previous problem of interpretation, analyzed in the paragraph above.

these Articles.⁷⁶⁸ On the other hand, the target by opting-out of Article 11 or 9 (depending on which is implemented respectively each time by the bidder) will make itself exempt from an Article which does apply to the bidder.⁷⁶⁹ If reciprocation in this case is allowed due to the textual argument ('the same articles'), then we have the absurd result of the target company being able to opt-out of a provision which is followed by the bidder.⁷⁷⁰ I think that allowing the target to opt-out of the Articles which are not applied by the offeror respectively is a fair solution for the bidder which facilitates his takeover efforts. If for example the target applies both Articles and the bidder only Article 9, the target should only be permitted to opt-out of Article 11 and not both Articles. Only this can really promote freedom of establishment through the facilitation of takeovers because at least the offeree company will be obliged to observe the Article implemented by the bidder. Nevertheless, this may also constitute a disincentive for Member States and companies implementing both provisions because they will know in advance that they cannot reciprocate.

Another practical aspect of this problem of interpretation arises when the bidder applies both Articles but the target company only one. If the target is free to retaliate on the only Article that it applies because the Articles applied are not the same (two for the bidder, one for the offeree company), this is an absurd result because the bidder is bound more strictly than the target.⁷⁷¹ The bidder does apply what the target applies and more.⁷⁷² Again if we prohibit the target company in these cases from opting out of the only Article that it applies, the freedom of establishment is promoted because the Article is preserved resulting in the removal of takeover barriers. However, the same

⁷⁶⁸ J. Rickford (n 696) 82.

⁷⁶⁹ J. Rickford (n 696) 82.

⁷⁷⁰ J. Rickford argues without being fully convinced that since Articles 9 and 11 will bear differently on different kinds of companies it makes some sense to allow a target to remove both if either is not adopted by the bidder. J. Rickford (n 696) 86.

⁷⁷¹ J. Rickford (n 696) 85.

⁷⁷² J. Rickford (n 696) 85.

disincentive as in the previous paragraph is also present here: Member States and target companies will be discouraged from applying even one Article of the two key provisions because they know that they can not opt out in this case.

Furthermore, another practical problem raises the same issue of interpretation. If the target applies Article 9 but not 11, and the bidder applies Article 11 but not 9, or if the target applies Article 11 but not 9, and the bidder applies Article 9 but not 11 (i.e. the bidder applies only the Article that is not applied by the target company, and simultaneously the target company applies only the Article that is not applied by the offeror), the text of Article 12 creates almost the same problem. The ‘does not apply the same articles as they do’ textual argument, allows the target to opt-out of the only articles that it applies. This is quite contradictory, because it allows the target company to opt-out of a provision that is applied by the bidder. However, this is compensated for by the fact that the target applies an anti-defensive measure provision that is not applied by the bidder, and thus this could justify the invocation of the reciprocity principle in this case. It is of course obvious, as was mentioned above, that a prohibition of reciprocity in this case favours takeover bids and thus promotes freedom of establishment by enhancing the market for corporate control. But it constitutes quite a strong disincentive for the application of the key provisions by Member States or companies, since they know that the reciprocity rule is not available in this case.

In a Member State which has opted-out of Articles 9 and/or 11, the board of a target company which has opted into either or both of these Articles may frustrate a bid by another company registered in that same Member State which has not opted-in, but may not frustrate a bid by a company registered in that same Member State which has opted-in or by a company registered in any other Member State which is subject to the relevant Articles, either because the relevant Member State has not opted-out, or

because although the relevant Member State has opted out, the bidder has opted in.⁷⁷³ This outcome has the same disadvantages as the previous examples discussed above. This reciprocity regime may lead to a bid from a company in the same Member State being subject to Articles 9 and/or 11, while a bid from a company registered in another Member State is not; this might seem to amount to indirect discrimination on grounds of nationality contrary to Article 43 EC Treaty.⁷⁷⁴ Yet any such difference in treatment is not in truth by reference to Member State of registration of the company, but by reference to differences in the legal regimes which may be applicable in different Member States and indeed within the same Member State; differences moreover which reflect not only Member State choices but also the choices of individual companies.⁷⁷⁵

The irrationality, the contradictions, and the inconsistencies of the reciprocity rule are revealed by the fact that, while, as it is mentioned in the three previous paragraphs, the reciprocity rule provides a disincentive for the application of Articles 9 and 11 of the Directive, at the same time the reciprocity rule is an incentive for the application of these two key provisions. The reciprocity rule creates an unintended incentive for those EU listed companies that want to be players (offerors) in consolidating markets rather than targets (offerees), to apply Articles 9 and 11 voluntarily.⁷⁷⁶ Only then will the companies obtain immunity when they bid for other companies, which will not be able to opt out of these two ground rules (if of course the reciprocity rule is available in their jurisdiction). So companies that want to be bidders on the takeover market rather than targets must first accept the takeover facilitating rules as applying to them.⁷⁷⁷ Since every target company may be a (potential) acquirer in the various phases of its existence, it may be wise for the sake of desirable or even necessary expansion to

⁷⁷³ D. A. Wyatt, A. Dashwood (n 46) 882-883.

⁷⁷⁴ D. A. Wyatt, A. Dashwood (n 46) 882-883.

⁷⁷⁵ D. A. Wyatt, A. Dashwood (n 46) 882-883.

⁷⁷⁶ J. Winter (n 725) 28.

⁷⁷⁷ J. Winter, 'We all want to go to heaven but nobody wants to die' (2004) 1 ECL 4, 4.

assume the status of a an opted-in company.⁷⁷⁸ This helps promotion of freedom of establishment by liberalization of the market for corporate control through the removal of post and pre-bid takeover defences. On the one hand if we adopt some of the interpretations mentioned in the three previous paragraphs, the reciprocity rule is a disincentive for opting in to Articles 9 and 11. On the other hand, the latter argument leads us to the conclusion that the reciprocity rule is a motive for the application of Articles 9 and 11 by potential bidders. Member States should be very careful in balancing these inconsistencies and contradictions.

Moreover, the reciprocity rules have more disadvantages. First, they transform target boards into instruments of international policy. From the mercantilist or international trade policy point of view it is argued that it is undesirable for companies from one Member State (or perhaps a third country) taking over those from another without the possibility of reciprocal vulnerability; this may be described as ‘fear of ‘one way’ traffic’.⁷⁷⁹ This general policy argument is likely to be completely irrelevant to the merits of the bid and not a matter which should be of concern to the target board.⁷⁸⁰ To confer on a board the power to take defensive measures against a bid on the basis of reciprocity seems inconsistent with the neutrality principle and raises all the dangers of conflict of interest which led to the adoption of the shareholder decision making model.⁷⁸¹ Furthermore, the resolution conferring this power can be achieved on the basis of pre-breakthrough majorities; disproportionate share structures will be still effective and the authorization decision of the general meeting will be incompatible with the proportionality principle.⁷⁸² Making target boards the instruments of such international policy objectives is wholly inappropriate; this area of international or

⁷⁷⁸ S.M. Bartman (n 653) 7.

⁷⁷⁹ J. Rickford (n 696) 81.

⁷⁸⁰ J. Rickford (n 696) 81.

⁷⁸¹ J. Rickford (n 696) 81.

⁷⁸² J. Rickford (n 696) 81.

intra-Community establishment belongs to the competence of Member States or at least to some national authorities to which this power has been regulated and should be regulated only by them. Boards of companies with the complicated nexus of interests that they represent and their personal interest temptations should not be given the power as legal entities to restore inequalities in the takeover bid game caused by the opt in/out system. Another deficiency of the reciprocity rule which shows that it is nothing more than a political compromise that does not comply with basic notions of company law is that the bidder's structure is normally irrelevant to offeree shareholders. There may be an argument that it is in the case of a share-for-share offer. In such a case the offerees stand to be locked into a company with a less open structure than their own, but, so long as they are properly informed, as they should be under Article 10, they can express their wishes on this by not accepting and/or demanding a higher price.⁷⁸³ Thirdly, there is a crucial question about how reciprocity would work if the breakthrough rule were only partially implemented in a given Member State; for example if national regulation prescribes the rule on share transferability set forth by Article 11 (2) only and not the remainder of Article 11.⁷⁸⁴ Can a company subject to Article 11 (2) only and thus not embracing the full breakthrough rule be exempted from applying the rule if the bid is made by a bidder that is not subject to it?⁷⁸⁵ The answer depends on the answer of another question: is partial implementation of the two key provisions allowed? The Directive remains silent to this point. However, partial implementation is better than not implementing at all the relevant optional provision. So, for the sake of corporate mobility facilitation, our answer should be positive to the second question. If reciprocity in cases of partial implementation is allowed, then freedom of establishment is weakened, because the target opts out of an anti-defensive measures mechanism. If it

⁷⁸³ J. Rickford (n 696) 80.

⁷⁸⁴ M. Gatti (n 684) 112.

⁷⁸⁵ M. Gatti (n 684) 112.

not allowed, then Member States or companies will be dissuaded from implementing at least this part of the provision. The contradiction is once more clear. Fourthly, reciprocity would restrict the group of potential bidders to listed companies that are themselves open to hostile bids, which would be at odds with the promotion of a vibrant market for corporate control, as it would impose a large demand-side restriction.⁷⁸⁶ This would result in both fewer takeovers and lower premiums.⁷⁸⁷

Another issue concerning the reciprocity rule is connected with its scope, and more specifically with 'international' freedom of establishment. Preamble 12 (3) and (21) apparently exclude offers by individuals, or companies not listed within the community (wherever incorporated), which are not subsidiaries of community-listed companies (such subsidiaries are expressly within Article 12 (3)) and third country companies, because these do not fail to apply Articles 9 and/or 11 'by use of the optional arrangements'.⁷⁸⁸ These categories of company are completely outside the scope of Article 12.⁷⁸⁹ Article 12 applies only to companies listed within the Community with registered offices within the territories of the Member States.⁷⁹⁰ Hence, the declaration of the preamble in paragraph 21 - 'Without prejudice to international agreements to which the European Community is a party, ...' - seems to be redundant because these alien companies are, independently of any international agreements or Treaties, outside the scope of the reciprocity rule, because they do not fail to implement Articles 9 and/or 11 'by use of the optional arrangements'.⁷⁹¹ This provision was inserted in order to

⁷⁸⁶M. Gatti (n 684) 111.

⁷⁸⁷M. Gatti (n 684) 111.

⁷⁸⁸J. Rickford (n 615) 1404. This argument is in favour of the liberal interpretation expressed above.

⁷⁸⁹ A possible contrary argument is that third-country companies are always open to reciprocity because all such companies (whether or not subject to their own national neutrality / breakthrough provisions) are not such companies as apply the same Articles 'as a consequence of the use of those optional arrangements' because they could not make such use. However, this argument is not quite clear because of the obscure text. J. Rickford (n 615) 1404.

⁷⁹⁰ J. Rickford (n 615) 1404.

⁷⁹¹ It is possible there are no such international agreements to which the European Community is a party.

ensure that where companies from third countries are entitled to national treatment in connection with takeover bids, their rights are not affected.⁷⁹² However, the reciprocity rule excludes these foreign companies from its implementation and this recital of the preamble seems to be unnecessary. The fact that the Directive in some respects lacks careful consideration because it is the result of a political compromise and not of a thorough policy analysis is revealed once more. This particular point seems curious because one of the main preoccupations of those arguing for a level playing field was the alleged immunity of third country, particularly US, companies to contested bids as the result of a lack of board neutrality.⁷⁹³ The European Parliament recognized this problem and the Committee on Industrial, External Trade etc. matters proposed a special reciprocity-Article 17 (a)-addressing bids from third-country companies, but this Article was not adopted in the final agreed text.⁷⁹⁴ It is quite strange that these concerns are not dealt with expressly in the text of the Directive, because they played an important role in the 2002 rejection of the draft Directive by the European Parliament. The European legislature should have taken a more lucid and unambiguous position, as far as the legal position of non-EU companies is concerned. The lack of a clear provision or at least an appropriate interpretation about the application of the reciprocity rule to foreign companies discourages Member States and companies from applying Article 9 and 11 due to vulnerability fears and protectionist concerns. This obviously undermines achievement of a European market in corporate control and does not promote cross-border corporate establishment.

⁷⁹² J. Rickford (n 696) 83.

⁷⁹³ J. Rickford (n 696) 83.

⁷⁹⁴ European Parliament, Report of 8 December 2003 of the Committee on industrial, External Trade, etc matters FINAL A5 0469/2003 p. 80-82 and 91-92. J. Rickford (n 696) 91.

13.6) Conclusion

Although the primary objective of these Articles is to protect shareholders by conferring on them the possibility of deciding on the merits of a bid, this multi-layered opt-in/opt-out system and reciprocity rule do not contribute to this aim. It amounts to ‘harmonized’ legal diversity and multiformity. Hence there are three levels of regulatory competition available in the market for corporate control: competition among national company laws, competition among the individual legal regimes of domestic companies and competition among the individual legal regimes of domestic and other EU registered companies. The choices that the opt-in/opt-out system combined with the reciprocity rule offers to Member State and to companies, can result in numerous combinations. Hence, the Takeover bid Directive offers 16 different legal regimes which are available for Member States. The available legal regimes can be dramatically increased due to the decisions at company level.^{795 796} The significance of multiple options in a measure of harmonization is that it places in doubt the extent to

⁷⁹⁵ Pursuant to Article 12 of the Takeover Bid Directive, each Member State must make four choices in connection with the non-frustration rule and the breakthrough rule. Each Member State must decide: 1) whether or not to implement the non-frustration rule, 2) whether or not to implement the reciprocity clause in relation to the non-frustration rule (which if not opted into by the Member State, can always be opted into at the company level), 3) whether or not to implement the breakthrough rule, and 4) whether or not to implement the reciprocity clause in relation to the breakthrough rule (given that, like the non-frustration rule, if the breakthrough rule is not implemented by a Member State, it can always be opted into at the company level). Given these four binary choices and, hence, all the possible combinations thereof, theoretically the Takeover Directive gives Member States the possibility of choosing among 16 different regimes. The actual number of possible combinations increases dramatically if two more possibilities are added: 1) where a Member State has opted out, making opt ins at the company level with regard to choices about the non-frustration rule and/or the breakthrough rule (Article 12(2)); and 2) where a Member State has adopted the reciprocity clause, deciding, again at the company level, whether or not to exploit reciprocity (Article 12(5)) M. Gatti (n 684) 104.

⁷⁹⁶ M. Gatti questions whether the opt-in/out system of the Directive is superior to an easier and functionally equivalent one in which a Member State that does not impose the board neutrality rule as mandatory would be required to set such a regime as the default rule with the possibility for companies to opt-out of it. This proposed system if compared with the opt-out /opt-in mechanism of Article 21 (1) and (2), is more pro-freedom of establishment and would have the virtue of clearly signaling to the market which issuers intend to depart from the pro-shareholders standard provided for by the board neutrality rule. M.Gatti (n 684) 110.

which the harmonization in question is worthy of the name, and might be said to imply that the objective of achieving solutions at European level has overshadowed the aim of promoting cross-border business activity.⁷⁹⁷ This is not to question the area of harmonization (takeover bid / European company law) but the method of harmonization, which provides so many totally different options. Moreover, the argument that different standards should co-exist and compete works better for tradeable goods and services than for company law legislation, because it comprises package deals.⁷⁹⁸ The only positive thing is that at least now we know in advance the content of these regimes because of the Directive and we do not have 27 national takeover regimes, which would be completely unpredictable and perhaps arbitrary. However, the number of the available legal regimes is quite high and does not provide legal certainty, nor does it combat the psychological obstacles of cross-border corporate establishment. Furthermore, the biggest problem is that the degree of flexibility resulting from the optionality and reciprocity regimes has provided Member States with several ways to escape from imposing strict regulation on takeover defences.⁷⁹⁹ This is definitely not compatible with the general principles of the Directive and especially with the general principle of Article 3 (1)(c). However, opting out of Article 9 (2), does not suspend or create an exception to application of the general principle laid down in Article 3 (1) (c) of the Directive, and this general principle might be read as aiming in part to ensure that opting out of Article 9 (2) remains compatible with Article 43 EC Treaty.⁸⁰⁰ This general principle in Article 3 (1) (c), would provide a safeguard for the protection of the shareholders' rights in cases of opt-outs from Article 9 (2). Otherwise,

⁷⁹⁷ D. A. Wyatt and A. Dashwood (n 46) 871-872.

⁷⁹⁸ G. Wolff (n 309) 20.

⁷⁹⁹ M.Gatti (n 684) 104.

⁸⁰⁰ Article 3 (1) (c) of the Takeover Bid Directive states that 'the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid'. D. A. Wyatt, A. Dashwood and others (n 46) 884.

without the guarantee and the overarching protection of this general principle, the conduct of the board runs the risk of infringing the freedom of establishment. An example of this kind of infringing behaviour, according to D.Wyatt, would be the break-up of the company by the board, without the authorization of the general meeting, when the acceptance of the bid by the shareholders and the success of the takeover are considered imminent.⁸⁰¹ The general principles might be characterized as a corrective to the deficiencies of the opt-in/out and reciprocity arrangements.

⁸⁰¹ D. A. Wyatt, A. Dashwood and others (n 46) 884.

CHAPTER 14

DISCLOSURE OF INFORMATION

The disclosure of information about companies plays a quite important role in the market for corporate control both for bidders and target companies. The Directive, unlike the Portuguese proposal, does not require the opting-out regime to be subject to discussion, every two years, in a general meeting of shareholders.⁸⁰² Nor does the Directive require structural aspects and the defensive mechanisms to be put to a vote at the general meeting at least every two years, as was suggested by the Commission⁸⁰³ in its 2002 proposal for a Directive on Takeover Bids.⁸⁰⁴ This is unfortunate, for such clause would put pressure on listed companies' directors and serve to speed up the process of de facto harmonization.⁸⁰⁵ Instead, the Directive only requires offeree companies to regularly present defensive structures and mechanisms in reports to general meetings of shareholders.⁸⁰⁶ The Preamble 18 of the Directive states that

‘In order to reinforce the effectiveness of existing provisions concerning the freedom to deal in the securities of companies covered by this Directive and the freedom to exercise voting rights , it is essential that the defensive structures and mechanisms envisaged by such companies be transparent and that they be regularly presented in reports to general meetings of shareholders’.

Article 10 obliges the potential target companies to disclose information which could affect the decision of a potential bidder to launch a bid. Article 6 obliges the bidder to

⁸⁰² F. Ipekel (n 554) 351.

⁸⁰³ COM (2002) 534 final, 2002/0240(COD), Brussels, 2 Oct. 2002, r 10 (3).

⁸⁰⁴ F. Ipekel (n 554) 351.

⁸⁰⁵ F. Ipekel (n 554) 351.

⁸⁰⁶ F. Ipekel (n 554) 351.

disclose information concerning the bid which is very important for the decision – making of the shareholders (or the board of the company in case of non-implementation of the non-frustration rule) about the bid. The disclosure of information contributes to a great extent to the transparency of the market for corporate control and to the protection of shareholders.

Article 10 obliges the potential target companies to reveal their structures, and especially defensive measures, which could influence the course of a bid. This disclosure includes defensive measures which are not caught by the Directive, either because of the opt-out/opt-in/reciprocity system, or because the narrow scope of the Directive does not apply to some defensive tactics. If the company does not implement Articles 9 and/or 11 because the Member State did not opt in to these provisions and the company did not voluntarily opt back in, it is obliged to disclose the defensive measures that are not permitted by the non-frustration or the breakthrough rule. Otherwise, if the company implements Articles 9/11 either obligatorily or voluntarily (the Member State decided to opt-in or the Member State opted-out but the individual company opted back in), it is obliged to disclose only the defensive structures that are not caught by the Directive's provisions because it will not be possible for the company to develop defensive structures that are prohibited by the Directive's key provisions. This disclosure of information must be published in the company's annual report as provided for in Directives 78/660/EEC and 83/349/EEC⁸⁰⁷ (Article 10 (2) of the Directive). Furthermore, according to Article 10 (3) of the Directive, the Board of the company is obliged to justify any kind of defensive measures or other tactics that it legally takes because it must present an explanatory report to the annual general

⁸⁰⁷ Now in Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (Text with EEA relevance) [2006] OJ L224/1.

meeting of shareholders. Hence, the board of the company could not take defensive measures which aim only at the entrenchment of its position and the securing of the personal interests of its members because it would have to report all these practices to the annual general meeting. This is something very positive for the protection of shareholders because it protects them from arbitrary decisions of the board and from otherwise un-notified defensive measures, which could distort the principle that the shareholders should primarily decide on the merits of the bid.

Article 10 demands disclosure of the defensive measures and company law structures that are the object of regulation of the breakthrough rule. The existence of dual class shares must be disclosed. The provision of Article 10 (1) (a) requires also the announcement of the rights and obligations attaching to each different class of shares and the percentage of total share capital that each class represents. Furthermore, other kinds of restriction on the transfer of securities and on voting rights, which fall within the scope of the breakthrough rule, shall be disclosed.⁸⁰⁸ Article 10 mentions indicatively limitations on the holding of securities or the need to obtain the approval of the company or other holders of securities (paragraph 1(b)) and limitations on the voting rights of holders of a given percentage or number of votes, deadlines for exercising voting rights, or systems whereby with the company's cooperation the financial rights attaching to securities are separated from the holding of securities (paragraph 1 (f)). The company is also obliged to publish detailed information on any agreements between shareholders which are known to the company and may result in restrictions on the transfer of securities and/or voting rights⁸⁰⁹. If the holders of securities have any special control rights, the company must provide information and describe these rights (Article 10 (1) (d)). The same obligation takes effect for the rules

⁸⁰⁸ Article 10 (1) (b) and (f)

⁸⁰⁹ Article 10 (1) (g)

governing the appointment and replacement of board members and the amendments of the articles of association (Article 10 (1) (h)). Although pyramid structures and cross-shareholdings avoid the protective scope of the provisions of the Directive, it is mandatory, according to Article 10 (1) (c), of the Directive, to publish information on significant direct and indirect shareholdings including indirect shareholdings through pyramid structures and cross-shareholdings. This latter provision is very important for the Directive's legal regime because the corporate structures of pyramids and cross-shareholdings can frustrate and discourage the efforts of a bidder. The potential bidder, knowing in advance through the disclosure of information that this kind of takeover barriers exists, will carefully re-consider his takeover plans before launching the bid.

Additionally, the defensive measures and protective structures that belong to the categories of defensive tactics of the non-frustration rule must be disclosed to the public. The company must provide information on the powers of the board and especially on its ability to issue or buy back shares, which could dilute the stake of the bidders in company's share capital and permanently impede the acquisition of control. 'Poison Pills' should be disclosed and especially any significant agreements to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid, and the effects thereof, except where their nature is such that their disclosure would be seriously prejudicial to the company (Article 10 (1) (j)). This exception shall not apply where the company is specifically obliged to disclose such information on the basis of other legal instruments. Furthermore, any agreements between the company and its board members or employees providing for compensation if they resign or are made redundant without valid reason or if their employment ceases because of a takeover bid (golden

parachutes) must be disclosed.⁸¹⁰ Moreover, any system of control of any employee share scheme where the control rights are not exercised directly by the employees, like in the Beiersdorf takeover in Germany, must be disclosed.⁸¹¹

Article 6 concerns the disclosure of information from the bidder's side. This disclosure of information plays an important role in the success or not of the bid because the shareholders of the target company, after the receipt of the information, could judge and decide if the bid is a value-increasing transaction for them. Article 6 (1) states that Member States shall ensure that a decision to make a bid is made public without delay and that the supervisory authority is informed of the bid (they may require that the supervisory authority must be informed before such a decision is made public). The bidder is also obliged to draw up and make public in good time an offer document containing the information necessary to enable the holders of the offeree company's securities to reach a properly informed decision on the bid.⁸¹² Article 6 (2) also establishes the mutual recognition principle; where the offer document must be approved in advance by the supervisory authority, it shall be recognized in any other Member State on the market of which the offeree company's securities are admitted to trading, without it being necessary to obtain the approval of the supervisory authorities of that Member State. However, the flexibility and adjustment to special national circumstances of the securities markets are recognized because the national supervisory authorities of the Member States on the additional market of which the offeree company's securities are admitted to trading may require the inclusion of additional information in the offer document only if such information is specific to the market of a Member State or Member States and relates to the formalities to be complied with to accept the bid and to receive the consideration due at the close of the bid as well as to

⁸¹⁰ Article 10 (1) (k), J.Rickford (n 615) 1390.

⁸¹¹ Article 10 (1) (e).

⁸¹² Article 6 (2).

the tax arrangements to which the consideration offered to the holders of the securities will be subject.⁸¹³ The elements that the offer document should at least include are found in Article 6 (3). Article 6 (3) (c) is very important in cases of dual (or more) class shares because the bidder must explicitly declare the class of shares to which its offer is addressed. This contributes towards legal certainty and shareholder protection because they know specifically if their class of shares is the object of the bid. Additionally, Article 6 (3) (a), (f), (h), (i), and (n) help the shareholders in their decisions and contribute to legal certainty and the transparency of the securities markets; the bidder shall provide information on the terms and conditions of the bid, the maximum and minimum securities that the bidders undertakes to acquire, and the offeror's intentions with regard to the future of the business and the governing law.

Information about the consideration and the compensation to be paid must also be provided. The bidder is also obliged to provide information on the consideration offered for each security or class of securities with a special notice on the very sensitive issue of the mandatory bid consideration. (Article 6 (3) (d)). Article 6 (3) (e) of the Directive states that the offer document shall provide information on the compensation offered for the rights which must be removed as a result of the breakthrough rule laid down in Article 11 (4), with particulars of the way in which that compensation is to be paid and the method employed in determining it. The quantification problems mentioned above in the breakthrough rule chapter obviously apply here. If the consideration of the offeror includes securities of any kind, the bidder should provide further information concerning those securities (Article 6 (3) (k)).

There are also disclosure of information provisions concerning the concerted party action and 'creeping' takeovers. Art 6 (3) (m) requires disclosure of information on the

⁸¹³ Article 6 (2).

identity of persons acting in concert with the offeror or with the offeree company, and in the case of companies, their types, names, registered offices and relationships with the offeror, and, where possible, with the offeree company. This information is very important to prevent the bidder evading the consequences of crossing the mandatory bid threshold or the sell-out threshold. Otherwise without this disclosure of information on concerted parties, the bidder could divide his total stake into smaller ones held by persons controlled by him with the final result of evading triggering the relevant protective rules. Moreover, the bidder must announce the details of any existing holdings that he has, and of persons acting in concert with him, in the offeree company. This provision tries to prevent the phenomenon of ‘the creeping’ takeover where the offeror secretly obtains large shareholdings in the offeree company without prior notification and the shareholders are left without any protection or cover in the face of an accomplished takeover. These provisions aim at protecting the shareholders by ensuring that protective rules (like the mandatory bid rule) are enforced and that value-decreasing situations characterized by arbitrage, market abuse and insider dealing do not take place⁸¹⁴.

The Large Shareholdings Directive (Directive 88/627/EEC)⁸¹⁵ sets disclosure requirements for shareholders as regards voting and cash flow rights which must be reported to national market regulators.⁸¹⁶ This is an additional source of information for market players. Each acquirer of a company’s stock has to give due notice within seven days to that company if his or her amount of shares equals, surmounts or falls below certain thresholds (10%, 20%, 1/3, 50% and 2/3).⁸¹⁷ This tries to combat the phenomenon of ‘creeping’ and secret takeovers. If somebody holds shares on behalf of

⁸¹⁴ Such as ‘creeping’ takeovers

⁸¹⁵ Council Directive 88/627/EEC of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of, [1988] OJ L348/62.

⁸¹⁶ J. Grant (n 630) 37.

⁸¹⁷ J. Grant (n 630) 37.

the bidder, these shares must be added to the percentage of the bidder. It must not be possible to circumvent the requirements of the disclosure of information and notification provisions as regards concerted party action. This also allows for easier monitoring and enforcement of European Directives on insider trading and facilitates the role of mergers and acquisitions arbitrageurs in pricing and bearing risk.⁸¹⁸ Disclosure of major shareholdings is very important for shareholder protection because it limits the raider's ability to gain secretly a significant foothold in the company's stock resulting potentially in a value-decreasing situation for 'trapped' minority shareholders.

However, one negative point is that the disclosure of information provisions do not include a certain type of agreement which is not very common in the European market for corporate control but began to spread recently, for example in the case of share listed on the Swedish Stock Exchange. In the case of a friendly takeover, a confidentiality agreement is sometimes entered into between the bidder and the target company, and the bidder is permitted to conduct an investigation of the target company (a due diligence investigation).⁸¹⁹ If the bidder's request to perform a due diligence investigation is granted, the bidder will get access to a significant amount of information regarding the target company, some of which might be of crucial importance for the potential bid.⁸²⁰ Often there will also be some important issues on which there is no information available.⁸²¹ Hence, the bidder and the shareholders of the target company could possibly be placed in an awkward and uneasy situation due to

⁸¹⁸ J. Grant (n 630) 37.

⁸¹⁹ S. Johansson 'Undertakings by Target Companies in Take-over Situations' (2002) 4 EBLR 335, 336.

⁸²⁰ S. Johansson (n 819) 336.

⁸²¹ S. Johansson (n 819) 336.

this lack of important information. Unfortunately, the Directive does not ensure that market operators get accurate and simultaneous information on these sensitive issues.⁸²²

The disclosure of information provisions of the Directive protect not only shareholders of the target company, but also shareholders of the offeror, by obliging the bidder to disclose information about the bid that he intends to launch. The shareholders of the offeror could be protected from arbitrary and irresponsible choices to launch a takeover bid and from bids that the offeror is not able to finance and accomplish. Hence, legal certainty and transparency of financial transactions are enhanced with the ultimate beneficiaries being the shareholders of the offeror, and of the target company, and indeed the bidder itself. The report from the consultants Coopers & Lybrand⁸²³ in 1989, commissioned by the British Department of Trade and Industry, found that some European jurisdictions require much less disclosure from companies than others, and this lack of transparency may put a bidder, especially a foreign bidder, at a disadvantage in deciding whether to bid for a company and what price to offer, thus posing difficulties in identifying take-over targets.⁸²⁴ Differing accounting standards and different approaches to the requirements for the filing of accounts may add to the problem.⁸²⁵ Additionally, along with factors like creditworthiness and corporate governance, differentiation in takeover protection between opted-in and opted-out companies may also give rise to a system of national and international market rating.⁸²⁶ The disclosure obligations in the Directive with regard to internal control structure and the current protection regime (Article 10) are of

⁸²² S. Johansson (n 819) 336.

⁸²³ 'Barriers to Takeovers in the European Community'; (H.M.S.O., 1989). See also the consultative document published by the Department of Trade and Industry under the same title (January 1990).

⁸²⁴ L.S. Sealy (n 4) 144.

⁸²⁵ L.S. Sealy (n 4) 145.

⁸²⁶ S. Bartman (n 761) 6, S. Bartman (n 690) 163 and S. Bartman (n 653) 6.

major importance in this respect.⁸²⁷ In the event of significant share price differences on the stock exchange between opted-in and opted-out companies– which otherwise have similar characteristics–opted out companies will sooner or later find themselves under strong shareholder pressure to opt in.⁸²⁸

⁸²⁷ S. Bartman (n 761) 6.

⁸²⁸ S. Bartman (n 761) 6.

CHAPTER 15

DIRECT EFFECT OF THE FUNDAMENTAL FREEDOMS IN EU LAW.

15.1) The doctrine of direct effect in EU Law.

The founding Treaties did not make express provision for the effect of EC Law in the national legal orders of Member States, the possibility of conferral of rights and obligations on individuals and the possible enforcement of such rights. The original Member States had the impression that EC Law would have the same domestic effects as international law which meant that the impact of EC law on domestic law would be determined by each Member State's own constitutional law (following either a monist or dualist approach).⁸²⁹ However, the ECJ had a different view and adopted the doctrine of direct effect.

In general, direct effect concerns the way in which a provision of one legal system is applied to another and encompasses the transfer of a provision between two legal systems.⁸³⁰ There is an academic and judicial uncertainty about the exact meaning of the term direct effect and two definitions, a broad one and a narrow one, have been introduced. According to the broad definition, direct effect is the capacity of a provision

⁸²⁹ K. Davies *Understanding European Union Law* (3rd ed. Routledge-Cavendish, Abingdon 2007) 63-64. P.-J. Kuijper 'Epilogue: Symbiosis?' in J. Prins and A. Schrauwen (eds) *Direct Effect-Rethinking a Classic of EC Legal Doctrine* (Europa, Groningen/Amsterdam 2002) 255, 260.

⁸³⁰ This transfer depends on the relationship between the two legal systems. When one system derives its validity from the other, the terms of this transfer are provided by the primary system. If neither legal system is dependent on the other, each legal system decides for itself whether provisions of the other can be transferred to it. T.C. Hartley 'The constitutional foundations of the European Union' [2001] LQR 225, 237, M. Dougan 'When worlds collide! Competing visions of the relationship between direct effect and supremacy' [2007] CMLRev. 931, 932. For an interesting study on the common constitutional principles governing the relationship between national and international law, see S. Prechal 'Direct Effect, Indirect Effect, Supremacy and the Evolving Constitution of the European Union' in C. Barnard *The Fundamentals of EU Law Revisited: Assessing the Impact of the Constitution Debate* (OUP, Oxford 2007) 35-69. See also: R. Barents *The autonomy of Community law* (Kluwer, The Hague 2003) 167, 193, 299, For an EEA view, see: M. Johansson and L. Sevón 'The protection of the rights of individuals under the EEA agreement' [1999] ELRev. 373. Direct effect is often characterized as a general principle of EC law by some academics. This is based on the rationale that direct effect is founded on a general principle of effectiveness being a typical feature of EC law. J. Bengoetxea 'Is direct effect a general principle of European law?' in U. Bernitz and others (eds) *General Principles of EC Law in a Process of Development* (Kluwer, AH Alpen aan den Rijn 2008) 4.

of EC Law to be invoked before a national court (objective direct effect).⁸³¹ In a narrower sense, direct effect is the capacity of a provision of EC Law to confer rights on individuals which they may enforce before national courts (subjective direct effect).⁸³² The definition of 'rights' being used determines the degree of difference between these two definitions. If 'right' is defined as the right to invoke EC law in a national court to assist one's case and to ameliorate its position, then the difference between these two definitions is not very big.⁸³³ Nevertheless, if the conferral of 'rights' on individuals includes conferral of a substantive right (e.g. prohibition of discrimination on grounds of nationality) or of a particular remedy or the imposition of a corresponding duty on a third party, then the difference between these two definitions is bigger.⁸³⁴

Direct effect is further divided into vertical and horizontal. On the one hand, vertical direct effect refers to the situation where an individual can rely on a Treaty article in judicial proceedings against a Member State or its emanations.⁸³⁵ On the other hand, horizontal direct effect refers to a situation where an individual can rely on a Treaty article in judicial proceedings against another individual.⁸³⁶ These two categories of direct effect will be approached through an analysis of the relevant case law. The ECJ's case law played a very important role in the evolution of the direct effect of the EC Treaty's provisions.

⁸³¹ P. Craig and G. De Burca (n 12) 269-270. See also: S. Prechal (n 830) 37, 44.

⁸³² P. Craig and G. De Burca (n 12) 270.

⁸³³ P. Craig and G. De Burca (n 12) 270.

⁸³⁴ P. Craig and G. De Burca (n 12) 270. See also: T.A. Downes and C. Hilson 'Making sense of rights: Community rights in EC Law' [1999] ELRev. 121-138.

⁸³⁵ A. Kaczorowska *European Union Law* (Routledge Cavendish, Abingdon 2009) 303.

⁸³⁶ A. Kaczorowska (n 835) 304. B. Bercusson 'Economic Policy: State and Private Ordering' in T. Daintith (ed) *Law as an instrument of economic policy: Comparative and critical approaches* (de Gruyter, Berlin/New York 1988) 363-365, 369, 376, 386-390, 414.

15.2) Establishment of vertical direct effect.

*Van Gend & Loos*⁸³⁷ was the ground-breaking ruling which introduced the doctrine of direct effect into the Community legal order. In this case, the ECJ examined whether a Dutch importer could argue before a Dutch national court that Article 25 EC Treaty was infringed and more specifically whether the importer could claim the protection of rights conferred on it by EC law.⁸³⁸ Three out of the six original Member States intervened in the proceedings. The Dutch and Belgian governments argued that the ECJ lacked jurisdiction and that the process of Articles 226-227 EC Treaty should have been followed. Additionally, the Dutch and Belgian governments did not exclude the possibility of an additional remedy and added that a national remedy could also be invoked. This national remedy would be determined by the Member States and not by the ECJ. They believed that the influence of EC law on national legal proceedings is a matter of pure national law and must be determined only by the Member States.⁸³⁹

AG Roemer argued that Community law does not consist of contractual relations between certain States as does international law. Community rules create rights in favour of and impose duties on Member States as well as their authorities and citizens. He accepted that some EC Treaty provisions were intended to apply directly in the national systems (e.g. Articles 81-82 EC Treaty). Finally, he concluded that Article 25 EC Treaty did not have direct effect because it did not refer explicitly to individual rights and contained an obligation on the part of the Member States.⁸⁴⁰

The ECJ rejected the arguments of the Dutch and Belgian governments that only the procedure of Articles 226-227 EC Treaty should be followed and held that the existence

⁸³⁷ Case 26/62 *Van Gend & Loos* [1963] ECR English special edition 1.

⁸³⁸ D. Chalmers and others (n 394) 366

⁸³⁹ D. Chalmers and others (n 394) 366-367.

⁸⁴⁰ For a brief discussion of the Advocate General's opinion, see: A. Arnall *The European Union and its Court of Justice* (Oxford EC Law Library, 2nd ed. OUP, Oxford 2006) 164-165.

of Articles 226-227 EC Treaty does not mean that individuals cannot plead a breach of Member State obligations before a national court.⁸⁴¹ In *Van Gend & Loos*, the action was against the Dutch State; hence, in that case the ECJ examined a vertical relationship between the State and the citizen. In general, vertical direct effect concerns the relationship between EC law and national law. Some Treaty articles create obligations on the State to ensure their observance. If a Member State does not comply with these obligations, then the European Commission could pursue the process of Articles 226-227 EC Treaty. Although the process of Articles 226-227 EC Treaty is always open, vertical direct effect empowers an individual to invoke Treaty provisions in an action against the State.⁸⁴² The doctrine of direct effect was based on the premise that the EC Treaty created rights for citizens which if invoked by them in the domestic courts would provide an additional supervisory function to that already contained in Articles 226-227 EC Treaty.⁸⁴³ Despite the fact that the EC Treaty does not contain an explicit provision on the direct effect of Treaty articles, the ECJ found that ‘the spirit, the general scheme and the wording of the Treaty’ produce direct effects and create individual rights which national courts must protect.⁸⁴⁴

Another strong argument of the ECJ is contained in its reference to the preliminary reference process (Article 234 EC Treaty). The existence of this article in the Treaty shows that the Member States have understood that EC law possesses an authority which can be invoked by their nationals before the domestic courts. The preliminary reference process reveals that at the very least Treaty articles may have some legal consequences when invoked before domestic courts.⁸⁴⁵

⁸⁴¹ D. Chalmers and others (n 394) 367.

⁸⁴² T. Storey and C. Turner *Unlocking EU Law* (2nd ed. Hodder Education, London 2008) 169.

⁸⁴³ J. Fairhurst *Law of the European Union* (6th ed., Pearson Longman, Essex 2007) 265.

⁸⁴⁴ D. Chalmers and others (n 394) 367.

⁸⁴⁵ D. A. Wyatt and A. Dashwood (n 46) 149.

In *Van Gend & Loos*, the ECJ also set certain conditions which needed to be fulfilled before a Treaty article could obtain direct effect. The conditions which were satisfied by Article 25 EC Treaty and which, subsequently, conferred direct effect on it were that it was: clear, negative, unconditional, containing no reservation on the part of the Member State, and not dependent on any national implementing measure.⁸⁴⁶ These conditions seemed to be quite strict but, in its subsequent case law, the ECJ loosened these initial conditions.⁸⁴⁷

The conditions that the Treaty article should be clear, unconditional, containing no reservation on the part of the Member State, were loosened. The ECJ did not consider that Member States' discretion could exclude the direct effect of a Treaty article. Direct effect could apply even where the Member States possessed discretion, on the ground that the exercise thereof could be controlled by the courts.⁸⁴⁸ Even when Treaty articles require the appreciation of complex issues, they are not precluded from being directly effective, as long as the requisite conditions are fulfilled.⁸⁴⁹

Furthermore, the condition that a Treaty article should not be dependent upon any national implementing measure was amended. The ECJ found that Article 43 EC Treaty was sufficiently certain and conferred direct effect on it, and disregarded the absence of implementing measures at national and EC level (as of the end of the transitional period for the realization of Community's general programme on freedom of establishment).⁸⁵⁰ The pivotal point in *Reyners*⁸⁵¹ which was about the freedom of

⁸⁴⁶ P. Craig and G. De Burca (n 12) 275.

⁸⁴⁷ P. Craig and G. De Burca (n 12) 275. J.H. Jans, R. de Lange, S. Prechal, R. Widdershoven *Europeanisation of Public Law* (Europa, Groningen/Amsterdam 2007) 65.

⁸⁴⁸ P. Craig and G. De Burca (n 12) 275. Case 13-68 *SpA Salgoil v Italian Ministry of Foreign Trade, Rome* [1968] ECR 453 English special edition.

⁸⁴⁹ In *Fink-Frucht*, the ECJ discussed the direct effect of Article 90(1) EC Treaty which entails complex evaluations of economic factors. D. A. Wyatt and A. Dashwood (n 46) 151-152. Case 27/67 *Firma Fink-Frucht GmbH v Hauptzollamt München-Landsbergerstrasse* [1968] ECR 223 English special edition.

⁸⁵⁰ P. Craig and G. De Burca (n 12) 275.

⁸⁵¹ Case 2/74 *Jean Reyners v Belgian State* [1974] ECR 631.

establishment of Member State nationals (Article 43 EC Treaty) was the realization of the Community's general programme on freedom of establishment. The general programme on freedom of establishment was aiming at the abolition of trade barriers in this part of the common market and required the adoption of the essential directives for market integration⁸⁵². The ECJ found that the basic principle of non-discrimination is directly effective and could be invoked before the national courts, although the freedom of establishment has not yet reached a satisfactory level of integration due to the slow realization of the Community's general programme on freedom of establishment.⁸⁵³ Article 43 EC Treaty seeks to facilitate the realization of Community's general programme on freedom of establishment but does not depend on it.⁸⁵⁴

The ECJ has moved from the strict conditions on direct effect introduced by *Van Gend & Loos* to a more relaxed test.⁸⁵⁵ This test could be characterised as a test of feasibility: if a provision is open to judicial application, it is capable of direct effect. It could be argued that the ECJ does not regard direct effect as an exceptional phenomenon but rather as the norm.⁸⁵⁶

⁸⁵² General Programme for the abolition of restrictions on freedom of establishment [1962] OJ 2/36–45 and [English spec ed: Series II Volume IX/7-15]

⁸⁵³ P. Craig and G. De Burca (n 12) 275-276.

⁸⁵⁴ D. A. Wyatt and A. Dashwood (n 46) 766.

⁸⁵⁵ T.C. Hartley *The Foundations of European Community Law* (6th ed. OUP, Oxford 2007) 197.

⁸⁵⁶ T.C. Hartley (n 855) 197.

15.3) Establishment of horizontal direct effect.

Horizontal direct effect deals with the relationship between individuals and other individuals; this could include any private body including companies.⁸⁵⁷ With regard to the substance of horizontal direct effect, it creates rights between persons and is therefore enforceable by them in national courts.⁸⁵⁸ It concerns a situation where an individual (that is a natural or legal person) is allowed to invoke a provision of EU law in national proceedings against another individual before a domestic court.⁸⁵⁹ It is possible that the actions of one individual obstruct another individual from exercising effectively the fundamental freedoms within the framework of the internal market. The significance of the horizontal effect of fundamental freedoms is raised due to the privatization programmes in many Member States and to the increasing importance of private conduct for the organization and operation of the internal market.⁸⁶⁰ With regard to horizontal direct effect, the ECJ has adopted different approaches towards free movement of goods and free movement of persons.

The ECJ discussed the vertical effect of Treaty articles in *Van Gend & Loos*, but, in *SABAM*⁸⁶¹, it had the opportunity for the first time to examine the horizontal effect of Treaty articles. In this case, the ECJ found that Articles 81-82 EC Treaty are capable of horizontal direct effect which is derived by 'their very nature' as competition law provisions. The ECJ started to endorse the proposition that Treaty articles could affect the rights of private parties (natural or legal persons) *per se*.⁸⁶² While, in *Dansk*

⁸⁵⁷ T. Storey and C. Turner (n 842) 169. B. Bercusson (n 836) 365

⁸⁵⁸ T. Storey and C. Turner (n 842) 170.

⁸⁵⁹ A. Kaczorowska (n 835) 304.

⁸⁶⁰ J. Baquero Cruz 'Free movement and private autonomy' [1999] ELRev. 603, 604.

⁸⁶¹ Case 127/73 *Belgische Radio en Televisie v SV SABAM and NV Fonior* [1974] ECR 51.

⁸⁶² D. A. Wyatt and A. Dashwood (n 46) 152.

*Supermarked*⁸⁶³, the ECJ considered that private parties are also bound by the obligations imposed by Article 28 EC Treaty, this approach was abandoned by later cases handed down by the ECJ (*van de Haar*⁸⁶⁴, *Vlaamse Reisbureaus*⁸⁶⁵, *Süllhöfer*⁸⁶⁶, *Sapod Audic*⁸⁶⁷). Therefore, Articles 28 and 26 EC Treaty bind only Member States and not private parties.⁸⁶⁸ This kind of anti-competitive behaviour of private persons (undertakings) falls within the scope of Articles 81-82 EC Treaty, as long as it distorts competition in an appreciable manner. An application of the free movement of goods provision to these actions would undermine the effectiveness of Articles 81-82 EC Treaty.⁸⁶⁹

Even within the sphere of free movement of goods and within other areas of the internal market which were related to commercial activities and were closely linked to the free movement of goods, the ECJ has not adopted a uniform approach towards horizontal direct effect. Some Treaty articles enjoyed both horizontal and vertical direct effect, while others were declared to have only vertical direct effect. The ECJ conferred both horizontal and vertical direct effect on many different Treaty articles. For example: Article 25 EC Treaty which prohibits impositions by the Member States of customs duties on imports and exports and charges having equivalent effect (*Van Gend*

⁸⁶³ Case 58/80 *Dansk Supermarked A/S v A/S Imerco* [1981] ECR 181 para 17.

⁸⁶⁴ Cases 177 and 178/82 *Van de Haar* [1984] ECR 1787, paras 11-12.

⁸⁶⁵ Case 311/85 *Vlaamse Reisbureaus* [1987] ECR 3801, para. 30.

⁸⁶⁶ Case 65/86 *Bayer AG and Maschinenfabrik Hennecke GmbH v Heinz Süllhöfer* [1988] ECR 5249 para. 11.

⁸⁶⁷ Case C-159/00 *Sapod Audic* [2002] ECR I-5031, para 74.

⁸⁶⁸ P. Oliver and W.-H. Roth 'The internal market and the four freedoms' [2004] CMLRev. 407, 422. *Dansk Supermarked* is not considered to be any more good law, since its findings were never confirmed by subsequent rulings. J. Baquero Cruz (n 860) 608.

⁸⁶⁹ P. Oliver and W.-H. Roth (n 868) 422. The fundamental freedoms and the competition rules constitute the basis of an efficient functioning of the internal market. Both sets of rules aim at the protection of the internal market, yet their respective emphasis is different. D. Vaughan 'Free movement and competition pillars of the single market' (2003) 4 CLI 8. For the notion of appreciable distortion of competition (Article 81 EC Treaty) see: Case 56/65 *Maschinenbau Ulm* [1966] ECR 235 and Case 5/69 *Volk* [1969] ECR 295.

& *Loos and Dubois & Fils*⁸⁷⁰), Article 31(1) EC Treaty regarding State monopolies (*Hansen*⁸⁷¹) and Article 90 EC treaty not allowing the imposition of discriminatory taxes on imported goods (*Lütticke*⁸⁷²)⁸⁷³. Other Treaty articles which have only vertical direct effect are Article 23 EC Treaty requiring the establishment of a customs union (*Denkavit*⁸⁷⁴), Article 31(2) prohibiting the introduction of new discriminatory measures in relation to State monopolies (*Costa*⁸⁷⁵) and Article 88(3) EC Treaty prohibiting state aids not notified to the Commission (*Capolongo and Lorenz*⁸⁷⁶).⁸⁷⁷

Commission v France concerned the destructive actions of French farmers against Spanish agricultural products imported into France. In this case, the French government had infringed Article 28 EC Treaty in combination with Article 10 EC Treaty by failing to adopt all necessary and proportionate measures in order to prevent the free movement of goods from being obstructed by actions of private individuals.⁸⁷⁸ Trade barriers do not necessarily derive only from State measures but include also the situations where a Member State fails to adopt the rules or to take the measures which aim at abolishing trade barriers not caused by the State.⁸⁷⁹ Moreover, the ECJ held that the fact that a Member State abstains from taking action or, as the case may be, fails to adopt adequate measures to prevent obstacles to the free movement of goods that are created, in particular, by actions of private individuals on its territory aimed at products originating in other Member States is just as likely to obstruct intra-Community trade as

⁸⁷⁰ Case C-16/94 *Édouard Dubois & Fils SA and Général Cargo Services SA v Garonor Exploitation SA* [1995] ECR I-2421.

⁸⁷¹ Case 91/78 *Hansen* [1979] ECR 935.

⁸⁷² Case 57/65 *Lütticke GmbH v Hauptzollamt Sarrelouis* [1966] ECR 205 English special edition.

⁸⁷³ A. Kaczorowska (n 835) 305-306.

⁸⁷⁴ Case 251/78 *Denkavit* [1979] ECR 3369.

⁸⁷⁵ Case 6/64 *Costa* [1964] ECR 585.

⁸⁷⁶ Case 77/72 *Capolongo* [1973] ECR 611, Case 120/73 *Lorenz* [1973] ECR 1471.

⁸⁷⁷ A. Kaczorowska (n 835) 306.

⁸⁷⁸ Case C-265/95 *Commission v French Republic*. [1997] ECR I-6959 para. 66. J. Snell *Goods and Services in EC Law* (OUP, Oxford 2002) 153.

⁸⁷⁹ Case C-265/95 *Commission v French Republic*. [1997] ECR I-6959 para. 30.

is a positive act.⁸⁸⁰ This positive obligation (preventing individuals from obstructing the free movement of goods) of a Member State must always be read in accordance with Article 10 EC Treaty.⁸⁸¹ The argument that Article 28 EC Treaty imposes both a positive and negative obligation on Member States was been referred implicitly in *de Peijper* but the ECJ had not the opportunity to address specifically this issue.⁸⁸²

Another case which involved the failure of a Member State to take measures against trade barriers imposed by individuals was *Schmidberger*.⁸⁸³ Austria decided not to prohibit an environmental demonstration which resulted in the temporary closure of a central motorway passing through Austria.⁸⁸⁴ This restriction on the free movement of goods was found to be justified on the basis of the overriding interest in respecting citizen's fundamental rights of freedom of expression and assembly.⁸⁸⁵ Apart from the very important issue of the place of fundamental rights in the Community legal order, it is quite interesting that the ECJ acknowledged that individuals could frustrate intra-community trade and that the State is responsible for securing the free movement of goods by taking all the necessary measures against such actions.

One of the fundamental cases in the area of horizontal effect which concerned a Treaty article specifically addressed to Member States is *Defrenne*⁸⁸⁶. *Defrenne* concerned Article 141 EC Treaty which demanded that 'Each Member State shall ensure that the principle of equal pay for male and female workers for equal work or work of equal value is applied.' This article appeared not to be sufficiently precise in

⁸⁸⁰ Case C-265/95 *Commission v French Republic*. [1997] ECR I-6959 para. 31.

⁸⁸¹ Case C-265/95 *Commission v French Republic*. [1997] ECR I-6959 para. 32. See also E.F. Hinton 'Case Note, *Commission v. France*' [1999] ColJEurL 477, 483.

⁸⁸² Case 104/75 *de Peijper* [1976] ECR 613. J. Baquero Cruz (n 860) 610.

⁸⁸³ Case C-112/00 *Eugen Schmidberger, Internationale Transporte und Planzüge v Republik Österreich* [2003] ECR I-5659.

⁸⁸⁴ J. Shaw, J. Hunt and C. Wallace (n 30) 131.

⁸⁸⁵ J. Shaw, J. Hunt and C. Wallace (n 30) 131.

⁸⁸⁶ Case 43/75 *Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena*. [1976] ECR 455. While *Van Gend & Loos* was about a negative obligation, this case was about a positive obligation imposed on Member States. F.G. Jacobs 'The evolution of the European Legal Order' [2004] CMLRev. 303, 307.

accordance with the *Van Gend & Loos* conditions.⁸⁸⁷ However, the ECJ declared the direct effect of the principle that men and women should receive equal pay, which is provided by Article 141 EC Treaty. More precisely, it was held that this principle could be relied on before the national courts which must ensure the protection of the rights conferred on individuals, in particular in the case of those forms of discrimination which have their origin directly in legislative provisions or collective labour agreements, as well as where men and women receive unequal pay for unequal work which is carried out in the same establishment or service, whether private or public.⁸⁸⁸ The horizontal direct effect of this provision could possibly result in amendments of independent agreements concluded privately or in the sphere of industrial relations such as individual contracts and collective labour agreements. The ECJ does not consider national legislatures as the exclusive recipients of this provision's mandate and explains that this article must be interpreted as including the intervention of the domestic courts in order to establish its direct applicability.⁸⁸⁹

As far as the free movement of persons is concerned, there was a very interesting line of cases concerning the collective regulation of professional activities, mostly in sports, by sports federations or other non-State regulatory bodies. In *Walrave and Koch*⁸⁹⁰, two professional pacemakers-motorcyclists claimed that a specific rule of the relevant sporting association requiring that the pace maker must be of the same nationality as the stayer breaches the EC Treaty's prohibition of discrimination on grounds of nationality. It was stated that Articles 12, 39 and 49 EC Treaty have in common the

⁸⁸⁷ P. Craig and G. De Burca (n 12) 277. The contribution of *Defrenne* to the liberalization of the direct effect of Treaty articles as endorsed by *Van Gend & Loos* is significant. Treaty articles which were less clear and unconditional could also have direct effect. D. Chalmers A. Tomkins (n 259) 369.

⁸⁸⁸ Case 43/75 *Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena*. [1976] ECR 455. para. 40.

⁸⁸⁹ Case 43/75 *Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena*. [1976] ECR 455. para. 37-38.

⁸⁹⁰ Case 36/74 *B.N.O Walrave and L.J.N. Koch v Association Union cycliste internationale, Koninklijke Nederlandsche Wielren Unie et Federación Española Ciclismo*. [1974] ECR 1405 para. 16-17.

prohibition, in their respective spheres of application, of any discrimination on grounds of nationality. The ECJ upheld that the prohibition of such discrimination does not only apply to the action of State bodies but includes rules seeking to regulate in a collective manner gainful employment and the provision of services. These private bodies act in a quasi-legislative role, when they regulate collectively some professional activities. In a subsequent case, *Dona*⁸⁹¹, the ECJ stated that Articles 39 and 49⁸⁹² enjoy horizontal effect and the domestic courts must ensure that the rules of sporting associations are not discriminatory on grounds of nationality.

In *Bosman*⁸⁹³, the ECJ confirmed its previous approach in *Walrave* regarding horizontality and stated that Article 39 EC Treaty not only applies to the action of public authorities but extends also to the rules of any other nature aimed at regulating gainful employment and the provision of services in a collective manner. The underpinning ground that the abolition as between Member States of obstacles to freedom of movement for persons and to freedom to provide services would be compromised if the abolition of State barriers could be neutralized by obstacles resulting from the exercise of their legal autonomy by associations or organizations not governed by public law, was also repeated in *Bosman*. Exactly the same findings were affirmed once more in *Deliège*⁸⁹⁴ and *Lehtonen*⁸⁹⁵. It seems that this rationale was

⁸⁹¹Case 13/76 *Gaetano Donà v Mario Mantero*. [1976] ECR 1333. E. Stein 'Lawyers, Judges and the making of a Transnational Constitution' [1981] AmJInt'IL 1, 17-20.

⁸⁹²The ECJ's decision, in *van Ameyde*, started from the assumption that private parties can infringe Article 49 EC Treaty. It was stated that in principle it was irrelevant whether the barrier came from measures of public authority or from rules produced by the national insurers' bureaux. However, in this case, the ECJ decided that there was no restriction to Article 49 EC Treaty as there was no discrimination. J. Snell 'Private parties and the free movement of goods and services' in M. Andenas and W.-H. Roth (eds) *Services and Free Movement in EU Law* (OUP, Oxford 2002) 224. Case 90/76 *van Ameyde v S.r.l. Ufficio centrale italiano di assistenza assicurativa automobilisti in circolazione internazionale (UCI)* ECR 1091 paras 28-30.

⁸⁹³Case C-415/93 *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman, Royal club liégeois SA v Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v Jean-Marc Bosman*. [1995] ECR I-4921 paras. 82-83.

⁸⁹⁴C-51/96 and C-191/97 *Deliège v Ligue francophone de judo et disciplines associées ASBL, Ligue belge de judo ASBL, Union européenne de judo (C-51/96) and François Pacquée (C-191/97)* [2000] ECR I-2549 para 47.

crystallized in the case law: if rules of private bodies regulating business activities in a collective manner compromise fundamental objectives of the internal market and neutralise the abolition of public obstacles to trade, then they fall within the scope of the fundamental freedoms.⁸⁹⁶ A further contribution of *Bosman* was that non-discriminatory measures, and not only discriminatory measures, of private regulatory bodies could constitute restrictions to free movement.⁸⁹⁷

In *Haug-Adrion*⁸⁹⁸, the ECJ scrutinized the refusal to grant a bonus to insured persons in Germany who had vehicles registered under customs plates and which mainly concerned nationals of Member States other than Germany or persons not residing in Germany. The application of these tariff conditions in (private) insurance contracts was found not to constitute an infringement of Articles 39, 49 and 54 EC Treaty because they were not discriminatory. Although the ECJ did not refer at all to rules regulating the market in a collective manner, it was argued that the standardised contract terms in the insurance scheme could be considered as comparable to collective agreements.⁸⁹⁹

The next important case which concerned private rules regulating collectively professional activities was *Wouters*⁹⁰⁰. The ECJ stipulated that Articles 43 and 49 EC Treaty apply also to rules which are not public in nature but which are designed to regulate, collectively, self-employment and the provision of services. It also stated that the abolition, as between Member States, of obstacles to freedom of movement for

⁸⁹⁵ Case C-176/96 *Lehtonen and Castors Canada Dry Namur-Braine ASBL v Fédération royale belge des sociétés de basket-ball ASBL (FRBSB)* [2000] ECR I-2681 para 35.

⁸⁹⁶ J. Baquero Cruz (n 860) 607. See an interesting research on the available remedies for compensation in case of 'horizontal liability' of private bodies regulating collectively economic activities (these private bodies could breach EC law and could cause damage to individuals): N. Reich 'Horizontal liability in EC law: Hybridization of remedies for compensation in case of breaches of EC rights' [2007] CMLRev. 705.

⁸⁹⁷ S. Van Den Bogaert 'Horizontality: The Court attacks?' in C. Barnard and J. Scott (eds) *The Law of the Single European Market* (Hart, Oxford 2002) 127.

⁸⁹⁸ Case 251/83 *Haug-Adrion v Frankfurter Versicherungs-AG* [1984] ECR 4277 paras 14-18.

⁸⁹⁹ S. Van Den Bogaert (n 897) 126.

⁹⁰⁰ Case C-309/99 *J. C. J. Wouters*, [2002] ECR I-1577.

persons would be compromised if the abolition of State barriers could be neutralised by obstacles resulting from the exercise of their legal autonomy by associations or organisations not governed by public law.⁹⁰¹

The horizontal effect of the Treaty articles on free movement of persons were extended in *Angonese*⁹⁰². Article 39 EC Treaty is binding on private parties (e.g. employers) with regard to employment contracts and other conditions.⁹⁰³ It was acknowledged that the principle of equality provided by Article 39 EC Treaty catches the actions of private persons not only in situations concerning collective regulation of the relevant sphere of employment or services.⁹⁰⁴ The ECJ examined Article 39 EC Treaty by reference to *Defrenne*. It held that the fact that certain provisions of the Treaty are formally addressed to the Member States does not prevent rights from being conferred at the same time on any individual who has an interest in compliance with the obligations thus laid down and that, in relation to a provision of the Treaty which was mandatory in nature, the prohibition of discrimination applied equally to all agreements intended to regulate paid labour collectively, as well as to contracts between individuals.⁹⁰⁵ Article 39⁹⁰⁶ EC Treaty is a specific application of the general prohibition of nationality discrimination of Article 12⁹⁰⁷ EC Treaty and together with Article 141 EC Treaty seek to ensure that there is no discrimination in the labour

⁹⁰¹ Case C-309/99 *J. C. J. Wouters*, [2002] ECR I-1577 para 120.

⁹⁰² Case C-281/98 *Roman Angonese v Cassa di Risparmio di Bolzano SpA* [2000] ECR I-4139.

⁹⁰³ P. Oliver and W.-H. Roth (n 868) 423.

⁹⁰⁴ D. A. Wyatt and A. Dashwood (n 46) 153.

⁹⁰⁵ Case 43/75 *Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena*. [1976] ECR 455 paras 31,39; Case C-281/98 *Roman Angonese v Cassa di Risparmio di Bolzano SpA* [2000] ECR I-4139. para 34.

⁹⁰⁶ Case 167/73 *Commission v France*. [1974] ECR 359 Paras. 43-48

⁹⁰⁷ In *Ferlini*, the ECJ moved a little bit forward by declaring that Article 12 EC Treaty binds private organizations exercising 'a certain power' over individuals. It stated that Article 12 EC Treaty applies in situations where a private group or organization exercises a certain power over individuals and is in a position to impose on them conditions which adversely affect the exercise of the fundamental freedoms guaranteed under the Treaty (see, to that effect, Case 36/74 *Walrave* [1974] ECR 1405; Case 43/75 *Defrenne* [1976] ECR 455; and Case C-415/93 *Bosman* [1995] ECR I-4921). Case C-411/98 *Ferlini v Centre hospitalier de Luxembourg* [2000] ECR I-8081 para. 50. P. Oliver and W.-H. Roth (n 868) 422.

market.⁹⁰⁸ It is quite odd that the ECJ based its reasoning on *Walrave and Koch* and on *Bosman* because this case did not concern rules aimed at regulating in a collective manner gainful employment.⁹⁰⁹

Nevertheless, the ECJ restricted the horizontal effect of Article 39 EC Treaty to discriminatory situations on the basis of nationality and did not include non-discriminatory barriers (*Bosman*). If horizontality was extended into non-discriminatory situations, the contractual freedom of private parties would be unduly restricted.⁹¹⁰ It should be brought in mind that *Bosman* and *Lehtonen* dealt with non-discriminatory rules of private regulatory bodies which constitute non-discriminatory restrictions on free movement of workers. This could potentially result in a differentiated treatment of private persons, undertakings, associations and organizations. If regulatory measures of a collective character coming from private regulatory bodies were non-discriminatory, they would be prohibited. Terms and conditions of agreements, contracts and other regulatory actions of individuals would be prohibited only as long as they were discriminatory on grounds of nationality.⁹¹¹

Another development that took place in *Angonese* is that the terms and conditions of a contract⁹¹² could constitute barriers to free movement of workers. The prohibition of discrimination applied equally to all agreements intended to regulate paid labour collectively, as well as to contracts between individuals. A condition in a contract which is not of a collective nature could also inhibit free movement of workers; this is a significant evolution. Nevertheless, the significance of collective agreements in the area

⁹⁰⁸ Case C-281/98 *Roman Angonese v Cassa di Risparmio di Bolzano SpA* [2000] ECR I-4139, para 35.

⁹⁰⁹ A. Dashwood 'Viking and Laval: Issues of Horizontal Direct Effect' [2008] CYELS (Hart, Oxford 2008) 530.

⁹¹⁰ D. A. Wyatt and A. Dashwood (n 46) 709.

⁹¹¹ P. Oliver and W.-H. Roth (n 868) 423, 426.

⁹¹² This expansion of the horizontal direct effect also grants the extension of the scope of party autonomy and private initiative at cross-border level. The autonomy of forming contracts and shaping their contents are now protected against discrimination. P.M. Muller-Graff 'Basic Freedoms-Extending Party Autonomy across Borders' in S. Grundmann, W. Kerber, S. Weatherill (eds) *Party Autonomy and the Role of Information in the Internal Market* (de Gruyter, Berlin 2001) 137.

of industrial relations should not be underestimated. A collective agreement could also have a more general application and be binding, or produce effects, on third parties which, for example, are not members of the participant trade unions. AG Fennelly argued that, where a collective agreement is attended by such consequences, whether by operation of law or through its approval by a public body, it should be deemed to be a law, regulation or administrative provision capable of regulating a professional activity. The fact that the State may not control the exact content of such agreements, in the absence of an overriding legislative measure, does not reduce their public and normative character.⁹¹³

Another case which is based on the conclusions of *Angonese* is *Raccanelli*⁹¹⁴. It was confirmed that Article 39 EC Treaty is a specific application of Article 12 EC Treaty and applies equally to all agreements intended to regulate paid labour collectively, as well as to contracts between individuals. Additionally, a private-law association, such as the research institute into question, must observe the principle of non-discrimination on grounds of nationality in relation to workers within the meaning of Article 39 EC Treaty.⁹¹⁵ Like in *Angonese* and *Ferlini*, this private body enjoys a certain degree of dominance in a horizontal relation, exercises a certain power over individuals and is capable of imposing certain conditions affecting their right to exercise the fundamental freedoms.⁹¹⁶ If a private body concentrates these characteristics, it could definitely breach Article 39 EC Treaty.

⁹¹³ Opinion of Mr Advocate General Fennelly Case C-234/97 *Teresa Fernández de Bobadilla v Museo Nacional del Prado*. [1999] ECR I-4773 paras 23-24.

⁹¹⁴ Case C-94/07 *Andrea Raccanelli v Max-Planck-Gesellschaft zur Förderung der Wissenschaften eV*, nry.

⁹¹⁵ Case C-94/07 *Andrea Raccanelli v Max-Planck-Gesellschaft zur Förderung der Wissenschaften eV*, nry. para. 45, 48.

⁹¹⁶ S. Prechal and S. De Vries 'Seamless web of judicial protection in the internal market?' [2009] ELRev. 5, 15-16.

As far as the justification of these restrictions is concerned, individuals could invoke the exceptions of Article 39(3) EC Treaty and the judicially-developed mandatory requirements in the general interest. The ECJ had clearly stated, in *Bosman*, that there is nothing to preclude individuals from relying on justifications on grounds of public policy, public security or public health and that neither the scope nor the content of those grounds of justification is in any way affected by the public or private nature of the rules in question.⁹¹⁷ This might be possible when a private body regulates conditions of employment or of a professional activity and conduct a quasi-public function.⁹¹⁸ However, the judicially-developed mandatory requirements are public in their nature and might not fit well into every horizontal relationship. For example, it would be difficult to imagine how a private party could serve the cohesion of national tax system. The mandatory requirements should definitely be adjusted to the nature and the role of individuals. For example, it could be assumed that a private party could possibly serve consumer protection.⁹¹⁹ The same considerations apply to the exceptions of Articles 30 and 46 EC Treaty. The allegation of an individual that it serves these objectives is certainly not convincing. Individuals have not the power and the duty to protect the public interest because they are deemed to act in their self-interest.⁹²⁰

Nevertheless, the ECJ's approach towards certain Treaty articles does not mean that every Treaty article has both horizontal and vertical direct effect. The specific objective and the broader context of the Treaty article play a decisive role in this conferral of horizontal and vertical direct effect. With regard to Treaty articles capable of direct effect, Member States have a legal obligation to give direct effect to provisions that are

⁹¹⁷ Case C-415/93 *Bosman*, [1995] ECR I-4921 paras. 85-86.

⁹¹⁸ J. Snell (n 892) 231.

⁹¹⁹ J. Snell (n 892) 232

⁹²⁰ R. Lane 'The internal market and the individual' in N.N. Shuibhne *Regulating the Internal Market* (Elgar, Cheltenham 2006) 273.

suitable for direct effect. The assessment whether a specific Treaty article is suitable is an EC law matter which must be decided by the ECJ.⁹²¹ If it is reasonably feasible for a national court to apply a certain Treaty article to a specific case, then this Treaty article is capable of direct effect.⁹²² A Treaty article which has met the conditions of direct effect is capable of judicial adjudication but the court has to decide whether it is applicable to the pending case. The application of the provision to a certain relationship is really crucial. Legal effects are not derived from inherent qualities of EU law but are the result of the interpretation and application of a rule to a concrete situation.⁹²³ Additionally, AG Van Gerven suggested that the ECJ should look if the Treaty articles are sufficiently operational in themselves to be applied by a national court in a specific situation.⁹²⁴

The different approach of the ECJ's case law to the horizontal effect of the free movement of goods and to the horizontal effect of free movement of persons reflects the difference balancing in these fields. Whereas the free movement of persons covers private individual restrictions, the free movement of goods does not (*Dansk Supermarked* was an exception).⁹²⁵ This enhanced protection granted to persons is justified not only by the wording of Article 39 EC Treaty but also by the importance of employment and persons as societal values bearing more weight in Member States' legislation. The relationship between an employer and an employee is not considered to

⁹²¹ T.C. Hartley *European Union Law in a Global Context* (CUP, Cambridge 2004) 156.

⁹²² For the stance of some Member States' courts towards direct effect and supremacy, see: T.C. Hartley (n 921) 156, 157-165.

⁹²³ P. Eleftheriadis 'The Direct effect of Community Law: Conceptual Issues' [1996] YEL 205, 212. J. Baquero Cruz *Between Competition and Free Movement, The Economic Constitutional Law of the European Community* (Hart, Oxford-Portland 2002) 107.

⁹²⁴ Opinion of Mr Advocate General Van Gerven Case C-128/92 *H. J. Banks & Co. Ltd v British Coal Corporation* [1994] ECR I-1209. J. Lever 'Mutual Permeation of Community and National Tort Rules' in J. Wouters, J. Stuyck and T. Kruger (eds) *Principles of Proper Conduct for Supranational, State and Private Actors in the European Union: Towards Ius Commune* (Intersentia, Groningen 2001) 106-107.

⁹²⁵ G. Davies *Nationality Discrimination in the European Internal Market* (Kluwer, The Hague 2003) 168.

be a fully private matter as the relationship between buyer and seller of goods and in many Member States employment is regulated by public law rules.⁹²⁶ This special interest of Member States in the relationship between an employer and an employee is based on the potential imbalance of power.⁹²⁷

The spillover of horizontality from workers to services is founded on their common connection with persons.⁹²⁸ This expansion has also taken place in the area of freedom of establishment. The analogy between Articles 39 and 141 EC Treaty⁹²⁹ can be transposed to Article 43 EC Treaty as Article 43 EC Treaty is also mandatory in nature, provides a fundamental freedom and applies the general prohibition of discrimination contained in Article 12 EC Treaty. AG Mayras suggested, in *van Binsbergen*, that the principle of equal treatment on grounds of nationality in Article 12 EC Treaty is the basis of the Treaty articles on workers, establishment and services alike.⁹³⁰ Article 43 EC Treaty is open to adopt the analogy between Articles 39 and 141 EC Treaty because the social objectives of Article 141 are also met in the freedom of establishment (yet, in the area of self-employed activities).⁹³¹

⁹²⁶ G. Davies (n 925) 168.

⁹²⁷ G. Davies (n 925) 168.

⁹²⁸ G. Davies (n 925) 168.

⁹²⁹ See *Angonese*.

⁹³⁰ S. Van Den Bogaert (n 897) 148-149. Opinion of Mr Advocate General Mayras Case 33/74 *van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid* [1974] ECR 1299.

⁹³¹ S. Van Den Bogaert (n 897) 149.

CHAPTER 16

HORIZONTALITY AFTER *VIKING* AND *MANGOLD*.

16.1) Horizontality after *Viking*.

The ECJ's ruling in *Viking*⁹³² confirmed the ECJ's previous case law on the horizontal effect of Articles 39, 43 and 49 EC Treaty. Its major contribution is that the horizontal effect of Articles 43 and 49 EC Treaty had been expanded and covers collective action of trade unions (e.g. strikes, boycotts etc).⁹³³ With regard to the factual background of *Viking*, Viking was a Finnish maritime firm owning a ferry, the *Rosella*, which operated between Helsinki and Tallin. The *Rosella* sailed under the Finish flag (is registered in Finland) and most of its employees are Finnish.⁹³⁴ The Finnish firm planned to re-register the *Rosella* in Estonia due to economic considerations. If its vessel was registered in Estonia, it could employ employees under much lower wages. The International Transport Workers' Federation (ITF) has a long-standing and well-known campaign against the use of flags of convenience.⁹³⁵ ITF and the Finnish Seamen Union which is affiliated to ITF took industrial action against Viking with a view to prevent the imminent re-flagging.

⁹³² Case C-438/05 *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti*. [2007] ECR I-10779

⁹³³ D. A. Wyatt 'Horizontal effect of fundamental freedoms and the right to equality after *Viking* and *Mangold*, and the implications for Community competence' [2008] CYELP 1, 1.

⁹³⁴ A.C.L. Davies 'The right to strike versus freedom of establishment in EC Law: The battle commences' [2006] ILJ 75, 75.

⁹³⁵ Flag of convenience means the use of the flag of one country (typically with lower labour standards) by a beneficial owner situated in another country. A.C.L. Davies (n 934) 75.

The ECJ decided that Article 43 EC Treaty is to be interpreted as meaning that, in principle, collective action initiated by a trade union or a group of trade unions against a private undertaking in order to induce that undertaking to enter into a collective agreement, the terms of which are liable to deter it from exercising its freedom of establishment, is not excluded from the scope of that article.⁹³⁶ Moreover, Article 43 EC Treaty is capable of conferring rights on a private undertaking which may be relied on against a trade union or an association of trade unions.⁹³⁷ As a matter of fact, Article 43 EC Treaty is to be interpreted to the effect that collective action such as that at issue in the main proceedings, which seeks to induce a private undertaking whose registered office is in a given Member State to enter into a collective work agreement with a trade union established in that State and to apply the terms set out in that agreement to the employees of a subsidiary of that undertaking established in another Member State, constitutes a restriction within the meaning of that article.⁹³⁸ The collective action in question makes less attractive, or even pointless, as the national court has pointed out, Viking's exercise of its right to freedom of establishment, inasmuch as such action prevents both Viking and its subsidiary from enjoying the same treatment in the host Member State as other economic operators established in that State.⁹³⁹ That restriction may, in principle, be justified by an overriding reason of public interest, such as the protection of workers, provided that it is established that the restriction is suitable for ensuring the attainment of the legitimate objective pursued and does not go beyond what is necessary to achieve that objective.⁹⁴⁰

⁹³⁶ Case C-438/05 *Viking* [2007] ECR I-10779 paras 55.

⁹³⁷ Case C-438/05 *Viking* [2007] ECR I-10779 paras 66.

⁹³⁸ Case C-438/05 *Viking* [2007] ECR I-10779 paras 90. See also: N. Reich 'Free Movement v. Social Rights in an Enlarged Union- the *Laval* and *Viking* Cases before the ECJ' [2008] GerLJ 125, 136, S. Sciarra 'Viking and Laval: Collective Labour Rights and Market Freedoms in the Enlarged EU' [2008] CYELS (Hart, Oxford 2008) 563.

⁹³⁹ Case C-438/05 *Viking* [2007] ECR I-10779 paras 72.

⁹⁴⁰ Case C-438/05 *Viking* [2007] ECR I-10779 paras 90.

The ECJ held that the collective action in question which tries to induce an undertaking to accept the demands of trade unions and which is liable to deter this undertaking from exercising its freedom of establishment falls within the scope of freedom of establishment.⁹⁴¹ This conclusion was based the fact that Articles 39, 43 and 49 EC Treaty do not apply only to the regulations of public bodies but include also rules of any other nature aimed at regulating in a collective manner gainful employment, self-employment and the provision of services. The ECJ referred to its previous case law on the regulation of professional activities by private bodies in a collective manner.⁹⁴² It was stated that the organisation of collective action by trade unions must be regarded as covered by the legal autonomy which those organisations, which are not public law entities, enjoy pursuant to the trade union rights accorded to them, *inter alia*, by national law.⁹⁴³ The collective action taken by the trade unions against Viking could be characterized as integral to a process of collective regulation of an economic activity.⁹⁴⁴ Trade unions could participate in the regulation of the labour market by way of collective agreements. Their negotiating position is strengthened by the possibility of collective action.⁹⁴⁵ The ECJ found that the regulatory role of trade unions is broadly analogous to that of private bodies regulating professional activities in a collective way because the collective action taken by the trade unions could inhibit establishment or the provision of services to another Member State.⁹⁴⁶ Nevertheless, the ECJ did not comment on the fact that this case concerned a phase before the

⁹⁴¹ Case C-438/05 *Viking* [2007] ECR I-10779 paras 55. The Commission in its submission argues that Article 43 EC Treaty does not have horizontal direct effect, so as to grant rights on a private undertaking which may be invoked against a trade union. B. Bercusson 'The Trade Union Movement and the European Union: Judgement Day' [2007] ELJ 279, 288.

⁹⁴² Case C-438/05 *Viking* para 33, Case 36/74 *Walrave and Koch* para. 17, Case 13/76 *Donà*, para. 17, *Bosman*, para. 82; Joined Cases C-51/96 and C-191/97 *Deliège* para. 47, Case C-281/98 *Angonese* para. 31 and Case C-309/99 *Wouters* para. 120

⁹⁴³ Case C-438/05 *Viking* para 35.

⁹⁴⁴ A. Dashwood (n 909) 536.

⁹⁴⁵ A. Dashwood (n 909) 539. See also: B. Bercusson 'Trade union rights in EU law' in F. Snyder (ed) *The Europeanisation of Law: The Legal Effects of European Integration* (Hart, Oxford 2000) 202-205.

⁹⁴⁶ A. Dashwood (n 909) 539.

introduction of those collective rules; trade unions were taking industrial action against Viking in order to convince it to accept a certain collective agreement.⁹⁴⁷

Additionally, the argument that the same subject matters are often regulated by rules of different nature in the various Member States was reiterated. For example, working conditions in the various Member States are regulated either by provisions laid down by law or regulation or by collective agreements and other acts concluded or adopted by private persons. If these regulations concluded or adopted by private persons fell outside the scope of the freedom of establishment, it would probably result in unequal situations.⁹⁴⁸ The analogy with collective action is easily drawn. If collective action did not fall within the scope of the fundamental freedoms, the power to invoke fundamental freedoms would differ from one Member State to another depending on the regulatory choices and the intensity of national laws. Member States could evade the application of the fundamental freedoms by adjusting their laws accordingly.⁹⁴⁹

Finally, the arguments of the International Transport Workers' Federation and of the Finnish Seamen's Union that the approach in *Albany*⁹⁵⁰ must be applied by analogy to *Viking*, because certain obstacles to freedom of establishment and freedom to provide services are inherent in collective action taken in the context of collective negotiations,

⁹⁴⁷ S. Prechal and S. De Vries (n 916) 14.

⁹⁴⁸ Case C-438/05 *Viking* para. 33, *Walrave and Koch* para. 19; *Bosman*, para. 84, *Angonese*, para. 33.

⁹⁴⁹ T. Blanke 'Three steps of reflections regarding the Viking and Laval case: Towards an effective European right to strike' in F. Pennings and others (eds) *Social Responsibility in Labour Relations* (Kluwer, AH Alpen aan den Rijn 2008) 504.

⁹⁵⁰ In *Albany*, the ECJ stated that it is beyond question that certain restrictions of competition are inherent in collective agreements between organisations representing employers and workers. However, the social policy objectives pursued by such agreements would be seriously undermined if management and labour were subject to Article 85(1) EC Treaty when seeking jointly to adopt measures to improve conditions of work and employment. It therefore follows from an interpretation of the provisions of the Treaty as a whole which is both effective and consistent that agreements concluded in the context of collective negotiations between management and labour in pursuit of such objectives must, by virtue of their nature and purpose, be regarded as falling outside the scope of Article 85(1) EC Treaty. Case C-67/96 *Albany International* [1999] ECR I-05751 para 59-60. See also: T. Novitz 'Labour rights as human rights: implications for employers' free movement in an enlarged European Union' [2007] CYELS 377.

was not endorsed by the ECJ.⁹⁵¹ This analogy is rejected due to the lack of the inherent effect of the collective action on the fundamental freedoms.⁹⁵² The exclusion of an analogy with *Albany* and the application of the fundamental freedoms mean that whenever there appears to be an intra-Community aspect to an industrial dispute, the collective action taken by the trade unions could be challenged before the courts. This is certainly an important change for established domestic systems of industrial relations.⁹⁵³ Future litigation will only show its impact on these industrial relations systems.

Then, the horizontal direct effect of Article 43 EC Treaty was examined. Article 43 EC Treaty was found to be capable of conferring rights on a private undertaking which may be relied on against a trade union or an association of trade unions. The first argument of the ECJ referred to the sources of possible trade barriers and could be characterized as a policy consideration.⁹⁵⁴ A dichotomy between obstacles deriving from public law bodies or from private law bodies would weaken significantly the effective exercise of the fundamental freedoms. In accordance with the previous case law, it was decided that the abolition of obstacles to freedom of movement for persons and freedom to provide services would be compromised if the abolition of State barriers could be neutralised by barriers resulting from the exercise, by associations or organisations not governed by public law, of their legal autonomy.⁹⁵⁵ This approach

⁹⁵¹ Case C-438/05 *Viking* paras 48-49. N. Reich “‘Widening’ vs. ‘Deepening’ The European Union: Free Movement vs. Social Rights in the Laval Case before the ECJ” in S. Blockmans and S. Prechal (eds) *Reconciling the Deepening and Widening of the European Union* (Asser, The Hague 2007) 33. B. Bercusson (n 941) 282.

⁹⁵² Case C-438/05 *Viking* paras 49-52.

⁹⁵³ T. Novitz ‘A clash in EC Treaty priorities’ (2007) 6 CLI 13, 14.

⁹⁵⁴ D. A. Wyatt (n 933) 5.

⁹⁵⁵ Case C-438/05 *Viking* paras 57. It was argued that applying horizontal direct effect of the fundamental freedoms to restrictions and not only to discriminatory behaviour on grounds of nationality constitutes a disproportionate interference with the exercise of the private autonomy of individuals. S. Prechal and S. De Vries (n 916) 18.

does not allow Member States to circumvent the application of the scope of Treaty articles by determining the private/public character of the regulatory body.

The next proposition was based on *Defrenne*⁹⁵⁶. Rights could still be conferred on individuals having an interest in compliance with the obligations thus laid down, even if these specific Treaty articles are addressed to the Member States. It was also stated that the prohibition on prejudicing a fundamental freedom laid down in a provision of the Treaty that is mandatory in nature, applies in particular to all agreements intended to regulate paid labour collectively.⁹⁵⁷ It was finally concluded these considerations must also apply to Article 43 EC Treaty which lays down a fundamental freedom.⁹⁵⁸ The ECJ also found that, in this present case, the collective action taken by the two trade unions tries to induce Viking to conclude an agreement which is meant to regulate the work of Viking's employees collectively, and, that those two trade unions are organisations which are not public law entities but exercise the legal autonomy conferred on them, *inter alia*, by national law.⁹⁵⁹ Nevertheless, the ECJ omitted to mention a very important aspect of *Defrenne*; the reference to 'Member States' in Article 141 EC Treaty encompasses the judicial as well as the legislative authorities of the Member States. AG Maduro notes that this aspect of *Defrenne* could support the horizontal effect of Treaty articles.⁹⁶⁰

An additional basis underpinning this conclusion on horizontality of freedom of establishment was the reference to its previous case law on free movement of goods. According to *Commission v France* and to *Schmidberger*, the Member States were responsible for the trade barriers caused by individuals because they failed to take all

⁹⁵⁶ Case 43/75 *Defrenne* paras 31,39.

⁹⁵⁷ Case C-438/05 *Viking* para .58.

⁹⁵⁸ Case C-438/05 *Viking* para .59.

⁹⁵⁹ Case C-438/05 *Viking* para. 60.

⁹⁶⁰ Case C-438/05 Opinion of Mr Advocate General Poiares Maduro *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti*. [2007] ECR 2007 I-10779 para 40. D. A. Wyatt (n 933) 6.

the necessary measures in order to prevent the actions of these individuals. Restrictions could also derive from actions of individuals or groups of such individuals rather than caused by the State.⁹⁶¹ The ECJ invokes its previous case law on free movement of goods⁹⁶² in order to strengthen the conclusion that Article 43 EC Treaty is capable of conferring rights on a private undertaking which may be relied on against a trade union or an association of trade unions. This reference to its previous case law is quite odd because the factual background of these cases had to do with State inaction.⁹⁶³

AG Maduro pondered over this point and adopted a much broader view. He suggests that constitutional rights should be given binding force for the judiciary when adjudicating a case between private parties. Thus, constitutional rights could enjoy normative force in horizontal relations. Moreover, it was stated that constitutional rules that are addressed to the State translate into legal rules applying between private parties, illustrating that the government is the third party to every private suit and is so in the very form of the law and the judge who administers it.⁹⁶⁴ AG Maduro also discussed the potential differences between, indirect horizontal effect and direct horizontal effect and found that there were not any substantial differences. He contended that the fact that there are no differences explains why the ruling in *Defrenne* is considered as having recognised the ‘direct horizontal effect’ of Article 141 EC Treaty, even though the Court construed the horizontal effect of that provision as a duty on the national courts.⁹⁶⁵ The suggestion that there is no difference between indirect

⁹⁶¹ Case C-438/05 *Viking* paras 62, Case C-265/95 *Commission v France* para. 30, and Case C-112/00 *Schmidberger* paras 57, 62. See also T. Blanke (n 949) 501.

⁹⁶² While in *Commission v France* and *Schmidberger*, the traders cannot exercise at all the relevant fundamental freedom, Viking can always run its ferry under the new flag with reduced profits. Viking continued to run its ferry for more than four years following protracted negotiations with the trade unions. N. Reich (n 938) 154.

⁹⁶³ A. Dashwood (n 909) 532.

⁹⁶⁴ Case C-438/05 Opinion *Viking* para 39.

⁹⁶⁵ Case C-438/05 Opinion *Viking* para 40. N. Reich does not agree that indirect horizontal effect and direct horizontal effect present any similarities. N. Reich (n 938) 153. See also: G. Orlandini ‘Right to

horizontal effect and direct horizontal effect was founded on the alleged equivalence between granting a right by way of an action against public authorities for their inaction and giving the same right to be directly invoked against the individuals responsible for the interference.⁹⁶⁶ This equivalence seems to indicate that a private action alleging an infringement of a fundamental freedom could be brought against individual protesters or the organizers of a strike.⁹⁶⁷ It is very difficult to accept this suggestion. In general, this approach of AG Maduro constitutes a rather broad interpretation which was not followed by the ECJ, yet the ECJ does cite *Defrenne*.⁹⁶⁸ The ECJ had used its previous case law on free movement of goods in order to boost its reasoning in the area of freedom of establishment. However, broader approaches should be avoided as the factual background in the free movement of goods cases and *Viking* is different. Any generalizations should be adopted carefully.

The ECJ also addressed the issue of the bodies producing the regulations. It did not accept that the horizontal direct effect applies only to quasi-public organisations or to associations exercising a regulatory task and having quasi-legislative powers.⁹⁶⁹ It stated that there is no indication in that case-law that could validly support the view that it applies only to associations or to organisations exercising a regulatory task or having quasi-legislative powers.⁹⁷⁰ Furthermore, it was held that, in exercising their autonomous power, pursuant to their trade union rights, to negotiate with employers or professional organisations the conditions of employment and pay of workers, trade unions participate in the drawing up of agreements seeking to regulate paid work

Strike, Transnational Collective Action and European Law: Time to move on?' [2007] The Jean Monnet Working Paper Series No 8/07, 15-18.

⁹⁶⁶ A. Dashwood (n 909) 532-533.

⁹⁶⁷ A. Dashwood (n 909) 532-533. For an interesting perspective on damages claims raised against trade unions for breach of Articles 43 and 49 EC Treaty, see: K. Apps 'Damages claims against trade unions after *Viking* and *Laval*' [2009] ELRev. 141.

⁹⁶⁸ D. A. Wyatt (n 933) 7-8. The ECJ might have adopted deliberately such an ambiguous stance on this matter.

⁹⁶⁹ Case C-438/05 *Viking* paras 64. A. Dashwood (n 909) 536.

⁹⁷⁰ Case C-438/05 *Viking* paras 65.

collectively.⁹⁷¹ Therefore, it is clear the intention of the ECJ was not to restrict horizontal effect to regulations coming from ‘formal’ private regulators such as sports federations or professional supervisory bodies.⁹⁷²

Pure private bodies could also breach the fundamental freedoms if they substitute the State as a regulator in the relevant parts of the market. Even if the public element is missing completely from a regulatory body, it could still be caught by the horizontal effect of Treaty articles. If private parties were treated differently from State, this would create an anomaly in the market and would allow the possibility of evasion of the application of the fundamental freedoms; Member States could simply delegate their legislative powers to private bodies or organizations. Other market participants who are not formally regulators could also interfere and inhibit the effective exercise of fundamental freedoms (e.g. the protesters in *Commission v France*).

It is relevant to mention here that AG Maduro discussed the private action which falls within the scope of fundamental freedoms. The horizontal effect would follow logically from the Treaty where it would be necessary in order to enable market participants throughout the Community to have equal opportunities to gain access to any part of the common market.⁹⁷³ He argues that the rules on freedom of movement cannot always be brought into play in proceedings against a private individual. He analysed the inherent characteristics of State actions; these characteristics add more potential to the State to impede market integration than individuals.⁹⁷⁴ The weakness of individuals to regulate market access in comparison with the State was further

⁹⁷¹ Case C-438/05 *Viking* paras 65.

⁹⁷² D. A. Wyatt (n 933) 8. Private law making constitutes a central and expanding feature of EU law. Some types of norms are introduced by private parties. This results in a ‘privatisation’ of the legislative process. The Community institutions play an indirect role in this private law making (review, mandate, monitoring, organization, recognition, reference in legal statutes, legal benefits) in order to make this private legislative process more effective and beneficial. D. Chalmers ‘Private power and public authority in European Union law’ *CYELS* (Hart, Oxford 2006) 59-60.

⁹⁷³ Case C-438/05 Opinion *Viking* para 35.

⁹⁷⁴ Case C-438/05 Opinion *Viking* para 41.

discussed by AG Maduro. In his opinion, it was stated that by contrast, in many circumstances private actors simply do not wield enough influence successfully to prevent others from enjoying their rights to freedom of movement.⁹⁷⁵ He gave an example in order to clarify his view: the case of an individual shopkeeper who refuses to purchase goods from other Member States would not be liable to obstruct the functioning of the common market.⁹⁷⁶ This individual shopkeeper would not possess sufficient power to influence the market access of foreign suppliers. Alternative marketing channels would always be available to foreign suppliers and the competitive behaviour of other shopkeepers would ‘punish’ this shopkeeper. In our example, this kind of action does not fall within the horizontal effect of the Treaty articles. Hence, he asserts that the rules on freedom of movement apply directly to any private action that is capable of effectively restricting others from exercising their right to freedom of movement.⁹⁷⁷ Nevertheless, AG Maduro was not absolutely sure of how one should determine whether that is the situation. He admits that the ECJ had proceeded very carefully, on a case-by-case basis in the recognition of the horizontal direct effect of the fundamental freedoms.⁹⁷⁸ Finally, he concluded that the provisions on freedom of movement apply to private action that, by virtue of its general effect on the holders of rights to freedom of movement, is capable of restricting them from exercising those rights, by raising an obstacle that they cannot reasonably circumvent.

The opinion of AG Maduro urges us to contemplate the characteristics of the ‘situation’ where actions of an individual restrict other individuals from exercising their right to freedom of movement. If the basic elements of this ‘situation’ would be tracked

⁹⁷⁵ Case C-438/05 Opinion *Viking* para 42.

⁹⁷⁶ Case C-438/05 Opinion *Viking* para 42.

⁹⁷⁷ Case C-438/05 Opinion *Viking* para 43. C. Barnard ‘Viking and Laval: An introduction’ [2008] CYELS (Hart, Oxford 2008) 470-471. A Dashwood criticizes the ambiguousness of this ‘action’/‘conduct’ restricting the exercise of fundamental freedoms through an obstacle that it cannot be reasonably circumvented. A. Dashwood (n 909) 534.

⁹⁷⁸ Case C-438/05 Opinion *Viking* para 43.

down, the case-by-case recognition of the horizontal effect of Treaty articles by the ECJ would be better understood. The notion of normal market behaviour is quite crucial in understanding the basic elements of this 'situation'. A first remark is that the EC fundamental freedoms ensure the right of market operators to pursue cross-border economic and business activities and to compete with other market operators.⁹⁷⁹ Therefore, normal market behaviour of individuals/market operators designed to improve the market position or the economic benefits of this market operator should not in principle constitute a restriction on the fundamental freedom of another market operator.⁹⁸⁰

The previous case law shows clearly that both State and private regulation of the market fall within the scope of the fundamental freedoms. This is justified by the fact that both categories of regulation could control market access and could potentially result in trade barriers. With regard to private regulatory action, discriminatory behaviour by market participants or behaviour which is not normal in market conditions (where the conduct involves an element of regulation of the market) would be caught by the horizontal effect of a fundamental freedom. This kind of behaviour restricts market access of other market participants or consumers and do not allow them to exercise effectively their fundamental freedoms.⁹⁸¹

In these cases, a private party plays the role of the State and regulates the conditions of market access. It is easily understood that this regulatory power exercised by private

⁹⁷⁹ D. A. Wyatt (n 933) 11.

⁹⁸⁰ D. A. Wyatt (n 933) 11.

⁹⁸¹ D. A. Wyatt (n 933) 12. A market access model results in closer scrutiny of national laws, including national employment laws, by the ECJ. In case of a conflict between national law and EC law, this market access test provides an additional solution; the ECJ had found in some cases that this market access model goes too far and that there is no substantial hindrance of market access (Case C-285/01 *Burbaud* [2003] ECR I-8219 and *Deliege*) M. Ronnmar 'Introduction: EU industrial relations v. national industrial relations-conflict, interplay or harmony?' in M. Ronnmar (ed) *EU industrial relations v. National industrial relations* (Kluwer, AH Alpen aan den Rijn 2008) 30-31, C. Barnard 'Employment rights, free movement under the EC Treaty and the services directive' in M. Ronnmar (ed) *EU industrial relations v. National industrial relations* (Kluwer, AH Alpen aan den Rijn 2008) 141-142, 145-146.

parties could potentially restrict market access of other market participants and consumers and could frustrate market integration. Individuals could abuse their power to regulate market access and this would exclude or deter other market operators or consumers from exercising their fundamental freedoms.

However, certain restrictions on competitors are inherent to normal competitive behaviour by market operators. Discriminatory conduct or conduct inconsistent with normal market behaviour might be justified on commercial grounds.⁹⁸² Market behaviour, such as the behaviour of the trade unions in *Viking*, which seeks to preserve the market position of their present members could fall within the scope of normal market behaviour.⁹⁸³ If collective action seeks to develop or to impose additional conditions and not only to preserve the market position of their present members or seeks to protect their future members, this market behaviour might be equivalent to the role of the regulator and might constitute an infringement of the freedom of establishment.

A further consideration to this market access model which was declared by the ECJ is that private actors may often still do things that public authorities may not. Workers are not in the superior position of power which is characteristic of State authorities.⁹⁸⁴ The ECJ stated that the finding that certain private actors are subject to the rules on freedom of movement does not mean automatically the end of their private autonomy and does not necessarily mean that they must be held to exactly the same standards as State authorities. The Court may apply different levels of scrutiny, depending on the source and seriousness of the impediment to the exercise of the right to freedom of

⁹⁸² D. A. Wyatt (n 933) 12.

⁹⁸³ D. A. Wyatt (n 933) 18. It is argued that while the Services Directive does not seek to regulate national employment laws, in cases falling outside the scope of the Services Directive, the fundamental freedoms apply. The interpretation of freedom of establishment in *Viking* shows that there is very little room for legitimate industrial action to interfere with the exercise of the four freedoms. M. Ronnmar (n 981) 31, C. Barnard (n 981) 168.

⁹⁸⁴ T. Blanke (n 949) 504.

movement, and on the force and validity of competing claims of private autonomy.⁹⁸⁵ Private autonomy should always be taken into account when actions of individuals are scrutinized as potential trade barriers. In accordance with the principle of subsidiarity, the national legislature and the domestic courts are responsible for determining the framework of private autonomy.⁹⁸⁶ However, when adjudicating on the dispute thus brought before it, the national court is invited to apply its domestic law in a manner that is consistent with the Treaty rules on freedom of movement. If that is not possible, and domestic law conflicts with the rules on freedom of movement, then the latter will prevail.⁹⁸⁷

An additional consideration is related to the substance of the market behaviour. It was argued that the fundamental freedoms apply to private parties and to trade unions in particular when they exercise regulatory tasks which would otherwise be exercised by the State itself (e.g. setting a minimum wage).⁹⁸⁸ However, when trade unions perform a function that the State cannot perform (e.g. collective bargaining over pay above the minimum laid down by law), this would not normally constitute a barrier to the fundamental freedoms.⁹⁸⁹ With regard to the latter functions, it could be said that they amount to normal market behaviour and that they seek to ameliorate the position of the trade union members in the labour market.

The element of ‘influence’ that AG Maduro mentions does not contribute to legal certainty in this field (‘private actors simply do not wield enough *influence* successfully

⁹⁸⁵ Case C-438/05 Opinion *Viking* para 49. It was argued that the extension of the fundamental right to the demand side of the market blurs the difference between barriers to market access and the autonomy of the individual. Private parties may suffer limitations to their liberty but exceptionally only and always in the framework of the EC Treaty. The ECJ had shown this approach in *Angonese* where it fetters the freedom of an individual (employer) only when it inhibits a worker from exercising his right to free movement. R. Lane (n 920) 271-272.

⁹⁸⁶ T. Blanke (n 949) 504.

⁹⁸⁷ Case C-438/05 Opinion *Viking* para 53.

⁹⁸⁸ P. Syrpis and T. Novitz ‘Economic and Social Rights in Conflict: Political and Judicial Approaches to their Reconciliation’ [2008] ELRev. 411. C. Barnard (n 977)[2008] 472-473.

⁹⁸⁹ P. Syrpis and T. Novitz (n 988) 411. C. Barnard (n 977) 472-473.

to prevent others from enjoying their rights to freedom of movement' (*emphasis added*)⁹⁹⁰). It is not quite clear when a certain action of a private party was large or influential enough for free movement provisions to apply.⁹⁹¹ This suggestion could also have wider effects outside the area of collective action. For example, a distribution agreement between private parties which is lawful under EC competition law, should also be examined under the fundamental freedoms in order to see if this agreement is capable of effectively restricting others from exercising their freedom of movement.⁹⁹² This approach is definitely against the aims of EC competition law.

Another issue that was not touched by the ECJ in *Viking* was the position of individual employees who proceed to collective action.⁹⁹³ If collective action is not supported by the trade unions and is organized by individual employees, will it still be caught by freedom of establishment? The ECJ's reference to *Commission v France* and to *Schmidberger* seems to indicate the actions of individuals not necessarily guided or coordinated by a union or an association fall within the scope of freedom of establishment and are capable of obstructing this fundamental freedom. The position of individual workers having recourse to autonomous collective action is connected to the position of shareholders in a company who decide to take protectionist defensive measures against an imminent takeover bid. This issue will be discussed in a subsequent part.

⁹⁹⁰ Case C-438/05 Opinion *Viking* para 42.

⁹⁹¹ T. Novitz (n 953) 15.

⁹⁹² T. Novitz (n 953) 15.

⁹⁹³ C. Barnard (n 977) 472.

16.2) Horizontality after *Mangold*.

Additionally, the horizontal effect of the fundamental principle of equality as structured by *Mangold*⁹⁹⁴ is very important. The ECJ, in *Mangold*⁹⁹⁵, held that the general principle of equality (this case was about discrimination on grounds of age) is capable of horizontal effect. This conclusion could enhance the horizontal effect of the fundamental freedoms. More specifically, it was held that it is the responsibility of the national court, hearing a dispute involving the principle of non-discrimination in respect of age, which is a general principle of Community law, to provide, in a case within its jurisdiction, the legal protection which individuals derive from the rules of Community law and to ensure that those rules are fully effective, setting aside any provision of national law which may conflict with that law, even where the period prescribed for transposition of a directive based on that general principle, such as Directive 2000/78 establishing a general framework for equal treatment in employment and occupation, has not yet expired.⁹⁹⁶

The general principle of equality⁹⁹⁷ encompasses Article 12 EC Treaty which prohibits discrimination on grounds of nationality. Article 12 EC Treaty applies within

⁹⁹⁴ Case C-144/04 *Mangold v Helm* [2005] ECR I-09981. In *Barber*, AG Van Gerven argued that a provision of international law (the prohibition of sex discrimination included in the relevant UN covenants) could possibly of its own accord apply in a horizontal relationship between private parties. Opinion of Mr Advocate General Van Gerven Case C-262/88 *Barber* [1990] ECR I-1889, para 53.

⁹⁹⁵ Case C-144/04 *Mangold v Helm* [2005] ECR I-09981. S. Prechal 'Enforcement of EC Labour Law: some Less Felicitous Consequences?' in F. Pennings and others (eds) *Social Responsibility in Labour Relations* (Kluwer, AH Alpen aan den Rijn 2008) 17.

⁹⁹⁶ Case C-144/04 *Mangold* para. 75-77. See also: C. Barnard 'Social Policy Revisited in the Light of the Constitutional Debate' in C. Barnard *The Fundamentals of EU Law Revisited: Assessing the Impact of the Constitution Debate* (OUP, Oxford 2007) 138.

⁹⁹⁷ In *Deutsche Post*, the ECJ recognized that equality was also a fundamental right. Joined Cases C-270/97 and C-271/97 *Deutsche Post* [2000] ECR I-929 para. 57. C. Barnard (n 996) 138. Some old but very interesting papers on the position of equality in EU law are the following: G. de Burca 'The role of equality in European Community law', E. Szyzszak 'Building a European constitutional order: prospects for a general non-discrimination standard', S. O'Leary 'The principle of equal treatment on grounds of nationality in Art 6 EC. A lucrative source of rights for Member State nationals' in A. Dashwood and S. O'Leary (eds) *The principle of equal treatment in EC law* (Sweet & Maxwell, London 1997) 13, 35, 105.

the scope of application of this Treaty, and without prejudice to any special provisions contained therein.⁹⁹⁸ These special provisions include the application of the general principle of non-discrimination on grounds of nationality to specific internal market situations in other Treaty articles, e.g. free movement of workers, freedom of establishment and freedom to provide services. With regard to the relationship between this general prohibition and the more specific ones, the ECJ held that the general prohibition of discrimination on grounds of nationality applies independently only to a case for which the EC Treaty does not contain a specific prohibition of discrimination.⁹⁹⁹ This means that Article 12 EC Treaty applies independently where the fundamental freedom in question does not catch the discriminatory behaviour on grounds of nationality. Hence, Article 12 supplements the scope of fundamental freedoms in certain situations not caught by them and contributes to a more complete and stronger protection against discrimination on grounds on nationality.¹⁰⁰⁰ *Mangold* seems to infer that Article 12 EC Treaty could be applied horizontally because it embodies an aspect of the general principle of equality, which the ECJ in this case treats as having horizontal direct effect.¹⁰⁰¹

Mangold was criticized by many Advocate Generals in their opinions.¹⁰⁰² This case was considered to be inconsistent with the legal framework of horizontality. The

⁹⁹⁸ Case C-309/89 *Codorniu* [1994] ECR I-1853, para. 26. D. A. Wyatt (n 933) 12.

⁹⁹⁹ Case 305/87 *Commission v Greece* [1989] ECR 1461 para 13. D. A. Wyatt (n 933) 13.

¹⁰⁰⁰ D. A. Wyatt (n 933) 13.

¹⁰⁰¹ D. A. Wyatt (n 933) 13. S. Prechal and S. De Vries use a fundamental rights model. They think that the horizontal direct effect of Article 12 EC Treaty as well as the horizontal direct effect of the more specific prohibitions of discrimination on grounds of nationality contained in the fundamental freedoms are based on this fundamental rights approach. However, this fundamental rights approach does not underpin the prohibition of restriction but applies only to discrimination on grounds of nationality. S. Prechal and S. De Vries (n 916) 17-18.

¹⁰⁰² Nevertheless, some authors welcome this ruling by analysing it in the light of the hierarchy of norms. They did not consider as something surprising that the general principles of EU law can have direct effect and can apply to a horizontal relationship. J. Jans 'The effect in national legal systems of the prohibition of discrimination on grounds of age as a general principle of Community law' [2007] LIEI 53, 59, 66, 62. X. Groussot and H.H. Lidgard 'Are there general principles of Community law affecting private law?' in U. Bernitz and others (eds) *General Principles of EC Law in a Process of Development* (Kluwer, AH Alpen aan den Rijn 2008) 173.

opinion of AG Sharpston in *Bartsch*¹⁰⁰³ reveals the substantial extent of this criticism. She refers to the opinion of AG. Geelhoed in Case C-13/05 *Chacon Navas*, herself in Case C-227/04 P *Lindorfer*, AG Mazak in Case C-411/05 *Palacios de la Villa* and AG Ruiz-Jarabo Colomer in Case C-267/06 *Maruko*.¹⁰⁰⁴ AG Sharpston scrutinizes the general theme of the criticism in *Mangold*. She stated that the Court (of its own volition, without good reason and against the wishes of the legislature) conferred horizontal direct effect on a directive before the end of its transitional period, by making an innovative reference to a general principle of Community law. She adds that the ruling is criticised for having produced a situation of considerable legal uncertainty.¹⁰⁰⁵ However, AG Sharpston suggests that it is not wise to exclude at the outset the possibility that a general principle of EU law could have horizontal direct effect. This latter comment should not be overestimated. It is argued that this does not mean that the *Mangold* approach should be accepted and that the general principle of equality enjoys horizontal direct effect in every possible situation. It seems that a narrower reading of the case is needed: the general principle of equality and in particular the prohibition of discrimination on grounds of nationality of Article 12 EC Treaty should be granted horizontal direct effect only when it supplements and enhances the protective scope of fundamental freedoms.¹⁰⁰⁶ This narrower interpretation would be more consistent with the purpose of market integration.

The proposition that Article 12 EC Treaty could apply to horizontal relationships is supported by *Walrave and Koch*. It was stipulated that the ECJ has recognised that the

¹⁰⁰³ Opinion of Advocate General Sharpston Case C-427/06 *Bartsch v Bosch und Siemens Hausgeräte (BSH) Altersfürsorge GmbH*. [2008] ECR not yet reported, paras 33-41.

¹⁰⁰⁴ Case C-13/05 *Chacon Navas* [2006] ECR I-6467, Case C-227/04 P *Lindorfer* [2007] ECR I-6767, Case C-411/05 *Palacios de la Villa* [2007] ECR I-8531 and Case C-267/06 *Maruko*, nyr. D. A. Wyatt (n 933) 14. For interesting comments, see: A. Dashwood 'From Van Duyn to Mangold via Marshall: Reducing Direct Effect to Absurdity?' [2007] CYELS (Hart, Oxford 2007) 107.

¹⁰⁰⁵ Opinion of Advocate General Sharpston Case C-427/06 *Bartsch* para. 31.

¹⁰⁰⁶ D. A. Wyatt (n 933) 15.

general principle of equal treatment, as regards nationality, can be applied horizontally when it is incorporated in a substantive Treaty article. Thus, in *Walrave and Koch* the ECJ held that the prohibition of discrimination on grounds of nationality contained in what are now Articles 12, 39 and 49 EC Treaty applied not only to the action of public authorities but also to rules of private organisations which aimed at regulating in a collective manner gainful employment and services and that the rule on non-discrimination applied in judging all legal relationships located within the Community. The Court developed this idea in *Angonese*, which concerned access to employment in a private bank, and ruled that ‘the prohibition of discrimination on grounds of nationality laid down in [Article 39 EC Treaty] must be regarded as applying to private persons’¹⁰⁰⁷ An additional argument which was invoked in other cases¹⁰⁰⁸ and which underpins the horizontality of Article 12 EC Treaty is that it does not refer explicitly to the issue of the sources of the discriminatory rules (public or private).¹⁰⁰⁹

A very important condition for the application of the general principle of equality was not explained sufficiently in *Mangold*. The requirement that the application of general principles demands a situation falling within the scope of the EC Treaty needs to be clarified further by the ECJ. In *Mangold*, the national provisions in question satisfied this condition because they were implementing EC rules on fixed-term contracts of employment.¹⁰¹⁰ The case where an autonomous national provision was adopted on a Member State’s own initiative seems to be quite problematic. In *Bartsch*¹⁰¹¹, the ECJ held that the application, which the courts of Member States must ensure, of the prohibition under Community law of discrimination on the ground of age

¹⁰⁰⁷ Opinion of Advocate General Sharpston Case C-427/06 *Bartsch* para. 84.

¹⁰⁰⁸ *Angonese* para 30, *Walrave and Koch* para 20.

¹⁰⁰⁹ D. A. Wyatt (n 933) 15-16.

¹⁰¹⁰ A. Dashwood (n 1004) 107.

¹⁰¹¹ Opinion of Advocate General Sharpston Case C-427/06 *Bartsch v Bosch und Siemens Hausgeräte (BSH) Altersfürsorge GmbH*. [2008] ECR not yet reported, para. 25.

is not mandatory where the allegedly discriminatory treatment contains no link with Community law. No such link arises from Article 13 EC Treaty or from Directive 2000/78 establishing a general framework for equal treatment in employment and occupation, before the time-limit allowed to the Member State concerned for its transposition has expired. It remains to see if the ECJ would confirm, in future cases, its approach with regard to the examination if Directive 2000/78 could provide this link with EC law. Only if a link with EC law is established, the general principle of equality could be invoked before the court.

A short reference to Article 13 EC Treaty should also be made. When Article 13 EC Treaty was introduced, the authors of the Amsterdam Treaty did not want to impose a directly effective prohibition of non-discrimination, as Article 12 EC Treaty does.¹⁰¹² The Community legislature was given competence to implement the principle of non-discrimination as regards sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation, by legislation. With regard to the disability and age discrimination aspects of the Directive 2000/78/EC, Member States enjoy a broad discretion in relation to its implementation.¹⁰¹³ The judicial intervention of the ECJ in *Mangold* was thought to undermine the system underlying the EC Treaty and the institutional balance, as stated in the opinion of AG Geelhoed in *Chacon Navas* and in the opinion of AG Mazak in *Palacios de la Villa*.¹⁰¹⁴

¹⁰¹² S. Prechal (n 995) 19. See also: L. Waddington 'Editorial: Throwing some light on Article 13 EC treaty' [1999] MJ 1, M. Bell 'The new Article 13 EC Treaty: a sound basis for European Anti-discrimination law?' [1999] MJ 5, R. Allen 'Article 13 EC, evolution and current contexts' in H. Meenan (ed) *Equality Law in an Enlarged European Union* (CUP, Cambridge 2007) 38.

¹⁰¹³ S. Prechal (n 995) 19.

¹⁰¹⁴ Case C-13/05 *Chacon Navas* [2006] ECR I-6467, Case C-411/05 *Palacios de la Villa* [2007] ECR I-8531. S. Prechal (n 995) 19.

CHAPTER 17

THE EXTENT TO WHICH CONDUCT OF THE BOARD AND ARTICLES IN THE CORPORATE CONSTITUTION MIGHT BE SAID TO CONSTITUTE RESTRICTIONS ON THE FREEDOM OF ESTABLISHMENT AND ON THE FREE MOVEMENT OF CAPITAL.

17.1)The scope of the chapter.

This chapter will first of all discuss the notions of direct investment and portfolio investment. This discussion will assist us in understanding the link between takeover bids and the fundamental freedoms because these financial techniques constitute an exercise of takeover bids. After showing this link, there will be an examination of the horizontal effect of the free movement of capital. It should be noted that the horizontal effect of the freedom of establishment was analysed in the previous chapter. The horizontal effect of the free movement of capital was not examined up-to-now by the ECJ. Policy considerations and other arguments tend to support the view that this fundamental freedom does not have horizontal direct effect. After analysing horizontality, we will then focus on a horizontal relationship within the framework of the market in corporate control. This is the relationship between the shareholders and the board of the offeree company and the offeror company. This latter subchapter will scrutinize if discriminatory and non-discriminatory provisions in the corporate constitution and defensive conduct of the offeree company's board against a takeover bid constitute restrictions on the internal market.

17.2) Direct investments and portfolio investments-the link between takeover bids and the fundamental freedoms.

Free movement of capital is one of the four fundamental freedoms. It constitutes a precondition for the effective exercise of the other fundamental freedoms and in particular of the right of establishment (*Casati*).¹⁰¹⁵ Article 56 EC Treaty states that all restrictions on the movement of capital and on payments between Member States and between Member States and third countries shall be prohibited. Article 58 EC Treaty contains some derogations from the liberalization of capital and payment movements and stipulates that:

‘The provisions of Article 56 shall be without prejudice to the right of Member States:

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.’

The text of Article 56 EC Treaty shows that the deciding factor is the movement of capital/payments between given geographical areas and not the residence or nationality of the person making or receiving a transfer.¹⁰¹⁶ This could possibly lead to the application of this freedom to residents of the same Member State conducting a capital movement between different Member States, while this freedom will not apply to

¹⁰¹⁵ Case 203/80 *Criminal proceedings against Guerrino Casati* [1981] ECR 2595. A.G. Toth, *The Oxford Encyclopaedia of European Community Law-vol.2 The law of the internal market* (Oxford Clarendon Press, Oxford 2005) 354.

¹⁰¹⁶ J. Handoll *Capital, payments and money laundering in the EU* (Richmond, Oxford 2007) 40.

residents of different Member States participating in a capital movement within the area of one Member State.¹⁰¹⁷ Nevertheless, this presumption was not confirmed by the ECJ yet and is based only on the text of Article 56 EC Treaty.

The EC Treaty does not provide a definition for ‘movement of capital’ but the ECJ referred to Directive 88/361¹⁰¹⁸ and to its annexed nomenclature in order to find such a definition.¹⁰¹⁹

Apart from an exercise of the freedom of establishment, a takeover bid constitutes also an exercise of the right to free movement of capital. This takes place mainly through direct investments. In *Commission v. Belgium*, the ECJ provide a definition for direct investment by reference to Directive 88/361 and to its annexed nomenclature. Points I and III in the nomenclature set out in Annex I to Directive 88/361¹⁰²⁰, and the explanatory notes appearing in that annex, indicate that direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market constitute capital movements within the meaning of Article 56 EC Treaty. Investments of all kinds by natural persons or commercial, industrial or financial undertakings, which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity fall within the scope of direct investments.¹⁰²¹ This concept must therefore be

¹⁰¹⁷ J. Handoll (n 1016) 40.

¹⁰¹⁸ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.

¹⁰¹⁹ Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661.

¹⁰²⁰ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5. The explanatory notes of this directive also clarify that direct investments encompass investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.

¹⁰²¹ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.

understood in its widest sense.¹⁰²² The explanatory notes state that direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its control.¹⁰²³

Moreover, the Commission referred to Directive 88/361 in order to define portfolio investments. In its 1997 Communication on certain legal aspects concerning intra-EU investment, it stated that in the Directive, the heading 'Acquisition . . . of domestic securities . . .' includes, among others, the transaction 'acquisition by non-residents' of shares and bonds in domestic companies on pure financial investment grounds, that is, without the aim of exerting any influence in the management of the company. Thus, this transaction is considered as a form of capital movement.¹⁰²⁴ Usually, venture capitalists participating in portfolio companies choose to exit their investment either through an initial public offering, through transferring their shares gradually or in a block transfer or through a takeover bid.¹⁰²⁵ Therefore, portfolio investments are also connected with the market in corporate control. These definitions differentiating between direct effect and portfolio investments were reiterated in some subsequent cases.¹⁰²⁶

¹⁰²² Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.

¹⁰²³ Case C-503/99 *Commission v. Belgium* [2002] ECR I-4809, para 38.

¹⁰²⁴ Communication of the Commission on certain legal aspects concerning intra-EU investment [1997] OJ C 220/15. As far as the position of portfolio companies in the internal market is concerned, the European venture capital market is characterized by regulatory hurdles obstructing early stage investments, and capital market structures that do not permit portfolio companies to liquidate their positions. E. Vermeulen 'Towards a New 'Company' Structure for High-tech Start-ups in Europe' [2001] MJ 233, 233.

¹⁰²⁵ E. Vermeulen (n 1024) 235.

¹⁰²⁶ The ECJ stated that movements of capital for the purposes of Article 56(1) EC Treaty include in particular direct investments in the form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control ('direct' investments) and the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking ('portfolio' investments) (Joined cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141 para. 19, Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661 para. 21, *Commission v France* [2002] ECR I-4781 paras 36-37, *Commission v United Kingdom(BAA case)* [2003] ECR I-4641, paras 39 and 40).

The scope of the free movement of capital is considered to be quite broad. While the free movement of capital protects both the potential investor and the shareholder, the freedom of establishment, apart from including the right to set up a company in another Member State, also includes direct investments into a company as far as they are regarded as an entrepreneurial investment. Such an investment must confer corporate control on the investor or at least a blocking minority.¹⁰²⁷ Additionally, the Directive's nomenclature states that the free movement of capital also includes all the financial techniques available on the market approached for the purpose of carrying out this capital movement. As an example, transactions in securities are mentioned. Thus, the concept of acquisition of securities and other financial instruments covers not only spot transactions but also all the dealing techniques available: forward transactions, transactions carrying an option or warrant, swaps against other assets, etc.¹⁰²⁸ This implies that any of these techniques attached to a takeover bid also fall within the scope of the free movement of capital. In a takeover, the free movement of capital catches not only the acquisition of shares and the change of control but also all the other financial instruments used in this tender offer process.

Different parts of securities transactions which result in a corporate control change fall within the scope of the free movement of capital and of the freedom of establishment. In *Baars*, it was stipulated that a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment.¹⁰²⁹ Therefore, an individual or a company seeking to acquire such a shareholding also fall within the scope of the

¹⁰²⁷ M. Andenas, T. Gutt and M. Pannier 'Free movement of capital and national company law' [2005] EBLR 757, 766.

¹⁰²⁸ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5.

¹⁰²⁹ Case C-251/98 *C. Baars* [2000] ECR I-02787 para. 22.

freedom of establishment.¹⁰³⁰ Hence, there is a difference between the conduct of a direct investment in a company incorporated in a Member State and the subsequent exercise of rights granted by that shareholding to exert a definite influence over the management and control of that EU company. The former falls within the scope of the free movement of capital but the latter falls within the scope of the freedom of establishment and entails the exercise of actual control or decisive influence over the investment.¹⁰³¹ The first stage of this process is the acquisition of shares which falls within the scope of the free movement of capital and which confers control on the new shareholders. The second stage is the exercise of control over the company which falls within the freedom of establishment and which derives from the acquisition of a controlling shareholding. In *Überseering* the ECJ had confirmed this differentiation. It stated that the acquisition by one or more natural persons residing in a Member State of shares in a company incorporated and established in another Member State is covered by the Treaty provisions on the free movement of capital, provided that the shareholding does not confer on those natural persons definite influence over the company's decisions and does not allow them to determine its activities. By contrast, where the acquisition involves all the shares in a company having its registered office in another Member State and the shareholding confers a definite influence over the company's decisions and allows the shareholders to determine its activities, it is the Treaty provisions on freedom of establishment which apply.¹⁰³² Although transactions in shares are such capital movements (in particular direct investments), they fall within the scope of freedom of establishment when they are aiming at the acquisition of

¹⁰³⁰ D. A. Wyatt (n 933) 41. This seems consistent with the choice of the Commission to insist on the adoption of a Takeover Bid Directive.

¹⁰³¹ T. O'Shea '*Thin Cap GLO* and Third-Country Rights: Which freedom applies?' [2007] *TaxNInt* 1 371, 373, Case C-208/00 *Überseering BV* [2002] ECR I-9919 para. 74-75.

¹⁰³² Case C-208/00 *Überseering BV* [2002] ECR I-9919 para. 77.

control over the offeree company.¹⁰³³ It could be deduced that the conduct of a takeover bid is caught by the freedom of establishment because the investor aims at the acquisition of control. Thus, the constituent actions of a takeover bid (e.g. mandatory bid, squeeze-out, sell-out, determination of the bid price etc) fall within the freedom of establishment. However, the direct investment as such aiming at the acquisition of shares which would subsequently grant the participation in the company's management falls within the protective scope of the free movement of capital. The same considerations also apply to mergers as a possible outcome of a takeover bid within the framework of EU corporate restructuring.

It is interesting to mention here that neither the Takeover Bid Directive nor its explanatory memorandum refer to Article 294 EC Treaty. Article 294 EC Treaty states that Member States shall accord nationals of the other Member States the same treatment as their own nationals as regards participation in the capital of companies or firms within the meaning of Article 48 EC Treaty, without prejudice to the application of the other provisions of this Treaty. As far as the 'without prejudice' clause is concerned, this article, dealing with portfolio investments, presents some differences from Article 43 EC Treaty. The freedom to acquire an absolute majority of shares (or even a controlling interest¹⁰³⁴) is caught by Article 43 EC Treaty as an exercise of this fundamental freedom.¹⁰³⁵ The acquisition of shares below the control level is caught by

¹⁰³³ G. Kemperink and J. Stuyck 'The Thirteenth Company Law Directive and Competing Bids' [2008] CMLRev. 93, 100. In *Commission v Germany (Volkswagen)*, it was confirmed its previous case law that national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the EC Treaty on freedom of establishment (Case C-251/98 *Baars* [2000] ECR I-2787, para. 22; Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, para. 31; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-0000, para. 27) Case C-112/05 *Commission v Germany (Volkswagen)* [2007] ECR I-8995 para. 13.

¹⁰³⁴ A controlling interest such as that acquired in a mandatory bid.

¹⁰³⁵ While Article 43 EC Treaty had to be implemented progressively over the transitional period, Article 294 EC Treaty had full effect since 1960. E. Stein (n 21) 47-48.

Article 294 EC Treaty.¹⁰³⁶ It is interesting to mention here that the Commission was really concerned with this issue of cross-border acquisition of shares since the early days of market integration. In the 1960s, there were deliberations between the Commission and Belgium for the abolition of a discriminatory company legislation requiring an authorization by the Belgian ministry of justice as a prerequisite for a takeover of a Belgian company by a company of another Member State and a Commission's reasoned opinion addressed to France for restrictions on direct investment transactions.¹⁰³⁷

Furthermore, with regard to the relationship between the free movement of capital and the freedom of establishment, the ECJ held, in its 'Golden Shares' case law, that to the extent that the legislation in issue involves restrictions on freedom of establishment, such restrictions are a direct consequence of the obstacles to the free movement of capital considered above, to which they are inextricably linked. Consequently, since a violation of Article 56 EC Treaty has been established, there is no need for a separate examination of the measures at issue in the light of the Treaty rules concerning freedom of establishment.¹⁰³⁸

¹⁰³⁶ E. Stein (n 21) 47-48.

¹⁰³⁷ E. Stein (n 21) 47-48.

¹⁰³⁸ Case C-367/98 *Commission v Portugal* [2002] ECR I-4731 para. 56, Case C-483/99 *Commission v France* [2002] ECR I-4781 para. 56, Case C-463/00 *Commission v Spain* [2003] ECR I-4581 para.86.

17.3) Horizontal effect of the free movement of capital.

In *Sanz de Lera*, the ECJ conferred vertical direct effect on the free movement of capital.¹⁰³⁹ Article 56 EC Treaty was found to have vertical direct effect, unlike the original Article 67 EEC Treaty.¹⁰⁴⁰ The original Treaty article on free movement of capital, Article 67 EEC Treaty, did not have direct effect. Only after the expiration of the time for transposing Directive 88/361/EEC (1st July 1990) into national law, direct effect was established for the first time (*Bordessa*¹⁰⁴¹). On that account, Article 56 EC Treaty grants rights to individuals which they can invoke before national courts, if these individuals consider that this article is breached by certain national provisions. The vertical direct effect of this article was not affected by the words ‘within the framework of the provisions laid down in this chapter’ or by the exceptions of Article 58 EC Treaty.¹⁰⁴² Although Article 56 EC Treaty has definitely vertical direct effect, it is not clear whether this Treaty article has also horizontal direct effect. There is no case law which could clarify this issue.¹⁰⁴³

¹⁰³⁹ Joined cases C-163/94, C-165/94 and C-250/94 *Criminal proceedings against Lucas Emilio Sanz de Lera and others* [1995] ECR I-4821.

¹⁰⁴⁰ A.G. Toth, *The Oxford Encyclopaedia of European Community Law-vol.2 The law of the internal market* (Oxford Clarendon Press, Oxford 2005) 359.

¹⁰⁴¹ Joined Cases C-358 & 416/93 *Bordessa* [1995] ECR I-361.

¹⁰⁴² J. Handoll (n 1016) 42. This seems to refer implicitly to the ECJ’s decision in *Van Duyn*, where limited discretionary vested to Member States was found not to inhibit the direct effect of Treaty articles. S. Mohamed *European Community Law on the Free Movement of Capital and the EMU* (Kluwer, Stockholm 1999) 45.

¹⁰⁴³ A.G. Toth, *The Oxford Encyclopaedia of European Community Law-vol.2 The law of the internal market* (Oxford Clarendon Press, Oxford 2005) 359. A few counter-arguments against the vertical direct effect of the freedom of establishment had been put forward. However, after *FII*, the direct effect of Article 56 EC Treaty should not be contested any more. Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] I-11753 para. 196. D. Smit and B. Kiekebeld *EC Free Movement of Capital, Corporate Income Taxation and Third Countries: Four Selected Issues* (Kluwer, AH Alphen aan den Rijn, 2008) 77-78.

Article 56 EC Treaty does not specify the source of the restrictions (public/private bodies) that must be abolished. This was invoked as an argument in favour of the horizontal direct effect of this EC Treaty article. This approach was reinforced by previous case law on Articles 39 and 49 EC Treaty which used this lack of specificity in the sources of restriction as a ground for the establishment of horizontal direct effect for these two fundamental freedoms.¹⁰⁴⁴ When private bodies play the same regulatory role on capital movements as the State, then private action could inhibit the free movement of capital (as State action could).¹⁰⁴⁵ While this lack of precision in the sources of the restrictions was used as an argument in favour of the horizontal effect of Article 56 EC Treaty, Article 58 EC Treaty suggests that the addressees of Article 56 EC Treaty are the Member States and that this freedom does not apply to individuals.¹⁰⁴⁶

The ECJ, in *Commission v Belgium*,¹⁰⁴⁷ missed the opportunity to clarify the conditions of the horizontal effect of the free movement of capital. The case was about a Eurobond issue. The terms and conditions of this issue of the Eurobond prohibited any sale to Belgian residents apart from the sophisticated investors. The Commission alleged that this term infringed the free movement of capital and brought the case before the ECJ. The first argument of the Belgian government was that the prohibition into question did not constitute a state measure of general application but was a simple commercial term. The second argument of the Belgian government was that its actions would not be caught by Article 56 EC Treaty because it had acted in its capacity as a

¹⁰⁴⁴Case 36/74 *Walrave and Koch* para. 20, Case C-281/98 *Angonese* para. 30. D. A. Wyatt (n 933) 37.

¹⁰⁴⁵D. A. Wyatt (n 933) 40-41.

¹⁰⁴⁶M. Andenas, T. Gutt and M. Pannier (n 1027) 777. Moreover, it was argued that this lack of specificity on the sources of restriction might imply that this situation could be analogous to the free movement of goods situation. G. Davies (n 925) 154, 160.

¹⁰⁴⁷Case C-478/98 *Commission v Belgium* [2000] ECR I-7587.

private operator and not in its capacity as a public authority.¹⁰⁴⁸ This distinction between actions of the state as private operator and actions of the State as a public authority was established in Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings¹⁰⁴⁹ and in the ECJ's previous case law (*Ufficio Distrettuale* and *LTU v Eurocontrol*¹⁰⁵⁰). The ECJ finally found that the Belgian government exercised its power as a public authority because it had introduced tax waiver provisions. Moreover, the argument that the State did no more, as a borrower, than agree with the financial intermediaries on a contractual term to be included in the conditions of the loan, in the same way as with contracts concluded by private borrowers, was not accepted.¹⁰⁵¹ Neither the ECJ nor AG Jacobs examined the 'private operator' allegation of Belgium.¹⁰⁵² The ECJ could have explained whether the free movement of capital has horizontal direct effect and, subsequently, if a private operator is caught by this freedom in its relationships with other market operators. The finding that Belgium was acting as a public authority could not have curbed the ECJ from clarifying this issue.

Notwithstanding, some policy considerations do not support the establishment of horizontal direct effect of the free movement of capital.¹⁰⁵³ One of the major differences between the free movement of capital and the other fundamental freedoms is that the free movement of capital catches also capital movements between Member

¹⁰⁴⁸ T. Van Byck 'Case Note: Case Case C-478/98 *Commission v Belgium*) [2002] ColJEL 311, 313.

¹⁰⁴⁹ [1980] OJ L195/35.

¹⁰⁵⁰ Joined Cases 231/87 and 129/88 *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d'Arda and Others v Comune di Carpaneto Piacentino and Others* [1989] ECR 3233 and Case 29/76 *LTU v Eurocontrol* [1976] ECR 1541.

¹⁰⁵¹ Case C-478/98 *Commission v Belgium* [2000] ECR I-7587 paras. 22-26. S. Mohamed 'Recent Case Law in the Field of Free Movement of Capital' [2001] EBLR 263, 268-270.

¹⁰⁵² T. Van Byck (n 1048) 320.

¹⁰⁵³ D. A. Wyatt (n 933) 38. Additionally, the Commission seems to be cautious in expanding the scope of free movement of capital into new parts of the financial sector. In some Commission's Decisions, banks were found to breach the competition rules and more specifically Article 81 EC Treaty. There was no extension to the free movement of capital. Decision 2003/25 German Banks, OJ [2003] L15/1 and Decision 2004/138 Austrian Banks-Lombard Club, OJ [2004] L56/1. R. Lane (n 920) 270-271.

States and third countries and not only capital movements among the Member States. If free movement of capital applied horizontally to relationships between market participants situated in a Member State and market participants situated in a third country, this would definitely improve the legal position of a third country market participant but would worsen the legal position of a Community-based market participant. A market participant located in a Member State could be the target of actions by third-country market participants on the basis of free movement of capital but it is uncertain if the former market participant is also granted this right against the latter market participant on the basis of mutuality.¹⁰⁵⁴ The legal rights of the market participant located in a Member State against another third-country market participant depends solely on the laws of the third country and mutuality could not be taken for granted.

It could be contended that the general principle of equality, in conjunction with Article 56 EC Treaty, would prohibit provisions of the articles of association of a company incorporated in a Member State which does not allow nationals or companies of other Member States to acquire shares in that company.¹⁰⁵⁵ Although Article 56 EC Treaty catches capital movements between Member States as well as capital movements between Member States and third countries, it can not be maintained that the general principle of equality and in particular the prohibition of discrimination on grounds of nationality in Article 12 EC Treaty¹⁰⁵⁶, will apply to nationals of third countries as regards shareholding of a company incorporated in a Member State.¹⁰⁵⁷

¹⁰⁵⁴ D. A. Wyatt (n 933) 38.

¹⁰⁵⁵ D. A. Wyatt (n 933) 38.

¹⁰⁵⁶ It was mentioned above that Article 12 EC Treaty supplements the scope of fundamental freedoms in certain situations not caught by them and contributes to a more complete and stronger protection against discrimination on grounds on nationality. D. A. Wyatt (n 933) 13.

¹⁰⁵⁷ D. A. Wyatt (n 933) 37-38.

Policy grounds argue for this approach.¹⁰⁵⁸ A company incorporated in a Member State and the rest of its shareholders who are nationals of Member States become quite vulnerable to third country nationals acquiring shares in that company, especially when the third country does not provide sufficient laws for the protection of the interests of the company and its shareholders who are EU nationals. A situation like this could create many inequalities; free movement capital provisions could be invoked by the third country nationals against the company and the other shareholders but the company and the rest of the shareholders could not invoke these provisions in the courts of this third country against its nationals. In the sphere of shareholding and of the financial transactions attached to it, the conferral of horizontal direct effect to the free movement of capital would create many problems in case of litigation between Member State nationals and third country nationals.¹⁰⁵⁹

Apart from the policy reasoning, an additional argument¹⁰⁶⁰ against the horizontal direct effect of free movement of capital derives from Article 57(1). This article states that the provisions of Article 56 EC Treaty shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets.

Some recent judgements of the ECJ on restrictions on the movement of capital between the Member States and third countries seem to imply this lack of horizontality in the field of free movement of capital. In *Skatteverket*, the ECJ held that the ECJ's

¹⁰⁵⁸ D. A. Wyatt (n 933) 37-38.

¹⁰⁵⁹ In recent case law, the ECJ seems to be aware of the rights that third-country nationals could derive from the free movement of capital and is quite willing to accept that a cross-border commercial activity between a Member State and third country falls within the scope of the free movement of services instead of the scope of the free movement of capital. Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521.

¹⁰⁶⁰ D. A. Wyatt (n 933) 39.

case-law, which relates to restrictions on the exercise of freedom of movement within the Community, cannot be transposed in its entirety to movements of capital between Member States and third countries, since such movements take place in a different legal context from that of the cases which gave rise to the judgments referred to in the two preceding paragraphs.¹⁰⁶¹ This approach seems to agree with the earlier ECJ's reluctance to equate internal market relations and relations between Member States and third countries.¹⁰⁶² The ECJ did not transpose the interpretation of EC Treaty concepts to agreements between the EC and third-countries (*Polydor*¹⁰⁶³). An internal market concept should not be construed in the same way in the framework of relations between Member States and third countries as in the relations between Member States because there is no intention to create an internal market under the free trade agreements.¹⁰⁶⁴ Furthermore, AG Geelhoed in his opinion in *Test Claimants in the FII Group Litigation*, distinguished an intra-EU capital movement from an exercise of the free movement of capital by a third country national. He held that, in analysing whether such restrictions are justified (whether under Article 58(1) EC Treaty or under the discrimination analysis of Article 56 EC Treaty), different considerations may apply than is the case with purely intra-Community restrictions. He justified this proposal by referring to his previous opinion in *Ospelt*¹⁰⁶⁵: the particular context of intra-Community freedom of capital is that it must be regarded as a constituent element of economic and monetary union and the fact that monetary policy is, following completion of economic and monetary union, set by the European Central Bank, presupposes complete unity in terms of the movement of money and capital. He

¹⁰⁶¹ Case C-101/05 *Skatteverket v A* [2008] nyr, para. 60.

¹⁰⁶² J. Usher 'EMU and Financial Services' in T. Tridimas and P. Nebbia (eds) *European Union Law for the Twenty-First Century, Rethinking the New Legal Order, Volume 2* (Hart, Oxford, 2004) 75.

¹⁰⁶³ Case 270/80 *Polydor Limited and RSO Records Inc. v Harlequin Records Shops Limited and Simons Records Limited* [1982] ECR 329

¹⁰⁶⁴ J. Usher (n 1062) 75.

¹⁰⁶⁵ Opinion of AG. Geelhoed Case C-452/01 *Ospelt* [2003] ECR I-9743, para 35-42.

deduced that this context does not apply to the case of movement of capital between Member States and third countries, although the movement of capital has been to a large extent liberalised worldwide. The conclusion was that a Member State may be able to prove that a restriction of capital movements with third countries is justified on a given ground, in circumstances where this ground would not amount to a valid justification of a restriction on purely intra-Community capital movements.¹⁰⁶⁶ The ECJ endorsed the latter conclusion and the reasoning of AG Geelhoed.¹⁰⁶⁷

Hence, Article 56 EC Treaty should have only vertical direct effect. However, the acquisition of shares in a company incorporated in a Member State is caught by Article 56 EC Treaty and any restrictions on such an acquisition are prohibited.¹⁰⁶⁸ Any provisions of the corporate constitution excluding non residents from acquiring shares in the company would constitute indirect discrimination on grounds of nationality contrary to Article 12 EC Treaty.¹⁰⁶⁹ Article 12 EC Treaty seems to be horizontally applicable to such situations.¹⁰⁷⁰ Nationals of Member States could invoke Article 12 EC Treaty against such discriminatory provisions but third country nationals could not invoke Article 12.¹⁰⁷¹ Only if a third country national resides in a Member State could invoke the general principle of equality, a part of which is embodied by Article 12 EC

¹⁰⁶⁶ Opinion of AG. Geelhoed Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11753 para. 121.

¹⁰⁶⁷ Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11753 para. 171.

¹⁰⁶⁸ D. A. Wyatt (n 933) 40. It was also argued that obligations of Member States should be read in conjunction with Article 10 EC Treaty and that they should take all the necessary measures in order to ensure that individuals respect the fundamental freedoms (Case C-265/95 *Commission v France* para. 32). Member States as legislators are responsible for private law legislation and therefore determine the limits of the acting of individuals. In this way, private autonomy of market operators is not limited by the EC treaty. It is limited by State measures and is protected by the fundamental freedoms. Individuals could also invoke the protection of the fundamental freedoms but are also bound by them. This proposition preserves the structure of the EC Treaty. It could be assumed that AG Maduro inclined towards this proposition when he found that there were not any substantial differences between, indirect horizontal effect and direct horizontal effect (Case C-438/05 Opinion *Viking* para 40). M. Andenas, T. Gutt and M. Pannier (n 1027) 777-778.

¹⁰⁶⁹ D. A. Wyatt (n 933) 41.

¹⁰⁷⁰ D. A. Wyatt (n 933) 41.

¹⁰⁷¹ D. A. Wyatt (n 933) 41.

Treaty.¹⁰⁷² This approach seeks to rationalize the financial relationships between nationals of Member States and third country nationals. On the one hand, unfair situations will be avoided. These situations are caused by conferral of full horizontal effect on third country nationals, while EU citizens are deprived of the protection of free movement of capital outside the EU. On the other hand, Article 56 EC Treaty liberalizing capital movements between Member States and between Member States and third countries would not be misinterpreted because a third country national could be protected against discriminatory provisions as long as he resides in a Member State.

A third-country national must be established in a Member State in order to be caught by the freedom of establishment; only then, he could be protected in a horizontal relationship by the freedom of establishment. This establishment provides an economic link with the Community. As long as this link is real and continuous, going beyond a mere registered office, third-country nationals can invoke the freedom of establishment.¹⁰⁷³ The freedom of establishment applies to the EU companies or subsidiaries set-up by a third-country national but does not apply to a third-country national directly. This could be illustrated by *Halliburton*¹⁰⁷⁴ where the US parent company's establishment of German and Dutch subsidiaries triggered the application of the freedom of establishment to this intra-EU corporate group. It should be stressed though that the formation of those subsidiaries by the foreign parent company entails an exercise of the free movement of capital.¹⁰⁷⁵ However, it is this secondary establishment of the foreign company, which enjoys the freedom of establishment and not the foreign company. The free movement of capital permits third-country nationals to invest in EU businesses but the freedom of establishment does not protect the control

¹⁰⁷² D. A. Wyatt (n 933) 41.

¹⁰⁷³ T. O'Shea (n 1031) 373.

¹⁰⁷⁴ Case C-1/93 *Halliburton Services BV* [1994] ECR I-1137.

¹⁰⁷⁵ T. O'Shea (n 1031) 373.

or managerial rights of these third-country investors over their businesses.¹⁰⁷⁶ The secondary establishment of the foreign company enjoys these managerial rights over any further secondary establishments in the Community.

17.4) Discriminatory and non-discriminatory provisions in the corporate constitution.

A provision of the corporate constitution prohibiting non nationals or non residents of Member States from acquiring shares in a target company would breach the general principle of equality, especially the prohibition of discrimination on grounds of nationality in Article 12 EC Treaty, and the freedom of establishment, either alone or in conjunction with the general principle of equality/Article 12 EC Treaty.¹⁰⁷⁷ It should be noted that the corporate constitution regulates in a collective way the terms and conditions of the acquisition and the selling of company's shares.¹⁰⁷⁸

Article 43 EC Treaty prohibits provisions of corporate constitutions which discriminate on grounds of nationality and inhibit nationals of other Member States to acquire shares and to participate in the management of this company.¹⁰⁷⁹ An analogy with the previous case law in *Walrave & Koch* underpins this argument. Such a discriminatory provision in a corporate constitution regulates in a collective way access to the self-employed activity of management of a corporate undertaking because this

¹⁰⁷⁶ T. O'Shea (n 1031) 375.

¹⁰⁷⁷ D. A. Wyatt (n 933) 40.

¹⁰⁷⁸ D. A. Wyatt (n 933) 40.

¹⁰⁷⁹ D. A. Wyatt (n 933) 42.

discrimination encompasses all potential EU bidders seeking to acquire a shareholding granting decisive control over the management of the company. In *Walrave & Koch*, the ECJ refers to Article 7(4) of Regulation 1612/68/EEC¹⁰⁸⁰ in order to enhance its proposition that Article 39 EC Treaty extends likewise to agreements and rules not being adopted by public bodies.¹⁰⁸¹ Article 7(4) of Regulation 1612/68/EEC declares that any clause of a collective or individual agreement or of any other collective regulation concerning eligibility for employment, employment, remuneration and other conditions of work or dismissal shall be null and void in so far as it lays down or authorises discriminatory conditions in respect of workers who are nationals of the other Member States. In *Walrave & Koch*, the ECJ clarified that the activities referred to in Article 49 EC Treaty are not to be distinguished by their nature from those in Article 39 EC Treaty, but only by the fact that they are performed outside the ties of an employment contract.¹⁰⁸² This consideration could also apply by analogy to Article 43 EC Treaty. The horizontal direct effect of Article 39 applying to agreements and rules which do not derive from public bodies and which impose discriminatory rules on access to employed activities induces to the horizontal direct effect of Article 43 EC Treaty with regard to rules in a corporate constitution excluding nationals of other Member States from the self-employed activity of managing a company.¹⁰⁸³

¹⁰⁸⁰ Regulation (EEC) No 1612/68 of the Council of 15 October 1968 on freedom of movement for workers within the Community [1968]OJ L 257/2.

¹⁰⁸¹ Regulation 1612/68/EEC was found not to create any new rights but to determine the scope and detailed rules for the exercise of rights conferred directly by the EC Treaty, Case 48/75 *Royer* [1976] ECR 497 para. 28. Case 36/74 *Walrave* para. 21-22. D. A. Wyatt (n 933) 41-42.

¹⁰⁸² *Walrave* para. 23. D. A. Wyatt (n 933) 42.

¹⁰⁸³ D. A. Wyatt (n 933) 42. Article 44(2)(f) EC Treaty states that the Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular [...] by effecting the progressive abolition of restrictions on freedom of establishment in every branch of activity under consideration, both as regards the conditions for setting up agencies, branches or subsidiaries in the territory of a Member State and as regards the subsidiaries in the territory of a Member State and as regards the conditions governing the entry of personnel belonging to the main establishment into managerial or supervisory posts in such agencies, branches or subsidiaries. In this line, see also Case 79/85 *Segers* [1986] ECR 2375 para. 15.

This analogy is also upheld by Article 8 of Regulation 1612/68/EEC which pronounced that a worker who is a national of a Member State and who is employed in the territory of another Member State shall enjoy equality of treatment as regards membership of trade unions and the exercise of rights attaching thereto, including the right to vote. Therefore, Article 39 EC Treaty protects the participation of workers in trade unions which are private bodies: their members enjoy equality of treatment as regards the right to membership and the right to vote (i.e. the right to take part effectively in the decision-making process and the governance of such private associations). It could be inferred that Article 43 EC Treaty should also confer equality and should protect the rights of persons willing to become members and subsequently to exercise their voting rights in private bodies such as companies.¹⁰⁸⁴

Even if this analogy could not be based upon Article 43 EC Treaty, the prohibition of provisions of corporate constitutions which discriminate on grounds of nationality and inhibit nationals of other Member States to acquire share and to participate in the management of this company could be founded on Article 12 EC Treaty. Article 12 EC Treaty supplements the protection of Article 43 EC Treaty. In *Commission v. France*, the ECJ held the general prohibition of discrimination on grounds of nationality laid down in Article 12 EC Treaty has been implemented by Article 43 EC Treaty in the specific domain which it governs and that, consequently, any rules incompatible with the latter provision are also incompatible with Article 12 EC Treaty.¹⁰⁸⁵ Since the acquisition of shares aiming at the acquisition of control over the management of the company falls within the protective scope of the freedom of establishment, Article 12 EC Treaty could be invoked against such provisions of the corporate constitution

¹⁰⁸⁴ D. A. Wyatt (n 933) 42.

¹⁰⁸⁵ Case C-334/94 *Commission v France* [1996] ECR 1996 I-1307 para. 13

discriminating on grounds of nationality.¹⁰⁸⁶ Additionally, when the investor does not seek for acquisition of corporate control but plans to proceed to a portfolio investment, any discriminatory provisions of the corporate constitution frustrating such investment would be incompatible with Article 12 EC Treaty.

With regard to free movement of capital, the ECJ ruled that Article 56 EC Treaty lays down a general prohibition on restrictions on the movement of capital between Member States. That prohibition goes beyond the mere elimination of unequal treatment, on grounds of nationality, as between operators on the financial markets.¹⁰⁸⁷ Not only discriminatory behaviour against nationals of other Member States but every restriction of cross-border transfer of capital is prohibited.¹⁰⁸⁸ In many cases¹⁰⁸⁹ before it the ECJ characterized as restrictions national measures which could dissuade or deter residents from investing capital, from conducting a financial transaction or from participating in capital movements in general. This seems to constitute a quite wide¹⁰⁹⁰ approach towards the definition of restriction. Even though the national provisions may not result in unequal treatment, they could still inhibit the acquisition of shares in the relevant undertakings and to dissuade investors in other Member States from investing in the capital of those undertakings.¹⁰⁹¹ For example, in *Weidert*, it was held that Articles 56(1) and 58(1)(a) EC Treaty preclude a legal provision of a Member State which denies the availability of income tax relief to natural persons for the acquisition

¹⁰⁸⁶ D. A. Wyatt (n 933) 42.

¹⁰⁸⁷ Case C-483/99 *Commission v France* [2002] ECR I-4781 para. 40. S.M. Seyad 'Contribution of general principles to EC financial market integration' in U. Bernitz and others (eds) *General Principles of EC Law in a Process of Development* (Kluwer, AH Alpen aan den Rijn 2008) 184-185

¹⁰⁸⁸ M. Andenas, T. Gutt and M. Pannier (n 1027) 769.

¹⁰⁸⁹ Case C-484/93 *Svensson et Gustavsson* [1995] ECR I-03955, C-439/97 *Sandoz GmbH* [1999] ECR I-07041, Joined cases C-163/94, C-165/94 and C-250/94 *Criminal proceedings against Lucas Emilio Sanz de Lera and others* [1995] ECR I-4821 para. 25, Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, Case C-302/97 *Konle* [1999] ECR I-3099 para. 44.

¹⁰⁹⁰ This wide approach was criticized and various solutions were proposed: S. Peers 'Free movement of capital: Learning Lessons or Slipping on Spilt Milk?' in C. Barnard and J. Scott (eds) *The Law of the Single European Market* (Hart, Oxford 2002).

¹⁰⁹¹ M. Andenas, T. Gutt and M. Pannier (n 1027) 770.

of shares representing cash contributions in capital companies established in other Member States.¹⁰⁹² Additionally, the line of cases known as the ‘Golden Shares’ cases¹⁰⁹³, confirms this approach towards restrictions. In all these cases, the ECJ ruled that not only discriminatory conduct on grounds of nationality constitutes a restriction but every national measure that may possibly impede an investment or dissuade an investor from investing constitutes a restriction.¹⁰⁹⁴ A possible refusal by the relevant national authorities of the Member States to approve an important decision, proposed by the organs of the company concerned as being in the company’s interests, or an exercise of other defensive measures against a profitable bid would be capable of depressing the (stock market) value of the shares of that company and thus reduces the attractiveness of an investment in such shares.¹⁰⁹⁵ This is considered to be sufficient in order to discourage investors from other Member States to proceed to a takeover bid.

As far as non-discriminatory provisions in the corporate constitution are concerned, it should be examined whether they constitute obstacles to freedom of establishment and to free movement of capital. It should be borne in mind that normal market behaviour on behalf of one market operator does not in itself restrict the exercise of fundamental freedoms by another market operator. Therefore, if any such provision of the corporate constitution constituted an expression of normal market behaviour, this provision would not restrict the exercise of fundamental freedoms.¹⁰⁹⁶ The so-called ‘golden shares’ case law will assist us in our analysis. Golden shares indicate a category of state imposed restrictions on takeovers, and may give clues to the kind of restriction

¹⁰⁹² Case C-242/03 *Weidert* [2004] nry

¹⁰⁹³ Case C-367/98 *Commission v Portugal* [2002] ECR I-4731, Case C-483/99 *Commission v France* [2002] ECR I-4781, Case C-503/99 *Commission v Belgium* [2002] ECR I-04809, Case C-463/00 *Commission v Spain* [2003] ECR I-04581, Case C-98/01 *Commission v United Kingdom* [2003] ECR I-464, Joined cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141, Case C-112/05 *Commission v Germany (Volkswagen)* [2007] ECR I-8995.

¹⁰⁹⁴ M. Andenas, T. Gutt and M. Pannier (n 1027) 770.

¹⁰⁹⁵ Joined cases C-282/04 and C-283/04 *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-9141 para. 27.

¹⁰⁹⁶ D. A. Wyatt (n 933) 42-43.

on takeovers which could infringe freedom of establishment and free movement of capital if carried out by the board of the company. It should also be mentioned that the Commission had emphasized this case law in its 2002 proposal. The Commission claims indirect links between the ‘golden shares’ case law and restrictions stemming from the corporate constitution. Although these decisions concern only rules adopted by Member States, the Court recalls, generally, that any restriction on investment or on the exercise of control in European companies is in breach of the principle of the free movement of capital: the free movement of capital, as a fundamental principle of the Treaty, may lawfully be restricted only by national rules which are justified by reasons referred to in Article 58 EC Treaty or by overriding requirements of the general interest and which are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State. Furthermore, in order to be so justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality (*Gebhard* test).¹⁰⁹⁷ The Commission then contends that the breakthrough rule of Article 11 of the Takeover Bid Directive is founded on this rationale: Article 11 is concerned specifically with private-law restrictions on the transfer of securities and the exercise of voting rights and renders them unenforceable or ineffective in the event of a takeover bid.¹⁰⁹⁸ Hence, some conclusions of the ‘golden shares’ case law could prove very useful for the examination of restrictions arising from the corporate constitution.

The ECJ accepted the possibility of the existence of non discriminatory restrictions on capital movements deriving from the provisions of a corporate constitution. In

¹⁰⁹⁷ Proposal for a Directive of the European Parliament and of the Council on takeover bids [2002] COM 534 final [2003] OJ 45E/4.

¹⁰⁹⁸ Proposal for a Directive of the European Parliament and of the Council on takeover bids [2002] COM 534 final [2003] OJ 45E/4.

Commission v United Kingdom (BAA case), the ECJ declared that, by maintaining in force the provisions limiting the possibility of acquiring voting shares (maximum 15% of the share capital) in British Airports Authority (BAA) as well as the procedure requiring ministerial consent to the disposal of the company's assets, to control of its subsidiaries and to winding-up on the basis of a unique one GB pound 'special share' owned by the relevant minister, the United Kingdom had breached Article 56 EC Treaty. Although the relevant restrictions on investment operations apply without distinction to both residents and non-residents, it must none the less be held that they affect the position of a person acquiring a shareholding as such and are thus liable to deter investors from other Member States from making such investments and, consequently, affect access to the market.¹⁰⁹⁹ National company laws inhibit market integration not only when they have an adverse impact on the market as a whole (i.e. rules with structural effects on company law and/or ownership structure) but also when they restrict specific investment possibilities under the fundamental freedoms.¹¹⁰⁰

It is worth mentioning here that Article 56 EC Treaty catches not only 'golden shares' created by legislation but also 'golden shares' created by domestic company law. The free movement of capital does not permit the general company law to confer on the State special rights over companies. Apart from *Commission v United Kingdom (BAA case)*, the ECJ, in *Commission v Netherlands* scrutinized the articles of association of two Dutch companies which granted a special share to the Dutch authorities conferring on it special rights to approve major decisions of the organs of

¹⁰⁹⁹ Case C-463/00 *Commission v Spain* [2003] ECR I-4579, para. 61, Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641, para. 47. This shrinks the distinction between purely internal situations and cross-frontier situations. These non-discriminatory provisions were held to infringe the free movement of capital, although they had no special propensity to hinder cross-frontier activity. D.A. Wyatt 'Trade, Tax and Takeovers-Can the European Court de-regulate Europe despite resistance from the Council and Parliament?' [2005] CYELP 95, 102,

¹¹⁰⁰ S. Grundmann and F. Moslein 'Golden Shares. State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' SSRN Working Paper Series < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410580 > accessed 27 January 2009, 24.

these companies and found that they infringed the free movement of capital.¹¹⁰¹ The fact that special rights are granted to the State by mechanisms of general company law does not prevent them from falling within the scope of the free movement of capital. In *Commission v Netherlands*, AG Maduro analysed the case that a State is acting as a normal market participant. AG Maduro stated that the Treaty rules on the free movement of persons, services and capital impose obligations on the Member States' national authorities, regardless of whether those authorities act in their capacity as a public authority or as an entity under private law. Member States are subject to the rules on free movement, of which they are clearly addressees, not on account of their functional capacity as public authority, but on account of their organic capacity as signatory of the Treaty. To the extent to which those rules do not create obligations for individuals, Member States, when operating as a market participant, may be subject to constraints that do not apply to other market participants.¹¹⁰² He did not consider the means and the forms used for the introduction of such special rights as important. Both general company law and special legislation could constitute sources of special rights infringing the free movement of capital.¹¹⁰³ Moreover, with regard to horizontality, AG Maduro contended that even if it were the case that the Dutch public authorities were exempt from Article 56 EC Treaty when acting, like any other shareholder, under general company law, the question should be raised as to whether legislation which enables some shareholders to obtain certain special rights in order to shield them from the market process, may itself constitute a restriction on the free movement of

¹¹⁰¹ A. Looijestijn-Clearie 'All That Glitters Is Not Gold: European Court of Justice Strikes Down Golden Shares in Two Dutch Companies' [2007] EBOR 429, 430-431. Joined cases C-282/04 and C-283/04 *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-9141.

¹¹⁰² Opinion of Mr Advocate General Poiares Maduro Joined cases C-282/04 and C-283/04 *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-9141 para. 22.

¹¹⁰³ Opinion of Mr Advocate General Poiares Maduro Joined cases C-282/04 and C-283/04 *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-9141 para. 23.

capital.¹¹⁰⁴ Legislation of this type may restrict access to capital in the national market by protecting the position of certain operators who have acquired a stronghold in that market. Such operators, moreover, are likely to be domestic shareholders. Legislation of this kind may therefore hinder access to the national market for investors established in other Member States.¹¹⁰⁵ It should be stressed that the latter suggestion of AG Maduro was restricted to legislation (state measures). It is legislation which authorizes certain shareholders to entrench their position and to obstruct market access. He did not discuss whether special rights included autonomously in the articles of association of a company and being exercised by shareholders infringe the free movement of capital.¹¹⁰⁶ Nevertheless, the ECJ did not respond to the proposal of AG Maduro to clarify the limits that the fundamental freedoms place on Member States acting as market participants.¹¹⁰⁷

In spite of the public source of measures in *Commission v United Kingdom (BAA case)*, which were adopted by the UK government, this proposition could partly apply to a horizontal situation between private parties. If the provisions requiring consent to the disposal of the company's assets, to control of its subsidiaries and to winding-up were adopted by private shareholders through a normal corporate resolution, it could be contended that these provisions would not have inhibited unlawfully a potential offeror company from launching its public offers because they would not constitute trade barriers.¹¹⁰⁸ Nonetheless, an equity limitation (like the maximum shareholding of 15% of the company's capital in *Commission v United Kingdom (BAA case)*) introduced in the corporate constitution by private shareholders could definitely deter potential

¹¹⁰⁴ Opinion of Mr Advocate General Poirares Maduro Joined cases C-282/04 and C-283/04

Commission of the European Communities v Kingdom of the Netherlands [2006] ECR I-9141 para. 24.

¹¹⁰⁵ Opinion of Mr Advocate General Poirares Maduro Joined cases C-282/04 and C-283/04 *Commission of the European Communities v Kingdom of the Netherlands* [2006] ECR I-9141 para. 24.

¹¹⁰⁶ A. Looijestijn-Clearie (n 1101) 430-444.

¹¹⁰⁷ A. Looijestijn-Clearie (n 1101) 430-443.

¹¹⁰⁸ D. A. Wyatt (n 933) 43.

bidders from launching a public offer and from taking over the company. This limitation of the possibility of acquiring voting shares is a permanent barrier to takeover bids and inhibits any investment aiming at participating decisively in the management of the company. The element of the single ‘special share’ to which these barriers are attached is purely procedural. It makes no difference, if this share is being held by the State or by a private shareholder. Even if this single ‘special share’ did not exist at all in a horizontal relation and the equity limitation was just inserted into the corporate constitution by private parties, the freedom of establishment and the free movement of capital would be breached. It should be noted here that while the horizontal direct effect of the free movement of capital is dubious, the horizontal effect of the freedom of establishment is well-established.¹¹⁰⁹

As we mentioned, in a horizontal relationship, normal market behaviour could not result in a trade barrier. The fundamental freedoms apply to private action only when it is similar to public action. This presupposes that private action does not simply follow market rules in order to compete with other market participants but constitutes some sort of private regulation which restricts unduly the exercise of the fundamental freedoms by other market participants.¹¹¹⁰ A very crucial point is the position of the individual vis-à-vis the other individual; if the individual is in the same position vis-à-vis the other individual as in its position vis-à-vis the State then it would be possible to have a restriction on the exercise of this fundamental freedom by the individual. This will depend on the binding nature of the private rules imposed on individuals. If an individual could not avoid the application of private rules, barriers could be created. This situation assimilates to the regulatory role of the State and to the possibility that

¹¹⁰⁹ D. A. Wyatt (n 933) 43-44.

¹¹¹⁰ J. Baquero Cruz (n 860) 618.

such State regulation could infringe the fundamental freedoms.¹¹¹¹ In its opinion in *Viking*, AG Maduro had also talked about the mandatory nature of private rules and the fact that the other market participants could not avoid the effects of any possible barriers. He declared that the provisions on freedom of movement apply to private action that, by virtue of its general effect on the holders of rights to freedom of movement, is capable of restricting them from exercising those rights, by raising an obstacle that they cannot reasonably circumvent.¹¹¹²

In the EU market for corporate control, an equity limitation inserted into the corporate constitution by private parties could not be considered as normal market behaviour.¹¹¹³ An equity limitation does not enable shareholders or the company itself to maintain or improve their position in the market but entrenches the position of the company's board and does not permit shareholders to benefit from the market of corporate control.¹¹¹⁴ Actually, an equity limitation could not allow the market in corporate control to operate at all or could allow it to operate only until the prescribed percentage of shares is reached. This is clearly against the goals of market integration. Takeovers could be proved to be beneficial for shareholders who could sell their shares to the bidder at a premium. In addition to that, the mandatory bid rule, the squeeze-out rule and the sell-out rule do not allow inequalities in the prices the shares are being sold and, in general, contribute to the shareholders' protection. The fact that the European Commission considered those shareholding and voting caps as incompatible with the internal market and decided that they should be abolished is the strongest argument against the allegation that an equity limitation is an outcome of normal market behaviour. Additionally, the fact that an equity limitation inhibits access to the market

¹¹¹¹ J. Baquero Cruz (n 860) 618.

¹¹¹² Case C-438/05 Opinion *Viking* para 43.

¹¹¹³ D. A. Wyatt (n 933) 44.

¹¹¹⁴ D. A. Wyatt (n 933) 44.

in corporate control is compatible with the ECJ's approach towards restrictions on free movement of capital.

Yet, this equity limitation could be preserved in the corporate constitution if it is justified in accordance with mandatory requirements in the general interest. The ECJ in *Bosman*¹¹¹⁵ had accepted that individuals could justify their actions infringing fundamental freedoms by reference to mandatory requirements in the general interest. For example, a company engaged with business in the media sector could invoke the public interest in press diversity in order to justify such an equity limitation.¹¹¹⁶ With regard to available justifications, in *Viking*, the ECJ stated that Article 43 EC Treaty is to be interpreted to the effect that collective action, which seeks to induce an undertaking whose registered office is in a given Member State to enter into a collective work agreement with a trade union established in that State and to apply the terms set out in that agreement to the employees of a subsidiary of that undertaking established in another Member State, constitutes a restriction within the meaning of that article. It held that this restriction may, in principle, be justified by an overriding reason of public interest, such as the protection of workers, provided that it is established that the restriction is suitable for ensuring the attainment of the legitimate objective pursued and does not go beyond what is necessary to achieve that objective.¹¹¹⁷ Judging the ECJ's stance in *Viking* towards the justifications invoked, the ECJ seems hesitant to

¹¹¹⁵ Case C-415/93 *Bosman*, [1995] ECR I-4921 paras. 85-86.

¹¹¹⁶ Reuters contains a similar provision in its corporate constitution. Case C-368/95 *Familiapress* [1997] ECR I-3689. D. A. Wyatt (n 933) 44. In *Mikhaniki A.E.*, the ECJ held among other things that the role of manager or shareholder of an undertaking active in the media sector is not incompatible with the role shareholder or management of an undertaking which contracts with the State. It stated that Community law must be interpreted as precluding a national provision which, whilst pursuing the legitimate objectives of equal treatment of tenderers and of transparency in procedures for the award of public contracts, establishes an irrebuttable presumption that the status of owner, partner, main shareholder or management executive of an undertaking active in the media sector is incompatible with that of owner, partner, main shareholder or management executive of an undertaking which contracts with the State or a legal person in the public sector in the broad sense to perform a works, supply or services contract. Case C-213/07 *Mikhaniki A.E. v Ethniko Simvoulío Radioteleorasis, Ipourgos Epikpatias; Interveners: Pantekhniki A.E., Sindesmos Epikhiriseon Periodikou Typou*, nry.

¹¹¹⁷ Case C-438/05 *Viking* [2007] ECR I-10779 para. 90.

accept such justifications and to allow private parties to protect mandatory requirements by their actions.

17.5) Defensive conduct of the offeree company's board against a takeover bid.

In addition to the provisions of a corporate constitution, action taken by the board of a company could also deter a potential bidder from launching a takeover bid and, thus, from investing in this company.¹¹¹⁸ The measures described in Article 9(2) of the Takeover Bid Directive seem to constitute such an action. According to this provision, the board of the offeree company must not adopt any measures, apart from seeking alternative bids, which could frustrate a takeover bid; such defensive measures are permitted, only if they are authorized by the general meeting of shareholders after the launch of the bid. It is interesting to mention here that Article 9(3) states that as regards decisions taken before the beginning of the crucial period of Article 9(2) and not yet partly or fully implemented, the general meeting of shareholders shall approve or confirm any decision which does not form part of the normal course of the company's business and the implementation of which may result in the frustration of the bid. Thus, Article 9(3) introduces an exception from Article 9(2). The term 'not yet partly or fully

¹¹¹⁸ D. A. Wyatt (n 933) 44.

implemented' is quite ambiguous. It is a very subtle point whether a decision is not partly or fully implemented. Further details were required here.¹¹¹⁹

In the 2002 Commission's proposal for a Takeover Bid Directive¹¹²⁰, it was stressed that in corporate control transactions only the target company's shareholders are entitled to decide on the acceptance or the rejection of the bid. The board of the offeree company could only take measures which ameliorate the position of shareholders, e.g. by seeking for alternative bids which would boost the premium offered. If shareholders consider a specific public offer as unsatisfactory, their general meeting could authorize the board of the company to adopt the necessary defensive measures against this inadequate bid. Only a general meeting resolution could authorize the adoption of these defensive measures by the ECJ. This might be interpreted as 'shareholders' consent' for the restriction of their rights to sell their shares to the bidder. However, there are special safeguards attached to this process of granting 'consent' for any restrictions introduced by the board: Article 11(3) of the Takeover Bid Directive does not permit any restrictions on voting rights or any multiple voting shares which could distort the decision-making process.

Moreover, the Takeover Bid Directive does not define the measures which can frustrate a bid. In general, such measures may be all operations which are not carried out in the normal course of the company's business or not in conformity with normal market practices.¹¹²¹ The Commission's view on this point fits with our prior approach to normal market behaviour. A market behaviour of one market operator which is not normal could inhibit the exercise of a fundamental freedom of another market operator.

¹¹¹⁹ B. Clarke 'Takeover Regulation- through the Regulatory Looking Glass' [2007] GermLJ 381, 395.

¹¹²⁰ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (COM/2002/0534 final) [2003] OJ 45E/1 p.8.

¹¹²¹ Proposal for a Directive of the European Parliament and of the Council on Takeover Bids (COM/2002/0534 final) [2003] OJ 45E/1 p.8.

¹¹²² It is clear that the Commission, in its 2002 proposal, considered defensive measures within the framework of Article 9(2) as not being carried out in the normal course of the company's business and as not being in conformity with normal market practices.¹¹²³ This statement indicates that unauthorized defensive measures aiming at the frustration of a bid constitute market behaviour which is not normal. But the broad definition of defensive measures contained in Article 9(2) of the Takeover Bid Directive, does not necessarily mean that all defensive measures incompatible with Article 9(2) would also infringe the freedom of establishment.¹¹²⁴ In its proposal, the Commission stated that the proposed directive did not define the measures which can frustrate a bid, i.e. which can infringe the freedom of establishment. This implies that the Commission did not envisage a definition for unauthorized defensive measures encompassing these defensive measures in total. Only measures capable of frustrating a bid and subsequently of breaching the freedom of establishment could fall within this definition.

One example of defensive measure which breaches Article 9(2) but which does not infringe the freedom of establishment is the following: the case of a company where its general meeting authorizes the board in advance of any bid being launched to adopt certain defensive measures against inadequate bids.¹¹²⁵ This conduct clearly violates Article 9(2) of the Takeover Bid Directive because this provision allows authorization only after the launch of the bid when its terms and conditions are published.

¹¹²² D. A. Wyatt (n 933) 46.

¹¹²³ D. A. Wyatt (n 933) 46.

¹¹²⁴ D. A. Wyatt (n 933) 46.

¹¹²⁵ D. A. Wyatt (n 933) 46. Despite the fact that shareholders benefit from the frustration of certain inadequate bids, another approach stresses the importance of the disclosure of the bid before the launch of defensive measures. Defensive measures that have been authorized by the general meeting being fully informed on the conditions of the bid do not constitute barriers on the market in corporate control. Any defensive measures which are not authorized by the general meeting or which are authorized by the general meeting before being informed on the exact terms and conditions of the bid must be scrutinized in the light of the fundamental freedoms. The latter defensive measures do not necessarily infringe freedom of establishment, if they have a wealth-enhancing impact on shareholders. G. Kemperink and J. Stuyck (n 1033) 118.

Nonetheless, this conduct seeks to protect shareholders of the offeree company from inadequate public offers and to enhance the positions of the offeree company in the negotiations on level of the premium. These defensive measures strengthen the position of the potential target company in the EU market for corporate control. The board of the company would frustrate inadequate bids but would welcome any bids satisfying the standards set by the shareholders. By authorizing the board in advance of any bid being launched to adopt certain defensive measures against inadequate bids, the shareholders improve their market position vis-à-vis bidder who plan to buy a shareholding in this company through a takeover bid. It was argued that non-discriminatory actions of a market participant aiming at improving his market position vis-à-vis his competitors, suppliers or customers does not constitute restrictions on the fundamental rights of others.¹¹²⁶ When the shareholders of a company protect their interests and seek to secure better conditions for the tender offer process (e.g. by receiving a higher premium), then the exercise of the freedom of establishment by the bidder is not infringed. The shareholders of the offeree company might not want to consider bids not fulfilling certain minimum standards.

It should be assumed that this prior authorization is not discriminatory and is addressed to all inadequate bids. The prior authorization should not exclude bids launched by certain categories of shareholders (e.g. non nationals) because then it would restrict access to the market in corporate control of other bidders. The prior authorization should focus only on economic criteria of what bid is adequate and which is not. It should be stressed that the prior authorization to adopt defensive measures against insufficient bids should be detailed and should specify which bids are

¹¹²⁶ D. A. Wyatt (n 933) 46.

considered to be insufficient and which are not. Only then, the risk of an abusive use¹¹²⁷ of this prior authorization would be avoided. In this line of argument, Article 10(1)(i) of the Takeover Bid Directive demands all listed companies, even if they are no indications of an imminent takeover bid, to disclose information on the powers of board members, and in particular the power to issue or buy back shares. This disclosure duty would increase transparency by revealing if certain powers of board member constitute normal market behaviour or not.

Even if the Takeover Bid Directive allows certain opt-outs, national law has to be in conformity with EU law. When the EU legislature adopts full harmonization, national measures must be examined in the light of the provisions of the harmonizing instrument and not of the fundamental freedoms.¹¹²⁸ Notwithstanding this rule, exceptions apply to cases where a directive only determines a minimum standard and Member States can adopt stricter provisions. In these latter cases, the implementing provisions are scrutinized on the basis of the Treaty provisions on the fundamental freedoms.¹¹²⁹ The opt-out provisions of the Takeover Bid Directive seem to allow Member States to preserve or to introduce national laws which are incompatible with the aims of the Directive and with market integration. Nevertheless, it could be argued that, as in the case of minimum harmonization, implementing national provisions in case of optional harmonization must also be examined in the light of the fundamental freedoms and most specifically in the light of the freedom of establishment and of the free movement of capital.¹¹³⁰

¹¹²⁷ An abusive conduct like this would also infringe the general principle of Article 3(1)(c) of the Takeover Bid Directive: ‘the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid’.

¹¹²⁸ Case C-37/92 *Vanacker and Lesage* [1993] ECR I-4947 para. 9, Case C-324/99 *Daimler-Chrysler* [2001] ECR I-9897, para. 32. M. Andenas, T. Gutt and M. Pannier (n 1027) 783.

¹¹²⁹ M. Andenas, T. Gutt and M. Pannier (n 1027)783.

¹¹³⁰ M. Andenas, T. Gutt and M. Pannier (n 1027) 785.

The fact that Article 9(2) of the Takeover Bid Directive is optional at both national and company level hints that at least some defensive measures taken by the board of a target company are against market integration. However, this situation is mitigated by the fact that the opt-out of Article 9/11 is still caught by the general principle¹¹³¹ of Article 3(1)(c) of the Takeover Bid Directive and by Article 43 EC Treaty; otherwise we would have infringement of a general principle of the Directive and consequently of a fundamental freedom.¹¹³² Any defensive measures must comply with the general principle of Article 3(1)(c) of the Takeover Bid Directive and, as a result, of Article 43 EC Treaty. This means that, in case of a national or corporate opt-out, the board of the company should obstruct only inadequate offers and should not frustrate adequate bids. Even in the case of an opt-out, the board of the company should not deprive shareholders of the opportunity to decide on the merits of an adequate bid which would be beneficial for them; otherwise, the board of the company is not acting in the interests of the company as a whole.¹¹³³ An opt-out of Articles 9 and/or 11 does not entail an opt-out of the general principles of Article 3 or a derogation from the fundamental freedom of establishment.¹¹³⁴ Whatever limitations may exist in this context on the horizontal effect of the Treaty provisions on freedom of establishment, it is argued that Member States are obliged to take all appropriate measures, i.e. having company law provisions which prevent the board from frustrating an advantageous public offer by the bidder and the shareholders' decision making, to ensure that private individuals do not interfere with the effective exercise of fundamental freedoms.¹¹³⁵ Member States should definitely take into account the liberalizing effects of the freedom of

¹¹³¹ N. Moloney (n 108) 823.

¹¹³² D. Wyatt and A. Dashwood (n 46) 884. N. Moloney (n 108) 823.

¹¹³³ D. A. Wyatt (n 933) 47.

¹¹³⁴ D. A. Wyatt (n 933) 47

¹¹³⁵ Case C- 265/95 *Commission v France* [1997] E.C.R. I-6959 and Case C-112/00 *Schmidberger* [2003] ECR I -5659. D. Wyatt and A. Dashwood (n 46) 863

establishment and the free movement of capital, when they implement the Takeover Bid Directive.

Furthermore, the indirect effect of directives could also be proved useful here. The ECJ ruled that since Member States had to take all appropriate measures to ensure fulfilment of the obligations arising out of the EC Treaty, in accordance to Article 10 EC Treaty, then the domestic courts were also obliged to interpret national provisions so that it would give full effect to EC law irrespective of whether or not it is directly effective (*Von Colson, Harz, Marleasing*).¹¹³⁶ Domestic courts must interpret national law and in particular national provisions that have been adopted for complying with the requirement of a directive, so far as possible, in the light of the directive concerned.¹¹³⁷ This strengthens the argument that a national or corporate opt-out must be interpreted in conformity with the general principles of Article 3 of the Takeover Bid Directive. The indirect horizontal effect could assist natural or legal persons in relying on national legislation when their rights are violated due to defensive measures allowed under the opt-out provisions. This national legislation should be interpreted in conformity with the general principles of Article 3 of the Takeover Bid Directive.¹¹³⁸ Therefore, the judicially developed doctrine of indirect effect could contribute to the protection of shareholders from defensive actions breaching Article 3(1)(c) of the Takeover Bid Directive.

As far as justifications are concerned, the ECJ adopted a quite restrictive approach towards the justifications that could be proposed by State-controlled companies. With regard to the available justifications, we should distinguish between discriminatory and non-discriminatory provisions. Discriminatory measures violating the free movement of

¹¹³⁶ T. Storey and C. Turner (n 842) 179. Case 14/83 *Von Colson* [1984] ECR 1891, Case 79/83 *Harz* [1984] ECR 1921, Case C-106/89 *Marleasing* [1990] ECR I-4135.

¹¹³⁷ G. Kemperink and J. Stuyck (n 1033) 127.

¹¹³⁸ G. Kemperink and J. Stuyck (n 1033) 128.

capital can be justified only on the basis of Articles 58-59 EC Treaty. The mandatory requirements of the general interest could be invoked as justifications of (indistinctly applicable) restrictions. The latter justification requires compliance with the *Gebhard* formula. The ECJ demanded the application of this formula and stressed the legal certainty requirement. When examining whether the least restrictive measure was chosen, three conditions must be fulfilled: a) the limits of the control power, b) the design of administrative proceedings and, c) the possibility of judicial review.¹¹³⁹ In a possible horizontal relationship brought before it, it could be deduced that the ECJ would not probably be less stringent towards the validity of the mandatory requirements invoked by pure private companies. A private company might not easily invoke the protection of the general interest in order to legitimise its actions which would restrict a fundamental freedom. Moreover, the allegations of the board of the company seeking to protect the interests of all the company's stakeholders and not only the interests of its shareholders could not be easily accepted by the ECJ.¹¹⁴⁰ Additionally, the approach that the ECJ followed towards the available justifications in its 'golden shares' case law is quite important for the breakthrough provision of the Takeover Bid Directive. Article 11(7) of the Takeover Bid Directive states that the breakthrough rule shall not apply either where Member States hold securities in the offeree company which confer special rights on the Member States which are compatible with the Treaty, or to special rights provided for in national law which are compatible with the Treaty or to cooperatives.

¹¹³⁹ C-483/99 *Commission v France* and paras 47-48, 50-53. Case C-503/99 *Commission v Belgium* para. 28. S. Grundmann and F. Moslein 'Golden Shares. State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' SSRN Working Paper Series < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410580 > accessed 27 January 2009, 29.

¹¹⁴⁰ G. Kemperink and J. Stuyck (n 1033) 118.

CHAPTER 18 CONCLUSION

Former Commissioner F. Bolkenstein has stated that the Takeover Bid Directive is not worth the paper that it is written on.¹¹⁴¹ He was not satisfied with the final text of the Directive which was the result of a political compromise. The Takeover Bid Directive did not achieve the aim of harmonization of the European market in corporate control, which was envisaged by the European Commission. The Commission was hoping that after all these years of efforts and negotiations, there would finally be enacted a Directive which would establish a level playing field for takeovers at EU level. The meaning of the statement above was that the Commission did not simply have objections over minor issues but that it disagreed with the key provisions of the Directive.

The Takeover Directive was one of the ten priorities outlined in the Financial Services Action Plan for the creation of a fully integrated market in financial services, which is one the last remaining areas in the process of completing the internal Market. The EU wishes to offer European businesses greater legal certainty with regard to takeover bids while protecting the interests of shareholders (and particularly minority shareholders), employees and any other interested parties.¹¹⁴² The European Commission was aware of the differences between the capital markets of the various Member States which influence national takeover regulations. These differences concerned terms of ownership patterns, structure and stage of development of the capital markets, availability of finance, the role of the banking sector and of the various

¹¹⁴¹ Bulletin Quotidien Europe 26 November 2003.

¹¹⁴² EUROPA, SCADPlus , Summaries of legislation < <http://europa.eu/scadplus/leg/en/lvb/l26012a.htm>> accessed in 7-7-2007.

institutional investors, socio-economic factors and political dimensions.¹¹⁴³ In response to these differences, the European Commission envisaged the creation of an EU market for corporate control which would promote the internal market procedure of consolidating the internal financial market, not only the market in financial services and investment but also with implications on the integration of EU industry.¹¹⁴⁴ The European Commission intended to introduce transparent rules that will apply throughout the EU to cross-border takeover bids, in the interests of all parties.¹¹⁴⁵ In this way, according to the Lisbon Agenda and to the Financial Services Action Plan, the EU seeks to promote European corporate restructuring to help boost the competitiveness of the internal market.¹¹⁴⁶

It is quite interesting to refer here to the argument against harmonization of takeovers which says that harmonization of corporate governance matters does not enhance the economic system and disrupts equilibria constituting the basis of our economic welfare. This is happening because harmonization, apart from the level playing field rationale, does not always take into account essential elements of social consensus such as the defensive mechanisms in a takeover.¹¹⁴⁷ A level playing field could not be established for those societal issues. Harmonization does not consider thoroughly essential elements of social consensus (sometimes shown by the co-determination model) which justify the social role of private business enterprises. Hence, regulatory competition is argued to be the optimal method of regulating takeovers and promoting competition among enterprise structures.¹¹⁴⁸

¹¹⁴³ B. Clarke (n 1119) 382.

¹¹⁴⁴ M. Andenas 'European Takeover Directive and the City' [1997] CoLaw 101, 103.

¹¹⁴⁵ EUROPA, SCADPlus , Summaries of legislation < <http://europa.eu/scadplus/leg/en/lvb/l26012a.htm>> accessed in 7-7-2007.

¹¹⁴⁶ EUROPA, SCADPlus , Summaries of legislation < <http://europa.eu/scadplus/leg/en/lvb/l26012a.htm>> accessed in 7-7-2007.

¹¹⁴⁷ E. Wymeersch (n 124) 321.

¹¹⁴⁸ E. Wymeersch (n 124) 321. The drafting process of the Takeover Bid Directive revealed the different political dynamics in this area. In general, British and German employer federations did not agree with an EU

Hence, apart from the optionality and the reciprocity regime, the non-frustration and breakthrough rules are also characterized by substantive deficiencies. For example, French double vote shares are not caught by these provisions. It is also not clear if restrictions on the transfer of securities or of voting rights do not apply vis-à-vis the bidder or if they are suspended. If they do not apply vis-à-vis the offeror, it means that they still apply to the contractual parties. If the restrictions are suspended, they do not produce any legal effects.¹¹⁴⁹ Furthermore, the reciprocity rule does not specify what happens in case of simultaneous bids where one offeror applies Article 9 and/or 11 and another offeror does not¹¹⁵⁰; practical difficulties may arise from a situation like this, if each offeror is treated differently. The reciprocity rule does not also explain the position of non listed offerors.¹¹⁵¹ Do they fall within the scope of this rule or not? The optional character of these provisions combined with the reciprocity rule confirm the statement of former Commissioner Bolkenstein that the Takeover Bid Directive is not worth the paper that it's written on. It is obvious that the optionality and the reciprocity rules are a blow to the efficacy of the Directive and to its practical effect on the market in corporate control. However, these deficiencies are not related only to the optional character of these provisions. There are many substantive deficiencies in these key provisions. The majority of these substantive deficiencies have to do with the fact that some defensive measures are not caught by the Directive. The fact that these defensive measures are outside the scope of the Directive is the result in some cases of political compromise (e.g cross-shareholdings and pyramid structures) and in others of

codetermination model, while trade unions supported this initiative. Nevertheless, in the area of takeover bids, different coalitions were formed. The German employer federations together with the German trade unions fought against an EU takeover regulation inspired by the UK regulatory approach. For an interesting political analysis: H.J. Callaghan 'Battle of the systems or multi-level game? Domestic sources of Anglo-German quarrels over EU takeover law and worker consultation' [2003] Northwestern University Working Paper, 1-28.

¹¹⁴⁹ M. Menjucq 'The European Regime on Takeovers' [2006] ECFR 222, 231.

¹¹⁵⁰ M. Menjucq (n 1149) 233.

¹¹⁵¹ M. Menjucq (n 1149) 233.

negligence and lack of careful policy considerations (eg competing bids and proxy voting). This opt-in/opt-out/reciprocity system, together with the deficient substance of the relevant key provisions, do not contribute to legal certainty. Opted-in Member States or companies give the impression that they are subjected to the regime of the Directive, but they can opt-out or can use the financial and share structures that are not caught by the Directive in order to avoid the application of the Directive. Moreover, the mandatory bid rule, the squeeze-out right, and the sell-out right, some of the few obligatory provisions of the Directive, present many disadvantages. For example, the quantification of the equitable price is a very difficult and subtle process and the directive does not provide the essential details for it. Member States and national supervisory authorities should be very careful when they quantify the equitable price, and when they grant an exception to it. These deficiencies of both the optional and the mandatory provisions of the directive constitute a serious disadvantage.

Member States have to decide on a number of important issues, when they transpose the Directive into their national legal systems. The transposition should follow the general principles of Article 3 of the Directive and be in accordance with the market making object of the harmonization initiative. National protectionism is hostile to the creation of an internal market. The national legislature and national supervisory authorities should always have in mind that the aim of this Directive is the protection of shareholders and the creation of a vibrant market in corporate control on EU level. The fact that the Member States could not agree and reached only a political compromise does not mean that the initial aims of the harmonization should be forgotten.

The opt-in/out system coupled with a reciprocity rule decreases significantly the potential contribution of the Takeover Bid Directive to freedom of establishment. The Commission's proposal for an EU wide take-over regime that would have made for a

more competitive Europe was modified into a regime which allows Member States to adopt protectionist opt-outs, and target companies to invoke reciprocity against bidders, both of which seem difficult to reconcile with the aims of the EC Treaty Chapter on Establishment.¹¹⁵² The fact that Article 12 of the Takeover Bid Directive authorizes at least some defensive conduct by the board of a target company which would seem to amount to an infringement of the right of establishment of a bidder constitutes a possible objection against the optionality and the reciprocity rules of the Takeover Bid Directive.¹¹⁵³ The optionality and the reciprocity regime raise doubts about its effectiveness of coordinating the national provisions aimed at protecting shareholders of the offeree company.¹¹⁵⁴ Moreover, it might be difficult to discern how it might be reconciled with the recognized need to combat distortions of EU corporate restructuring, which derive from arbitrary differences in corporate governance and management cultures.¹¹⁵⁵ It is probably national ‘adaptive mechanisms’ such as stock options and shorter service contracts, and not the optional Articles 9 and 11, which could possibly force managers to get after maximization of shareholder value.¹¹⁵⁶

Nevertheless, apart from these national mechanisms seeking to restrict the negative effects of the optionality and reciprocity regime, the Takeover Bid Directive contains certain safeguards which prohibit a wide interpretation of the optionality and the reciprocity rules. One important effect of the Directive is that takeovers at European level will no longer be left to the complete discretion of Member States. Member States will be bound by the (few) mandatory provisions of the Directive and more importantly by the general principles of Article 3. These general principles constitute an

¹¹⁵² D. A. Wyatt, A. Dashwood (n 46) 882-883.

¹¹⁵³ D. A. Wyatt (n 933) 46.

¹¹⁵⁴ B. Clarke ‘Articles 9 and 11 of the Takeover Directive (2004/25) and the market for corporate control’ [2006] JBL 355, 374.

¹¹⁵⁵ B. Clarke (n 1154) 374.

¹¹⁵⁶ A. Johnston ‘The European Takeover Directive: ruined by protectionism or respecting diversity?’ [2004] CoLaw 270, 270.

overarching guarantee which requires the respect of certain safeguards during the conduct of a takeover bid and with which (harmonized and non-harmonized) national provisions should comply. The introduction of the general principles of Article 3 follows the ideas of the Lamfalussy Report¹¹⁵⁷ on the regulation of securities markets at EU level. However, the general principles set only minimum standards for the conduct of takeover bids and Member States may lay down additional conditions and provisions more stringent than the general principles of this Directive for the regulation of bids (Article 3(2)).¹¹⁵⁸ Potentially, a better and more comprehensive shareholders' protection could arise from more stringent rules.

The fundamental freedoms constitute the cornerstone of EU company law which is a very important part of the internal market. In particular, Article 43 was found to embody one of the fundamental principles of the Community legal order and has been directly applicable in the Member States since the end of the transitional period.¹¹⁵⁹ It should be stressed that national company law can not be applied without considering the case law of the ECJ¹¹⁶⁰ on the fundamental freedoms and especially on the freedom of establishment and on the free movement of capital. Neither can EU company law directives, such as the Takeover Bid Directive, be applied without regard to the fundamental freedoms and the case law of the ECJ.¹¹⁶¹ The fundamental freedoms shall constitute a guide for the Member States when they implement EU legislation. This

¹¹⁵⁷ The Committee of Wise Men Report on the Regulation of European Securities Markets [2001].

¹¹⁵⁸ Minimum harmonization of some basic principles entails different regulation of takeovers in every Member State. B. Clarke (n 1119) 386.

¹¹⁵⁹ Case C-270/83 *Commission v France* [1986] ECR 273 para. 13. Although the Treaty provisions was claimed to have direct effect, this does not have resulted in the integration of an internal market in corporate restructuring and in financial services. S.M. Seyad 'Contribution of general principles to EC financial market integration' in U. Bernitz and others (eds) *General Principles of EC Law in a Process of Development* (Kluwer, AH Alpen aan den Rijn 2008)188-189. Additionally, it should be mentioned that the legal consequences of an applicant's successful reliance on the direct effect of a Treaty article are twofold: EC law must be applied in its entirety and the provision of national law which infringes EC law must be set aside. Case 106/77 *Simmenthal* [1978] ECR 629. J.H. Jans, R. de Lange, S. Prechal, R. Widdershoven (n 847) 84.

¹¹⁶⁰ M. Andenas 'Free movement of companies' [2003] LQR 221-225.

¹¹⁶¹ M. Andenas 'EU Company Law and the Company Laws of Europe' [2008] ICCLJ 7, 8.

overarching role of the fundamental freedoms over national legislation is more crucial in the case of optional EU legislation, such as the Takeover Bid Directive, where Member States are granted discretionary powers. Respect for fundamental freedoms by Member States entails compliance with certain common rules regulating the internal market as those common rules are interpreted by the ECJ. Thus, in case of optional harmonizing measures, the fundamental freedoms will prevent widely divergent or even conflicting implementing measures from frustrating the smooth functioning of the internal market.

Some of these EU law considerations could be questioned if they are scrutinized in the light of a Law and Economics perspective. The European Commission's legislative goal of harmonizing takeover bids at EU level was accused of lacking empirical evidence. The Directive's rationales (managerial discipline and cross-border restructuring of EU industry) were criticized for not being based on generally accepted economic theories underpinned by strong empirical evidence.¹¹⁶² The economic foundations of the harmonization of takeovers at EU level were undermined by the political compromises reached during the drafting process. The adoption of a Takeover bid Directive became an end in itself¹¹⁶³ without considering the economic effectiveness of the Directive's substantive provisions. For example the Takeover Bid Directive does not take into account the fact that defensive measures sometimes increase the premiums paid for an offeree company.¹¹⁶⁴ The Takeover Bid Directive does not allow directors from protecting shareholders from inadequate bids or from coercive bids.¹¹⁶⁵

¹¹⁶² B. Sjaafjell 'Political path dependency in practice: the Takeover Directive' [2008] YEL 395, 396.

¹¹⁶³ B. Sjaafjell (n 1162) 401.

¹¹⁶⁴ C. Bergstrom and others 'The Regulation of Corporate Acquisitions: A Law and Economics Analysis of European Proposals for Reform' Col.BLRev. 495, 510. C. Kirchner and R.W.Painter (n 547) 458.

¹¹⁶⁵ C. Kirchner and R.W.Painter (n 547) 458.

It might also follow that certain activities of the board of a target company which have the aim of frustrating a takeover bid might amount to restrictions on the freedom of establishment of the bidding company.¹¹⁶⁶ The activities of the board in order to be characterized as restrictions of freedom of establishment must comply with the *Bosman* and *Walrave* Test¹¹⁶⁷ which results in considering private operators as regulators.¹¹⁶⁸ Discriminatory conduct on the part of market operators or action which restricts access to the market of other market operators, would seem capable of amounting to a restriction on a fundamental freedom.¹¹⁶⁹ Hence, the hostile behaviour of the board (especially its expression with defensive measures) or the stance of certain activist shareholders of the target company towards the takeover bid could be characterized as a restriction of the freedom of establishment because they inhibit the bidder from exercising this fundamental freedom through the acquisition of shares (and potentially the control of the company). When the European Commission decided to propose the harmonisation of Takeover Bids at European level, it thought that the conduct of the board in general might impede the exercise of the freedom of establishment by the bidder and it did not mention all the specific impeding practices that might occur. The Explanatory Memorandum of the Commission's 2002 Proposal¹¹⁷⁰ says: 'The Directive does not define the measures which can frustrate a bid. In general, such measures may be all operations which are not carried out in the normal course of the company's business or not in conformity with normal market practices'. Furthermore, defensive measures embedded in the articles of association (like restrictions on the transfer of

¹¹⁶⁶ D. A. Wyatt and A. Dashwood (n 46) 850

¹¹⁶⁷ The collective regulation of economic activities by private operators under private law may amount to a restriction on fundamental freedoms, including non-discriminatory restrictions on access to the market. Mandatory requirements in the general interest may be invoked in order to justify these restrictions. Case C-415/93 *Jean Marc Bosman* [1995] ECR I-4921 and Case 36/74 *B.N.O. Walrave and L.J.N. Koch v Association Union cycliste internationale, Koninklijke Nederlandsche Wielren Unie et Federación Española Ciclismo*. [1974] ECR 01405

¹¹⁶⁸ D. A. Wyatt and A. Dashwood (n 46) 861

¹¹⁶⁹ D. A. Wyatt and A. Dashwood (n 46) 861

¹¹⁷⁰ COM (2002) 534 Final 8, D. A. Wyatt and A. Dashwood (n 46) 870

shares or multiple voting rights¹¹⁷¹ or special rights for the appointment of members of the management which are combated by the breakthrough rule of Article 11 of the Directive) of the target company could also be characterized as barriers to freedom of establishment because they entrench the position of the target's board or certain shareholders without improving their position in the market and restricts access to the market in corporate control by preventing such market from operating. Hence, national legislation and rules of the company's articles of association constitute restrictions in the exercise of the right of establishment by companies which do not result from the disparities between national rules in one or more Member States, but from the fact that the rules in question, or practices authorized by such rules are intrinsically capable of inhibiting cross-frontier establishment.¹¹⁷² Nevertheless, not all the activities of the board of the company result in a barrier to freedom of establishment. Non-discriminatory activities by or on behalf of market operators to improve their market position vis-à-vis their competitors or their suppliers or customers do not infringe this fundamental freedom¹¹⁷³ (e.g actions which form part of the 'normal course of company's business'- Article 9(3) of the Takeover Bid Directive).

However, the optionality regime of Article 12 of the Takeover Bid Directive seems to be inconsistent with the previous approach. An opt-out from Article 9 and/or 11 of the Takeover Bid Directive permits types of defensive behaviour which constitute restrictions on freedom of establishment. Therefore, it is inferred that these restrictions of a fundamental freedom are allowed again by the European legislature. The Commission by proposing the non-frustration rule (Article 9) and the breakthrough rule (Article 11) strongly believed that these defensive behaviours obstruct the exercise of a

¹¹⁷¹ It refers to the principle of proportionality between ownership and control

¹¹⁷² D. A. Wyatt and A. Dashwood (n 46) 870

¹¹⁷³ D. A. Wyatt and A. Dashwood (n 46) 861

fundamental freedom.¹¹⁷⁴ However, this negative situation could be alleviated by the fact that the opt-out of Articles 9 and/or 11 is still caught by the general principle¹¹⁷⁵ of Article 3(1)(c) of the Takeover Bid Directive and Article 43 EC Treaty; otherwise there would be an infringement of a general principle of the Directive and consequently of a fundamental freedom.¹¹⁷⁶ Hence the defensive behaviour should respect the meaning of the general principle of Article 3(1)(c) of the Takeover Bid Directive and, as a result, of Article 43 EC Treaty. Whatever limitations may exist in this context on the horizontal effect of the Treaty provisions on freedom of establishment (and on free movement of capital), it is argued that Member States are obliged to take all appropriate measures, i.e. having company law provisions which prevent the board from frustrating the public offer of the bidder and the shareholders' decision making, to ensure that private individuals do not interfere with the effective exercise of fundamental freedoms.¹¹⁷⁷

Of course, optionality and reciprocity do not diminish totally the importance of the Takeover Bid Directive for Member States not possessing a sophisticated regulatory framework for takeover bids and its significance as an internal market measure. Many Member States had introduced new takeover legislation before the adoption of the Directive¹¹⁷⁸ but the Takeover Bid Directive guides them towards a common direction and limits totally divergent regulatory approaches. While it was argued that a directive

¹¹⁷⁴ D. A. Wyatt and A. Dashwood (n 46) 883

¹¹⁷⁵ N. Moloney (n 108) 823. S. Schwarcz declares that although principles-based regulation is thought to more closely achieve normative goals than rules, the extent to which that occurs can depend on the enforcement regime. A person who is subject to unpredictable liability is likely to attach to the most conservative interpretation of the principle especially where that person would be a potential deep pocket in litigation. This creates a paradox: Unless protected by a regime enabling one in good faith to exercise judgement without fear of liability, such a person will effectively act as if subsequent to a rule and, even worse, an unintended rule. S. Schwarcz, 'The "Principles" Paradox', Duke Law School Legal Studies Research Paper Series, Research Paper No. 205, March 2008, 1. This view could have significant influence on the interpretative approach of the Takeover Directive's general principles that could follow both the Member States which should implement the Directive and the company's board which could frustrate a bid.

¹¹⁷⁶ D. A. Wyatt and A. Dashwood (n 46) 884. N. Moloney (n 108) 823.

¹¹⁷⁷ Case C-265/95 *Commission v France* [1997] E.C.R. I-6959 and Case C-112/00 *Schmidberger* [2003] ECR I-5659. D. A. Wyatt and A. Dashwood (n 46) 863

¹¹⁷⁸ B. Clarke (n 1119) 386.

without Articles 9, 11 and 12 would have been simpler and clearer¹¹⁷⁹, the slow move towards a common regulatory approach would have never started without these articles. More specifically, the reciprocity rule might contribute to an indirect harmonization because it could urge companies to opt in voluntarily since an offeree company could also be an offeror under other circumstances.¹¹⁸⁰ Thus, this may result in a trend towards convergence of national laws on takeover bids or towards convergence of rules applied voluntarily by listed companies.¹¹⁸¹ Although the non-frustration and the breakthrough rules are diluted due to the optionality and reciprocity regime, they constitute a common legal framework for the EU. The directive provides certain minimum safeguards for minority shareholders. Additionally, without Articles 9, 11 and 12, the general principles of Article 3 would not be so important. The importance of the mandatory provisions of the Takeover Bid Directive such as the general principles of Article 3, the mandatory bid rule, the equitable price rule, the disclosure and transparency provisions, the endorsement of the information and consultation rights of employees and the possibility for individual companies to opt in Article 9 and/or 11 should not be underestimated. Even if these mandatory provisions are characterized by various deficiencies, they impose some minimum harmonized standards at EU level. Nobody could exclude the possibility of a removal of the opt-out and reciprocity regime and of the various substantive deficiencies in a future amendment of the directive. However, the Directive, in its current form, is not capable of altering decisively cultural or institutional obstacles to the creation of a market for corporate control but it can contribute to a movement in this direction.¹¹⁸²

¹¹⁷⁹ J. Simon 'OPA: divine surprise ou faux semblant?' [2003] *Euredia* 229. M. Menjucq (n 1149) 223.

¹¹⁸⁰ M. Menjucq (n 1149) 235.

¹¹⁸¹ M. Menjucq (n 1149) 235.

¹¹⁸² M. Andenas 'European Takeover Directive and the City' [1997] *CoLaw* 101, 102.

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