Article

The Defensive Measures in case of Takeover under German Takeover Act and Delaware Corporate Law

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I. INTRODUCTION

The distinct features of German corporate governance are the supervisory board and works council labor codetermination. In comparison with the market-driven American model, the German model is codetermined and bank-centered.[1] Therefore, the corporation's social responsibility is different between the American and German models. The American corporation model customarily requires shareholder primacy; on the contrary, the German corporation is required to operate for the common good of shareholders, employees, creditors and communities.[2] With the growing importance and penetration of American economic and social methods in Europe, the tension between European and American political economics and its relationship to the theory and practice of corporate governance has become a very important issue.[3] With globalization, the Europeans have faced the pressure of the giant corporations resulting from the takeover wave since 1980's in the United States. In response, the European Union has tried to harmonize the various legal systems among its member states. The challenge is a tough task for the European Union due to a variety of culture, languages and national traits. The German legal system represents the features of civil law system. The German corporations have also faced the pressure of globalization and takeover wave from the other side of the Atlantic. Delaware offers the most important and resourceful corporate law jurisdiction in the United States; therefore, the influence of the Delaware takeover defensive measures is considered in this paper in order to find a reasonable way.

Hostile takeover is one of the corporate governance mechanisms to compel managers to act in a shareholder-oriented way. Share prices will fall when managers lack shareholder orientation. As a result, lower share prices create incentives for takeovers, because the new owners may increase shareholder orientation, make profits, and boost share prices. Thus, managers ought to act in a shareholder-oriented manner in order to prevent hostile takeover from the outside world. It is widely accepted that

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1. *See* John W. Cioffi, *Review Essay: State of the Art: A Review Essay on Comparative Corporate Governance, The State of the Art and Emerging Research*, 48 AMERICAN JOURNAL OF COMPARATIVE LAW 506 (2000).

2. *See* Symposium, *Corporate Social Responsibility: Paradigm or Paradox?*, 84 CORNELL LAW REVIEW, Jul. 1999, at 1290.

3. *See* Mark G. Robilotti, *Recent Development: Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARVARD INTERNATIONAL LAW JOURNAL 538 (1997); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE LAW JOURNAL 1927 (1993); York Schnorbus, *Tracking Stock in Germany: Is German Corporate Law Flexible Enough to Adopt American Financial Innovations?*, 22 UNIVERSITY OF PENNSYLVANIA JOURNAL OF INTERNATIONAL ECONOMIC LAW 543 (2001).

markets for hostile takeovers are critical features of a shareholder-oriented corporate governance system. Due to the concentrated ownership of shares and the codetermination on the supervisory board, a hostile takeover of a German public corporation is not possible without support by incumbent block shareholders. Like German system lacks hostile takeover practice,[4] however, the emergence of markets for hostile takeovers in Europe[5] leads to more market-driven and liberal directions.[6]

II. THE GERMAN CORPORATE LANDSCAPE

The German business organizations system has developed four main forms of business enterprises: offene Handelsgesellschaft (unlimited liability company), Kommanditgesellschaft (limited partnership), Gesellschaft mit beschränkter Haftung (limited liability company), and Aktiengesellschaft (stock corporation). The Gesellschaft mit beschränkter Haftung is similar to the closely held corporation in the American system. Only the Aktiengesellschaft is eligible to be traded publicly on the stock exchange, and is therefore the closest equivalent to the American publicly traded corporation.[7] The following discussion is limited to the stock corporation.

A. *Ownership structure and role of banks*

German corporate governance is closely tied to the structure and operation of financial system and plays a very important role in the structural adjustment of national economics — the social market economy (Soziale Marktwirtschaft).[8] The ownership structure of German corporation is concentrated and banks, state, works councils and labor

4. The first and only successful hostile takeover of a German company by a foreign company took place in November 1999. The British Vodafone paid over 372 Euros per share for German Mannesmann with the goal of creating the world's largest telecommunications company. *See* Theoder Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 17/2003, Nov. 2003, at 37; Mark J. Loewenstein, *What can we learn from foreign Systems?: Stakeholder Protection in Germany and Japan*, 76 TULANE LAW REVIEW 1682 (Jun. 2002).

5. EU Takeover Directive was enacted in 2001.

6. *See* Martin Hoepner, *European Corporate Governance Reform and the German Party Paradox*, MAX-PLANCK-INSTITUT FUER GESELLSCHAFTSFORSCHUNG DISCUSSION PAPER 03/2004, Mar. 2003, at 7.

7. *See* Franck Chantayan, *An Examination of American and German Corporate Law Norms*, 16 ST. JOHN'S JOURNAL OF LEGAL COMMENTARY 431, 434 (2002).

8. *See* John W. Cioffi, *Review Essay: State of the Art: A Review Essay on Comparative Corporate Governance, The State of the Art and Emerging Research*, 48 AMERICAN JOURNAL OF COMPARATIVE LAW 505 (2000).

unions which limit the power of shareholders.[9] Individual stock ownership is very low in Germany in comparison to the United States. Although the situation has changed, especially after the privatization of Deutsche Telekom AG (German Telecommunication Corporation) in late 1996,[10] large banks[11] and other institutional investors such as insurance companies[12] still own large blocks of stocks.[13]

The large German universal banks use long-term equity stakes in customers' companies to stabilize their earnings streams and support their deposit-taking and lending business. The banks seek stable earnings but shareholders seek profits, therefore in a conflict of interests between banks and other shareholders. As a result, the cross-ownership stakes are prevailing in German corporations. Therefore, the American principal-agent model of corporate governance is inconceivable. On the other hand, banks control over German corporations due to the high concentration of ownership, proxy votes and board membership.

German banks may lawfully offer a full range of commercial banking and investment banking services. Since the merger and hostile takeover fever began in Germany, banks have furthermore acted as initiators, advisors and financiers of acquisitions and mergers.[14] Banks play a crucial role in German corporate control because they exercise their influences on corporate control by proxy voting and supervisory board seats.[15] Banks were very important in a distinctive style of German industrial development. They not only provided capital, but also coordinated investment decisions among small firms and assisted in cartelizing markets.[16] Because banks are creditors, they have different

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9. *See* Martin Hoepner, *European Corporate Governance Reform and the German Party Paradox*, MAX-PLANCK-INSTITUT FUER GESELLSCHAFTSFORSCHUNG DISCUSSION PAPER 03/2004, Mar. 2003, at 7.

10. *See* Thomas J. Andre, Jr., *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideolgies to Germany*, 73 TULANE LAW REVIEW 98 (Nov. 1998).

11. The three banking giants in Germany are Deutsche Bank, Dresdner Bank and Commerzbank.

12. The insurance giant is Allianz.

13. *See* Mark J. Loewenstein, *What can we learn from foreign system?: Stakeholder Protection in Germany and Japan*, 76 TULANE LAW REVIEW 1678 (Jun. 2002).

14. *See* Susan-Jacquline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 560 (2000).

15. *See* Hoepner & Jackson, *An Emerging Market for Corporate Control? The Manmesmann Takeover and German Corporate Governance*, MAX-PLANCK-INSTITUT FUER GESELLSCHAFTSFORSCHUNG DISCUSSION PAPER 01/2004, Sep. 2001, at 18; Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE LAW JOURNAL 1942, 1945 (1993); Susan-Jacquline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 560 (2000).

16. *See* David Charny, *The German Corporate Governance System*, COLUMBIA BUSINESS LAW REVIEW 157 (1998).

goals and value than pure dividend-oriented shareholders. Thus, it may mean a different corporate policy than maximizing the profit for a pure financial shareholder.[17]

The most important provision of voting rights deviating from ownership is the German proxy–voting system. Art. 135 Aktiengesetz (Stock Corporation Law) regulates how shareholders can name proxy agents as their representatives at the annual general shareholders' meeting. The proxy vote may be cast by any organization, bank, or other agent of the shareholders. The shareholder has the option to reveal his name, regardless of whether he provides explicit instructions how to vote his shares or not. Typically, shareholders remain anonymous, deposit their shares with banks, and grant general power of attorney to that bank with respect to all shares in their portfolio. The German stock market is dominated by large institutional shareholders. Thus, banks and insurance companies are closely related through direct ownership and voting control. Especially, universal banks exercise their depository voting rights and are usually also members of the supervisory board.

B. *Two-tier board structure*[18]

German corporations have two-tier boards which consist of a management board[19] and a supervisory board[20] with a system called codetermination which comprises one-half of employee-elected directors and one-half of shareholder-elected directors. According to the Codetermination Act of 1976,[21] all stock corporations and all other business entities such as limited liability company, a partnership limited by shares and limited liability partnership, must have a two-tiered board structure that includes the management board and the supervisory board with employee representation. For entities that have between 500 and 2000 employees, one-third of the supervisory board members must be employee representatives; for enterprises which have 2000 or more employees, one-half of the supervisory board members must consist of

17. *See* Patrick Speeckaert, *Corporate Governance in Europe*, 2 FORDHAM FINANCE, SECURITIES AND TAX LAW FORUM 34 (1997).

18. Within the European countries, the United Kingdom, Ireland, Italy, Spain, Portugal and Greece have the one-tier board structure, while Germany, Switzerland, Austria, the Netherlands and the Scandinavian countries have two-tier system. France and Belgium have a mixed system with both board forms available. *See e.g.*, Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, *in* COMPARATIVE CORPORATE GOVERNANCE 232 (Klaus J. Hopt et al. (eds.), Oxford, 1998); Mark G. Robilotti, *Recent Development, Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARVARD INTERNATIONAL LAW JOURNAL 546, 547 (1997).

19. Art. 76 Aktiengesetz.

20. Art. 96 Aktiengesetz.

21. Bundesgesetzblatt I S. 1153.

employee representatives, and some of these must be representatives of the labor unions.[22] Thus, the different board members may have different values and interests. Different social and financial responsibilities are taken into account.[23] However, the representatives elected by the shareholders and the representatives of the employees are equally obliged to act in the best interests of corporation.

The general shareholders' meeting which is the highest institution[24] of German corporation elects the members of the supervisory board.[25] Subsequently, the supervisory board appoints the representative members of the management board for at most 5 years.[26] According to the German Stock Corporation Law, the supervisory board is responsible for overseeing the board of management, examining the corporation's books, reviewing its assets, giving approval for certain management decisions, and calling a shareholder meeting when it is in the corporation's best interest.[27] Although the supervisory board cannot make management decisions, it can determine that certain actions to be taken by the management board require its prior approval.[28] The management board and the supervisory board are together responsible for the corporate governance in German stock corporations.

To sum up, German shareholders have no authority to give instructions to the management board. It is the main task of the supervisory board to supervise the management activities of the management board. The management board decides the details of management and is responsible for conducting the affairs of the corporation and representing the corporation in all matters, including court proceedings.[29] In function, the German board of management is similar to the American board of directors.[30] However, the supervisory board has the power to remove the management board if the shareholders'

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22. *See* Mark J. Loewenstein, *What can we learn from foreign system?: Stakeholder Protection in Germany and Japan*, 76 TULANE LAW REVIEW 1677 (Jun. 2002).

23. *See* Patrick Speeckaert, *Corporate Governance in Europe*, 2 FORDHAM FINANCE, SECURITIES AND TAX LAW FORUM 34 (1997).

24. *See* Susan-Jacqueline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 570 (2000).

25. Art. 103 Aktiengesetz.
Art. 95 Aktiengesetz indicates number of members to supervisory board is based on capital amount of corporation, with three board members as miminum number, unless articles of incorporation provide for greater number. Corporations with more than 10,000,000 Euro have maximum number of twenty-one board member.

26. Art. 84 (1) Aktiengesetz.

27. Art. 111 Aktiengesetz.

28. Art. 90 Aktiengesetz.

29. Art. 76 (1) and 78 (1) Aktiengesetz.

30. *See* Franck Chantayan, *An Examination of American and German Corporate Law Norms*, 16 ST. JOHN'S JOURNAL OF LEGAL COMMENTARY 438 (2002).

meeting passes a vote of no confidence against the management board.[31] The supervisory board plays the strategic oversight role while the management board performs the day-to-day management. There may be no membership overlaps between the two boards.

C. *Codetermination*

The unique characteristic of German corporate governance is the codetermination on the supervisory board. The corporate governance structure has been made up from various interests and representatives since the post-war society and polity in Germany.[32] Besides the stakeholder conception of governance, employee representatives take part in the governance by their codetermination on the supervisory board. Thus, the German corporate governance model combines with economic interests, ideological commitments, and social values.[33]

The codetermination permits the company's employees to take part in the decision-making process.[34] Although shareholder representatives have ultimate voting control of a tie vote on a major corporate decision,[35] employee representatives may compel the supervisory board to give greater considerations to the social consequences of their actions, especially the potential outcomes of unemployment and relocation of the plants. Thus, the influence of employee representatives on the decision-making of the supervisory board may not be ignored. Any takeover plan must be approved on the supervisory board but the shareholders can never attain the approval of the entire supervisory board due to the codetermination of employee representatives. That is the most important reason why takeover is still unknown and unsuccessful in Germany. Hostile takeover is still very unpopular with trade unions and labor but also among large parts of German industry and German press. Politicians confronted this topic for reelection with great care.[36]

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31. Art. 84 (3) Aktiengesetz.

32. The non-shareholder interests were regulated explicitly by a new business corporations statute in 1937, Hitler's government. *See* Mark G. Robilotti, *Recent Development: Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARVARD INTERNATIONAL LAW JOURNAL 550 (1997).

33. *See* Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, *in* COMPARATIVE CORPORATE GOVERNANCE 236-237 (Klaus J. Hopt et al. (eds.), Oxford, 1998).

34. *See* Susan-Jacqueline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 561 (2000).

35. In the event of the tie vote, the chairman of the supervisory board elected from the shareholder members will cast the tie-breaking vote.

36. *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 4.

III. THE GERMAN TAKEOVER ACT

The British Telecommunications firm Vodafone undertook takeover of the German industrial giant Mannesmann in 1999 — 2000. This event impelled the German Federal Government to seriously reconsider the restructure of the German corporate and securities law. Thus, the German legislature engaged in the topics of takeover.[37] The German Takeover Act[38] came into effect on January 1, 2002 and contains anti-takeover provisions.

A. *Background of enacting the Takeover Act*

1. *Failure of the EU Takeover Directive*

The European Commission attempted to harmonize takeover law among the Member States since 1974[39] and proposed Thirteenth Directive governing corporate takeovers throughout the European Union in 1989.[40] However, the European Union Parliament did not pass this proposed Thirteenth Directive in July 2001.

The Thirteenth Directive is principally based on the London City Code which is a voluntary agreement concluded by financial institutions in the city of London. Tender offers in the United Kingdom are regulated by the Panel on Takeovers and Mergers, a self-regulatory organization that functions pursuant to the City Code on Takeovers and Mergers.[41] The Thirteenth Directive prohibits target company directors from taking defensive measures against hostile takeover bids unless such measures are authorized by a general shareholders' meeting that takes place during the period of the takeover bid.[42] On the other hand, the proposed Thirteenth Directive restricts the conduct of the bidding corporation in order to protect the target company's shareholders against partial bids. The Member States have to adopt rules that protect minority shareholders, including a "mandatory bid" rule requiring an offeror that acquires a control block of a company's stock to offer an "equitable price" in cash or liquid securities for all of the shares of the company.[43]

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37. *See* Peer Zumbansen, *European Corporate Law and National Divergences: The Case of Takeover Regulation*, 3 WASHINGTON UNIVERSITY GLOBAL STUDIES LAW REVIEW 878 (2004).
38. Wertpapiererwerbs- und Uebernahmegesetz vom 20. Dezember 2001, BGBl. I. S. 3822.
39. EC-Commission DOC XI/56/74.
40. COM (88) 823 final, OJC 64/8 of Mar. 14, 1989.
41. *See* Christian Kirchner & Richard W. Painter, *Takeover Defenses under Delaware Law, the Proposed Thirteenth EU Directive and the new German Takeover Law: Comparison and Recommendations for Reform*, 50 AMERICAN JOURNAL OF COMPARATIVE LAW 476 (2002).
42. Art. 8 (1)(a) of proposed Thirteenth Directive.
43. Art. 5 of the proposed Thirteenth Directive.

2. *Development of German Takeover Act*

The Federal Ministry of Finances established a private advisory body (Börsensachverständigenkommission) under a voluntary Takeover Code in 1975 to operate the takeover issue. The German Takeover Code was a self-regulation.[44] Most German corporations have signed the Takeover Code; however, the Takeover Code is only a voluntary agreement and not binding on the corporations which did not sign.[45] Among the German stock exchange DAX 30 companies, the most prominent companies like BMW and Volkswagen still refused acceptance of Takeover Code.[46] Due to the unique corporate structure and the fear[47] of takeover wave to Germany, the German Federal Government strongly opposed the proposed EU Thirteenth Directive.[48] The new Takeover Act which adopted the Takeover Code was passed in December 2001 and became effective on January 2002. The German legislature empowered the management board of the target company to take defensive measures against hostile bids without prior approval from the shareholders' meeting.[49]

B. *The crucial role of the Supervisory Board and the Shareholder Meeting in Anti-takeover*

§ 33 of the Takeover Act provides (1) after the publication of the decision to make an offer until publication of the results of the offer under § 23 (1) Sentence 1, Number 1, the management board of the target company may not implement any measures by means of which the success

44. *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 3.

45. *See* Christian Kirchner & Richard W. Painter, *Takeover Defenses under Delaware Law, the Proposed Thirteenth EU Directive and the new German Takeover Law: Comparison and Recommendations for Reform*, 50 AMERICAN JOURNAL OF COMPARATIVE LAW 463 (2002).

46. *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 30.

47. For example, German Chancellor Schroeder opposed the EU Thirteenth Directive of cross-border takeover and said, "hostile takeovers were never helpful, because they destroyed corporate cultures and undermined employees' commitment to their companies." *See* Scott Mitnick, *Cross-border Mergers and Acquisitions in Europe: Reforming Barriers to Takeovers*, COLUMBIA BUSINESS LAW REVIEW 683 (2001).

48. *See* Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 17/2003, Nov. 2003, at 38; Peter O. Müelbert, *Make It or Break It: The Break–Through Rule as a Break–Through for the European Takeover Directive?*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 13/2003, Aug. 2003, at 6.

49. *See* Peer Zumbansen, *European Corporate Law and National Divergences: The Case of Takeover Regulation*, 3 WASHINGTON UNIVERSITY GLOBAL STUDIES LAW REVIEW 880 (2004).

of the offer could be prevented. This does not apply to measures that an ordinary and informed manager of a company not affected by a takeover bid would also carry out, to the search after a competing offer, or to measures that the supervisory board of the target company has consented to. (2) Authorization from a shareholders' meeting, that before the time period of the offer authorizes a management board to undertake that fall within the authority of the shareholders' meeting and that will prevent the success of the offer, shall specify the general type of measures in the authorization. The authorization can be given for at most 18 months. The decision at the shareholders' meeting requires a majority of at least three-fourths of the capital stock that is represented at the passing of the resolution. The by-laws can set forth a larger majority of the shares and additional requirements. Measures of the management board pursuant to the first sentence require the agreement of the supervisory board. (3) It is forbidden for the bidder and persons working together with the bidder, in connection with the offer to grant or to promise unjustifiable payment or other unjustifiably valuable advantages to the management board members or to the supervisory board members of the target company.

The German Anti-takeover Act empowers the supervisory board to defend against the hostile takeover. According to § 33 (1), the management board of the target company may take defensive measures only upon approval of the supervisory board, without first going to the shareholders' meeting for prior approval. Due to the codetermination system, the supervisory board actively takes part in the corporate governance. The conflicts of interests in the supervisory board, especially the interests of employees, result in more difficult obstacles to the takeover bid than before. Takeover offers frequently accompany the restructure and reduction of workforce due to the efficient allocation of resources. The fear of unemployment and the powerful influence of the trade unions become a very decisive factor to oppose the takeover offer in the supervisory board. Obviously, the regulatory and structural barriers to takeovers that exist seriously in Germany are the subjects of a particular concern.[50] In addition, the block shareholders[51] and the large commercial banks — Deutsche Bank, Dresdner Bank, Commerz Bank — with the concentrated voting rights control over the supervisory board and make the hostile takeover offer hardly possible.[52]

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50. *See* Clas Bergstrom, Peter Hogfeldt, Jonathan R. Macey & Per Samuelsson, *The Regulation of Corporate Acquisitions: A Law and Economics of European Proposals for Reform*, COLUMBIA BUSINESS LAW REVIEW 504 (1995); Jeffrey N. Gordon, *An American Perspective on the New German Anti-takeover Law*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN FINANCE, No. 02/2002, at 2.

51. Family controls over a corporation very commonly in Germany, like BMW, Porsche, Siemens.

52. *See* Clas Bergstrom, Peter Hogfeldt, Jonathan R. Macey & Per Samuelsson, *The*

Post-bid defensive measures are permissible with the consent of the shareholders' meeting, which can be given in advance, or even with the mere consent of the supervisory board.[53] § 33 (2) of the Anti-takeover Act allows the shareholders' meeting before the publication of the decision regarding takeover offer to authorize the management board taking defensive measures to prevent the success of the takeover offer. Despite the prior authorization of shareholders' meeting, the defensive measures of the management board still require the agreement of the supervisory board. The supervisory board is crucial to the success of the takeover offer pursuant to the German Anti-takeover Act.

C. *The new EU Takeover Bids Directive*

Finally the EU Takeover Bids Directive[54] has entered into force on May 20, 2004. Member States shall bring into force the law, regulations and administrative provisions necessary to comply with this Directive no later than May 20, 2006. The aim is to provide an equivalent protection through the European Union for minority shareholders of companies listed on the stock exchange in the event of a change in control and to provide for minimum guidelines for the conduct of takeover bids, in particular as regards the transparency of the procedure.

The law provides a set of general principles governing public takeover bids, such as equal treatment of shareholders and shareholder protection. It also sets out the procedures to be followed before and after the announcement of the public takeover bid, the mechanics of a public takeover bid, restrictions on the offeror company after the bid is announced and the circumstances in which the initial public takeover bid can be revoked. The EU Takeover Bids Directive also includes new squeeze-out and sell-out provisions.

The Directive regulates obligations of the board of the offeree company. Although the Directive does provide for arrangements in this area, it leaves it up to Member States whether or not to apply them. The requirement that the board of the offeree company must obtain the prior authorization of its shareholders before taking any defensive action is thus optional. Member States leave it up to the companies themselves to decide whether or not to apply this rule. The requirement to freeze member states' extraordinary rights such as multiple voting rights, appointment

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Regulation of Corporate Acquisitions: A Law and Economics of European Proposals for Reform, COLUMBIA BUSINESS LAW REVIEW 506 (1995).

53. *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 4.

54. OJ 2004 L 142/12-23.

rights and restrictions on the transfer of securities during the bid is also optional. Member States leave it up to the companies themselves to decide whether or not to apply this rule. Germany transposed the new EU Takeover Bids Directive and adopted the new provisions into §§ 33a – 33d.

IV. THE PRACTICE OF TAKEOVER DEFENSES UNDER DELAWARE CORPORATE LAW

Takeover offers are common in the United States. The advantages of takeover create more efficient asset combination, more efficient management and better corporate governance structures.[55] Delaware corporate law allows the target company's board of directors to take defensive measures against takeover offers.[56]

A. *Development of Defensive Measures against Takeover*

The Delaware corporate law practice has developed different types of defensive measures against takeover offers, such as liquidations, spin-offs, recapitalizations, a white knight, poison pills, sale of crown jewels, lock-up agreements, greenmail, Pac Man defense, and golden parachutes.[57] The board of directors can retain takeover defenses if those defenses are neither coercive nor preclusive and fall within a range of reasonableness.[58] The primary exception is when the board of directors' actions have effectively put the company up for sale. Under such circumstances, the duty of the board had thus changed from the preservation of the corporate entity to the maximization of the company's value at a sale for the shareholders' benefits.[59]

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55. *See* Clas Bergstrom, Peter Hogfeldt, Jonathan R. Macey & Per Samuelsson, *The Regulation of Corporate Acquisitions: A Law and Economics of European Proposals for Reform*, COLUMBIA BUSINESS LAW REVIEW 499 (1995).

56. *See* Lucian Arye Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VIRGINIA LAW REVIEW 116 (Mar. 2001).

57. *See* Theoder Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 17/2003, Nov. 2003, at 34, 35; Gregg H. Kanter, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the Unocal Test*, 138 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 234 (Nov. 1989); John H. Matheson, *Corporate Governance at the Millennium: The Decline of the Poison Pill Antitakeover Defense*, 22 HAMLINE LAW REVIEW 729 (Spring 1999).

58. Unitrin, Inc. v. American General Corp., 651 A.2d at 1367 (Supreme Court of Delaware 1995).

59. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Supreme Court of Delaware 1986).

B. *Role of Target Company's Board*

The target company's board plays a more and more important role in the takeover offer process. The primacy of shareholders reflects the fiduciary duty of the directors to the shareholders to maximize the value of their stock. Thus, the board of directors may take anti-takeover devices and offer the shareholders with a good opportunity to tender their shares to attain the best interest and profits for the shareholders.[60]

According to § 141 (a) Delaware General Corporate Law, the business and affairs of every corporation organized shall be managed by or under the direction of a board of directors. The business judgment rule protects centralized management and allows management discretion for the business and affairs of the corporation.[61] The business judgment rule is "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[62]

The Delaware Supreme Court has developed a management discretion doctrine to allow the target company's board of directors to defend takeover bids.[63] The takeover bids frequently cause conflicts between the self-interests of the incumbent management and the shareholders' interests. The Delaware Supreme Court asserted in Unocal case that heightened scrutiny is required in reviewing takeover defenses because of "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders; there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[64] Before the business judgment rule is applied to a board's adoption of a defensive measure, the burden will lie with the board to prove (1) reasonable grounds for believing that a danger to corporate policy and effectiveness existed; and (2) that the defensive measure adopted was reasonable in relation to the threat posed.[65] The holdings of the Delaware Supreme Court provided shareholders with the power to ultimately decide the fate of hostile takeover offers.[66]

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60. *See* Gregg H. Kanter, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the Unocal Test*, 138 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 226 (Nov. 1989).

61. *See* Richard E. Kihlstrom & Michael L. Wachter, *Corporate Policy and the Coherence of Delaware Takeover Law*, 152 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 538 (Dec. 2003).

62. Aronson v. Lewis 473 A.2d 805, 812 (Supreme Court of Delaware 1984).

63. *See* Richard E. Kihlstrom & Michael L. Wachter, *Corporate Policy and the Coherence of Delaware Takeover Law*, 152 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 525 (Dec. 2003).

64. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Supreme Court of Delaware 1985).

65. Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Supreme Court of Delaware 1995).

66. Interco, 551 A.2d at 799-800 (Delaware Chancery 1988).

The Delaware Supreme Court did not apply the business judgment rule but the intrinsic fairness test to examine the substantive merits of the corporate transaction and upheld it only if the directors can demonstrate that the transaction was fair in its entirety to the corporation. The fairness included fair dealing and fair price.[67] The court must make its own evaluation of the directors' action and substitute its judgment for that of directors pursuant to the intrinsic fairness test.[68] Thus, the Delaware courts can review the anti-takeover devices of target company's board of directors and protect the best interests of the shareholders.

V. CONCLUSION – BALANCING POINT

A. *Impact of globalization on the German corporate structure*

With growing industrialization and globalization on the international capital markets, the conditions for the corporate governance have changed. To improve the competitiveness of German corporations on the international market, it is necessary to amend and adjust the conservative German corporate governance system. The frequent takeover activities since 1990 in the United States lead to more efficient securities markets because "investors in capital markets are concerned with returns on their investments and they demand efficiently run business. This has resulted in a much larger equity market with relatively liquid funds."[69] On the contrary, German securities market is less integrated with the takeovers.[70] The market for corporate control is still underdeveloped. Between the World War II and 1993, there were only four hostile takeovers in Germany.[71] The inflexible corporate structure and the conservative takeover law reflect obviously the side effects on the German capital market. The market for corporate control is very active in the United States. For example, more than 9,000 American firms are listed on the three major stock exchanges in 1997: the New York Stock Exchange, the American Stock Exchange and NASDAQ. In contrast, Germany lists only

67. Weinberger v. UOP, Inc., 457 A.2d at 710 (Supreme Court of Delaware 1983).

68. *See* Gregg H. Kanter, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the Unocal Test*, 138 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 242 (Nov. 1989).

69. *See* Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VANDERBIT JOURNAL OF TRANSNATIONAL LAW 838, 839 (Oct. 2000).

70. *See* Peter O. Mülbert, *Make It or Break It: The Break-Through Rule as a Break-Through for the European Takeover Directive?*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 13/2003, Aug. 2003, at 9.

71. *See* Julian Franks & Colin Mayer, *German Capital Markets, Corporate Control, and the Obstacles to Hostile Takeovers: Lessons from Three Case Studies*, LONDON BUSINESS SCHOOL WORKING PAPER 1 (1993).

fewer than 700 firms in the equity markets, although there are 500,000 German corporations. Stock market capitalization as a percentage of GDP is less than 40%, compared to 136% in the United States.[72]

B. *Comparison of the both corporate laws under the aspect of the separation of ownership and control*

The German Stock Corporate Law has the same principle of separation of the ownership and control as the Delaware Corporate Law. Shareholders are owner of the corporation and manager is an agent; the primacy of shareholders is the basis in the Delaware corporate structure. In short, the relationship between the corporation and directors is a fiduciary relationship. The corporate fiduciaries must exercise their duty in a good–faith. However, the shareholders' meeting is the highest organ of the German corporation. Due to the unique codetermination system, the management board and the supervisory board are together responsible for the corporate governance. There is lack of the fiduciary relationship between the management board and the corporation in the German corporate system. The management board has direct responsibility for the management of the corporation under Art. 76(1) Aktiengesetz. This responsibility reaches beyond the shareholders and includes the interest of the employees and even the common good.[73] The German Stock Corporate Law clearly provides that managers must operate the corporation for the benefit of multiple stakeholders, not just shareholders.[74] It is obviously the different interpretation of the principle of separation of the ownership and control under Delaware and German Corporate Law.

Employee representatives are members of the supervisory board and take part in the corporate governance. On the one hand, the German corporate legal system takes into account the employee's benefits and assumes the social responsibility. However, the most of the disadvantage shows the inflexibility of the whole system. The two-tier system mainly aims at the independence and the supervisory function of the supervisory board. Due to the cross-holding of the large commercial banks among the

72. *See* Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VANDERBIT JOURNAL OF TRANSNATIONAL LAW 839 (Oct. 2000).

73. *See* Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VANDERBIT JOURNAL OF TRANSNATIONAL LAW 845 (Oct. 2000); Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 32, 33.

74. *See* Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VANDERBIT JOURNAL OF TRANSNATIONAL LAW 845 (Oct. 2000).

corporations, it is doubtful whether the supervisory board can remain its independent role. In the event of takeover, the approval of the supervisory board is crucial to the success of the takeover offer. The lack of the juridical review regarding the takeover process is a flaw of the German Anti-takeover Act. The Delaware court can review whether the defensive measures against takeover offer are fair to the shareholders. Shareholders are owner of the German corporation; however, they cannot take a lawsuit to call for the juridical review whether the anti-takeover decision of the management board and the supervisory board are in the best interest of shareholders. The proxy-voting system under Art. 135 Stock Corporation Law brings about that shareholders typically remain anonymous and grant the depository banks as agent to cast their vote at the annual general shareholders' meeting. Besides, banks operate mutual funds and vote the shares by the mutual funds. Thus, the large banks can easily control over shareholders' meeting and the supervisory board.

Unlike the development in the Anglo-American corporate system, German corporate law did not develop the system of fiduciary duties.[75] There is lack of principal-agent relationship between the corporation and the management board. For example, in Delaware corporate law practice, the business judgment rule, as a standard of judicial review, is a common-law recognition of the statutory authority to manage a corporation that is vested in the board of directors.[76] The business judgment rule is a presumption that, in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the best honest belief that the action taken was in the best interests of the company and its shareholders.[77] Directors are acting as fiduciaries in discharging their statutory responsibilities to corporation and its shareholders. Under business judgment rule, corporate directors are charged with unyielding fiduciary duty to protect interests of corporation and to act in best interests of its shareholders. Duty of directors of company to act on informed basis forms duty of care element of business judgment rule. Duty of care and duty of loyalty are traditional hallmarks of fiduciary who endeavors to act in service of corporation and its shareholders; each of these duties is of equal and independent significance.[78]

The German Stock Corporation Law (Aktiengesetz) has no explicit

75. *See* Theoder Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 17/2003, Nov. 2003, at 3; Franck Chantayan, *An Examination of American and German Corporate Law Norms*, 16 ST. JOHN'S JOURNAL OF LEGAL COMMENTARY 434 (2002).

76. *See* Omnicare v. NCS Healthcare, 818 A.2d 914 (Supreme Court of Delaware 2002).

77. Emerald Partners v. Berlin, 787 A.2d 85 (Supreme Court of Delaware 2001).

78. Cede v. Technicolor, 634 A.2d 345 (Supreme Court of Delaware 1994).

provisions about business judgment rule [79] to balance groundless shareholder activism and to protect directors from liability for decisions that prove only in hindsight to have been wrong.[80] Until now, the business judgment rule gives the U.S. board of directors broader discretion than the German management board. Generally, directors are protected from liability for the consequences of their business judgment if they exercised due care, acted in good faith, and had a rational basis for the decision.[81] Although German Federal Court of Justice (Bundesgerictshof) recognizes that management board needs wide discretion in running the corporation and must consider all special circumstances and relevant facts of the particular situation before the decision-making, the absence of German jurisprudence on such determination of typical business judgment rules like in the United States.[82] The German jurisprudence adopted the business judgment rule in the landmark case ARAG/Garmenbeck in 1997 that the management board "has acted on an informed basis, in good faith in the interest of the company, upon due inquiry, and without self-interest in a situation involving disparate impacts on the respective classes."[83]

The Government Corporate Governance Commission[84] adopted the business judgment rule into the German Corporate Governance Code[85] in

79. Art. 76 I Aktiengesetz: The management is, on its own responsibility, to manage the corporation. The opinion of Professor Klaus J. Hopt is a basic provision of the business judgment rule under Art. 76 I Aktiengesetz. "The traditional interpretation of the business judgment rule for the management board under Section 76 of the German Stock Corporation Act (Aktiengesetz) is that the management board has direct responsibility for the management of the company, and that this responsibility reaches beyond the shareholders and includes the interest of the employees and even the common good. Under this opinion, the management board is neither obliged nor entitled to act solely in the interest of the shareholders. It is therefore the responsibility of the management board to balance these interests and to bring them to practical concordance." *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 21.

80. *See* Oliver Seiler, *Shareholder Participation in Corporate Decision-making under German Law: A Comparative Analysis*, 24 BROOKLYN JOURNAL OF INTERNATIONAL LAW 572 (1998).

81. *See* Susan-Jacqueline Butler, *Models of Modern Corporations: A Comparative Analysis of German and U.S. Corporate Structures*, 17 ARIZONA JOURNAL OF INTERNATIONAL AND COMPARATIVE LAW 591 (2000).

82. *See* KLAUS J. HOPT & PATRICK C. LEYENS, BOARD MODELS IN EUROPE: RECENT DEVELOPMENTS OF INTERNAL CORPORATE GOVERNANCE STRUCTURES IN GERMANY, THE UNITED KINGDOM, FRANCE, AND ITALY 5 (Hamburg, 2004).

83. *See* York Schnorbus, *Tracking Stock in Germany: Is German Corporate Law Flexible Enough to Adopt American Financial Innovations?*, 22 UNIVERSITY OF PENNSYLVANIA JOURNAL OF INTERNATIONAL ECONOMIC LAW 632 (2001).

84. The Social-Democratic Federal Government charged a commission "Government Corporate Governance Commission" with investigating corporate governance and needs for reform in German company law. *See* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks*, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW, No. 03/2002, Oct. 2002, at 25.

85. The German Corporate Governance Code is a self-regulation. The aim of the German Corporate Governance Code is to make Germany's corporate governance rules transparent for

2003. "The management board and supervisory board comply with the rules of proper corporate management. If they violate the due care and diligence of a prudent and conscientious managing director or supervisory board member, they are liable to the company for damages."[86]

C. *Summary*

To sum up, the model of Delaware anti-takeover measures has shown the advantages, especially the judicial review provides shareholders with claim for court to determine whether the takeover offer price is a fair value or whether managers accepted the tender price in self-interest at expense of shareholders. Under the principle of separation of ownership and control, shareholders are true owners of the corporations; however, shareholders have no enough rights to take part in the anti-takeover decision; there is lack of cause of action for shareholders to call for judicial review when they are not satisfied with the defensive measures of the management board. On the contrary, the supervisory board is crucial to the success of the takeover offer under the German system.

Owing to the market pressure and international competitiveness, the German corporations will move toward the classical American model of corporate governance. However, the social responsibility of corporation plays a crucial role in the German corporate philosophy. Of course, on the other hand, the change will occur slowly because of the two-tier board structure and the unique German cultural, social and historical circumstances. The unique codetermination system in the supervisory board is on the one hand a good model of the corporation's social responsibility; however, it is doubtless that the two-tier board structure is very inflexible to keep pace with the globalization. The codetermination system remains untouchable and painful for the German federal government. Thus, the developments in German corporate governance are towards improving investor protection and the functioning of the capital markets, but it is still very difficult to have a capital market-based system of corporate governance.

The new EU Takeover Bids Directive has influence on the takeover practice in Europe. Germany has transposed the provisions into its Takeover Act. It is to expect to build a level playing field for the takeover practice in the future.

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both national and international investors, thus strengthening confidence in the management of German corporations. *See* Foreword of the German Corporate Governance Code.

86. The German Corporate Governance Code 3.8.

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