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**The Annoyances of European Company Law
Cross-border Merger in Europe and Shareholder Protection**

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The Annoyances of European Company Law
Cross-border Merger in Europe and Shareholder Protection

"...the completion of the internal market...means not only that barriers to trade must be removed, but also that the structure of production must be adapted to the Community dimension"¹

"Differing definitions for stock exchange regulations, competition law, taxation, national security, minority protection, and so on will also vary greatly from country to country. (...) Defining an international or cross-border merger or acquisition might be done by saying that it is a merger when all of these differences become an annoyance."²

Introduction

"International merger" - this seems to be a dreary technical problem in a remote corner of company law, only of interest for a few highly specialized lawyers. At second sight, one discovers that this seemingly remote problem occupies a fairly large part of the EC activities in the field of company law and has provided lawyers and politicians with material for embittered disputes for now more than twenty years.

With this thesis I hope to prove that the complex matter of international merger is not only of rather great importance for the economic policy of the EC, but also that it is situated at a focal point of company law. Merger involves fundamental changes in the structure of the participating companies and the position of their shareholders. Therefore I shall concentrate less on the technical aspects of this transaction than on its position within the framework of company law and corporate culture.

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- 1) Commission, preamble to the revised proposal for the Statute for the *Societas Europaea*, OJ No C 176 of 8 July 1991, p. 1.
 - 2) Campbell, in: Campbell/Garbus (eds.), *Mergers and Acquisitions*, p. 3.

Part 1: The context of merger

1.1 The phenomenon

1.1.1 Merger activities in general...

From time to time, the world economy is shaken by a phenomenon called "merger waves": after periods of only little merger activity the amount of merger activities multiplies¹. Four of these great waves can be distinguished: the first at the beginning of the century, the second after the First World War in the 1920s, the third in the 1960s with its peak 1968-73, and the fourth in the 1980s.

The first great merger wave, consisting mostly of horizontal mergers, took place in the early 20th century². It was followed by the second wave in the 1920s as response to the newly developed techniques of mass production. Many of the great firms created during this period have defended their leading positions until today, for example the British Unilever³. The next wave in the 1960s was at least partly caused by increased international competition as a result of the development of GATT, EFTA, EEC. It was seen as necessary to achieve economies of scale and to reduce costs in order to stand this increased competition⁴. In a similar manner the 1980s merger wave in Europe may be partly seen as a consequence of the completion of the European internal market⁵.

All waves had a global range, covering all major economies of the world⁶. In the last wave, European, North American, Japanese, Australian, Kuwaiti and South African firms were involved, to name only a few⁷. The reason for this wave phenomenon is still discussed among economists. As

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- 1) Golbe/White, in: Auerbach, Mergers and acquisitions, p. 25;
Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 5;
King, in: Fairburn/Kay, Mergers and Merger Policy, p. 101.
 - 2) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 1.
 - 3) Kay, in: LBS (ed.), Continental Mergers, p. 2.
 - 4) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 4.
 - 5) Bertoni, Note economica 1990, p. 563;
Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 13;
Wessel, Rivista Internazionale 1990, p. 629.
 - 6) de Jong, in: Jacquemin et al., Merger and Competition Policy, p. 41;
cf. Hughes/Singh, in: Mueller (ed.), Determinants and Effects of Mergers, p. 1.
 - 7) de Jong, in: Jacquemin et al., Merger and Competition Policy, p. 41.

a general rule, it can be said that merger waves take place in periods of increased economic activity¹.

1.1.2 ... and international merger in particular

All the four great merger waves included a certain amount of cross-border activities. However, up to the 1960s/1970s merger wave, the number of inter-country mergers in Europe was relatively small in comparison with the number of domestic mergers.

In the 1980s this pattern was changed. This time the merger activities included a significant amount of cross-border mergers, compared with the other "waves"². According to an OECD report, international mergers make up more than one third of all merger transactions in the the EEC countries: out of a total of 561 acquisitions involving one of the 1000 largest firms in the Community in the period 1985-6, 217 involved a foreign firm³.

For the period between 1987 and 1991, the following pattern of takeover and merger activities involving one of the 1000 leading industrial firms in the Community was observed⁴:

	1987/88	1988/89	1989/90	1990/91
National	214	233	241	186
EC	111	197	257	170
Extra-EC	58	62	124	99

After three years of extraordinarily high activity, the period 1990/91 saw a decrease in the activity. But this seems to be still a very high level. An important trend is that cross-border operations within the EC, which were in 1987/88 only half as important as purely national operations, now are of equal importance. In 1989/90, they were even the most important type of activity. It should be further noted that the

1) Kay, in: LBS (ed.), Continental Mergers, p. 2.

2) Kay, in: LBS (ed.), Continental Mergers, p. 3.

3) OECD, p. 7.

4) Commission of the EC, XXIst report on competition policy, p. 418.

relation between domestic and intra-EC activities in 1990/91 was somewhat biased because of a large number of domestic mergers in Germany as a consequence of reunification¹.

1.1.3 What is a merger?

The term "merger" is not unambiguous. Its use is complicated by the fact that it is used in two different contexts. When an economist speaks of merger, he does not mean necessarily the same thing as a lawyer would understand. In an economic context, a merger "...can be defined as the coming together of two or more enterprises to form a new enterprise"². Accordingly, an *economic* merger need not necessarily coincide with a *legal* merger. "Merger" can be used in an economic context to name a procedure that results in a group of companies preserving the legal identities of the participating companies. In particular in the UK, "merger" usually designates a mere acquisition of shares of one company by another company³.

On the contrary, by a merger in the *legal* sense of the word the merging companies are fully integrated in the legal framework of one legal entity⁴. The Third EC Directive concerning the merger of public limited companies⁵ uses the term⁶ in this sense. An economist would call this procedure a "full legal merger"⁷. The more exact legal terms are "amalgamation", "consolidation" and "absorption". "Amalgamation" means any full legal merger, whereas "consolidation" designates a merger by forming a new, third company. In art. 4 of the Third Directive, this type is called "merger by forming a new company". It can be distinguished from an absorption, when one company absorbs another one, and only

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- 1) Commission, XXIst report on competition policy, pp. 418-419.
 - 2) Cowling et al.: Mergers and Economic Performance, p. 1.
 - 3) Ffrench, International law III, p. 11.
 - 4) Ffrench, International law III, p. 201.
 - 5) OJ No L 295 of 20. 10. 1978, p. 36. Hereinafter usually referred to as the "Third Directive".
 - 6) cf. artt. 3 and 4 of the directive.
 - 7) See, for example, Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 10.

the latter ceases to exist as legal entity¹. In the terminology of the Third Directive, this is called "merger by acquisition". But the economic differences between the two types of full legal merger are rather small, and economists tend to neglect this difference².

The consequence is that from a legal point of view mergers must be distinguished from other forms of external growth. One is the transfer of a controlling interest, be it in the form of a simple sale of shares, or as a public offer to buy the shares of a certain company with the objective of acquiring a controlling interest in this company, a "takeover bid". A third form of less importance is the purchase of all the assets of the company, which reduces the selling company to a mere holding. Although these are completely different proceedings from a legal point of view, their economic effects may be quite similar to a merger. If a full legal merger is not possible, as for example in an international context, these transactions may therefore be used as substitutes.

As this is a *legal* thesis, its main subject is *legal* mergers. But when dealing with the economic context of these legal transactions, we will have to accept the *economic* meaning of the term, simply because economists usually do not distinguish between the different legal transactions. Even from an economic point of view, however, there are some significant differences between a mere acquisition and an amalgamation.

Whereas economists are likely to overlook the sophisticated legal distinctions between amalgamation, absorption and consolidation, they will classify mergers according to a different scheme. They will distinguish three basic types of mergers: horizontal, vertical, and conglomerate merger. By a horizontal merger, one company merges with another company of the same type of business. In the case of vertical merger, the merging companies belong to different stages of the same production process (for example: a supplier of raw materials merges with a manufacturer). In the case of a conglomerate merger, two companies from completely different branches of business merge.

However, this is a rather theoretical approach. In practice, most

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- 1) Kumps/Wtterwulghe, in: Mueller (ed.), *Determinants and Effects*, p. 67.
Rawlins, in: Campbell/Garbus, *Mergers and Acquisitions*, p. 146.
 - 2) Kumps/Wtterwulghe, in: Mueller (ed.), *Determinants and Effects*, p. 67.

mergers consist of elements of two or even all three different types¹. Only a few attempts exist to classify mergers according to their type. One survey for the UK, reproduced by Hughes², showed that the most important type is the horizontal merger, although its importance has decreased over time.

For an economist, it does not make a great difference whether the merging companies are partnerships, public limited companies, or whatsoever legal construction the lawyers may invent. For the lawyers, of course, the differences do matter. The following delineation of the economic context of merger activities is more or less valid for all types of firms. However, as the relevant legislation is mainly concerned with public companies, I shall restrict myself to this type of company. At first view, this limitation seems to be justified since most firms with Europe-wide activities that might be interested in international merger are incorporated as public companies³. Nevertheless we shall have to return to this point at the end of the argument.

1.2 The economic context: Beneficial restructuring tool or evil anti-competition weapon?

1.2.1 Why do firms merge? - The impact of merger on the participating companies

Considering the amount of merger activities as presented in the last section, the question if mergers are beneficial for the participating firms seems to be a rhetorical one. Nevertheless, a surprising number of empirical studies claim that there are no real gains for the firms. The suspicion arises that mergers are pursued by managers and other egoistic actors to the detriment of their firms and shareholders. If this suspicion turns out to be true, the only legislative consequence should be the abolition of these evil doings.

1) Hughes, in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 43.
 2) in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 44.
 3) cf. Commission, *Bulletin of the EC*, Suppl. 13/73, p. 42;
 Behrens, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 13.

1.2.1.1 Cost benefits

The basic motive for merger is quite simple: it is the belief that the merged company will be more valuable than the sum of the merged companies (sometimes referred to as the "2+2=5" criterion)¹. This means that the merging firms possess complementary resources which they could neither use fully nor sell because they are indivisible or non-marketable².

The economies which can be achieved by merger can be divided into economies of scale and economies of scope. Economies of scale are generated by the combination of market shares: the higher the production, the lower are the fixed costs per each produced unit and the cost of each extra unit of a good or service decreases³. Economies of scale are mainly restricted to horizontal mergers. Purely vertical or diversifying mergers are unlikely to generate any economies of scale⁴, with the exception of the reduction of transaction costs by internalizing activities⁵. The economies of vertical integration in particular consist of reduced costs of contracting, communication and cooperation⁶.

Economies of scope, on the other hand, result from the joint production and marketing of different products by the same firm, and thus the sharing of overhead costs like research and development, marketing, legal assistance departments, finance, etc.⁷ Of particular importance is the fact that a larger firm may be better able to raise

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- 1) Kay, in: LBS (ed.), Continental Mergers, p. 10.
 - 2) Davis, in: LBS (ed.), Continental Mergers, p. 51.
 - 3) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 1; Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 8; Hughes/Mueller/Singh, in: Mueller (ed.), Determinants and Effects, p. 30.
 - 4) Cowling et al., Mergers and economic performance, p. 31.
 - 5) George, in: Jacquemin et al., Merger and Competition Policy, p. 74.
 - 6) Bertoni, Note economica 1990, p. 569; Hughes/Mueller/Singh, in: Mueller (ed.), Determinants and Effects, p. 30; van Hulle, Tijdschrift voor Economie 1986, p. 421.
 - 7) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 1; George, in: Fairburn/Kay (eds.), Mergers and Merger Policy, p. 282; Hughes/Mueller/Singh, in: Mueller (ed.), Determinants and Effects, p. 30.

capital in the market, thereby reducing capital costs¹.

The effect of reduced costs of research and development activities is regarded as particularly important in high technology industries requiring a high amount of such. There exists in the EC a tendency to support mergers in these areas because of apprehended losses of world market shares of EC firms². Research and development activities are indivisible up to a certain threshold, and moreover, it may be necessary to have access to a large market to justify the development of new products³. An example for activities in this field is the German aircraft industry. In 1960, 14 independent firms were active in this sector. In 1970, only four remained as result of merger activities (which were heavily pressed by the government); and today, the number is reduced to one⁴.

There exists a great number of empirical studies concerned with the aforementioned advantages of merger. Nevertheless, it is almost impossible to arrive at safe conclusions in this field: profitability is not a clear indicator for efficiency gains, as such gains may be also the consequence of increased market power. However, as merger is more likely to increase market power, the absence of higher profits after a merger can be seen as evidence for neutral or even negative effects of the merger on efficiency. Some existing studies even show a slight decline of profitability after a merger⁵.

Quite often, the acquiring firms seem to be already above the level of optimum size, so that economies of scale are unlikely. One study carried out for different nations dismissed economies of scale as

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- 1) Hughes/Mueller/Singh, in: Mueller (ed.), *Determinants and Effects*, p. 31;
van Hulle, *Tijdschrift voor Economie* 1986, p. 422.
 - 2) Jacquemin, in: Jacquemin et al., *Merger and Competition Policy*, p. 23; see also a case study on the British computer industry in the late 1960s and the early 1970s by Cowling et al., *Mergers and Economic performance*, pp. 272-289, which showed certain positive effects as a consequence of merging activities in this field.
 - 3) Farrands, *European Trends* 4/1988, p. 40.
 - 4) Bühner, *IFO-Studien* 36/1990, p. 22 (on merger activities);
Layton, *Cross Frontier Mergers*, p. 65 (on government pressure).
 - 5) Meeks, *Disappointing Marriage*, p. 33 for the UK;
but cf. also Cosh/Hughes/Singh, in: Mueller (ed.), *Determinants and Effects*, pp. 256-261, who found for the same period evidence of a slight improvement in profitability.

determinant of merger altogether, because the acquiring firms were on average as big or even bigger than non-acquiring firms and therefore probably not below the minimum efficient size¹. Also the assumed link between the level of concentration and the rate of technological progressiveness is not beyond any doubt from an empirical point of view². Moreover, the high technology industries did not play an important role in the recent European merger activities³.

1.2.1.2 Mergers as means of entry into new markets

Diversifying mergers do not bring great cost advantages with them, although some rationalization effects are possible, for example common marketing arrangements⁴. Their main advantage is the opportunity to access new markets. Diversification by merger has some significant advantages compared to diversification by external growth⁵:

- The first advantage is speed. By a merger, the acquiring company gets at once an operating firm with experienced management.
- This is accompanied by lower set-up costs, as no new plant has to be established. There is also less need to build up goodwill and market presence.
- The competition costs are lower, as no new capacity is added to the market⁶.
- A merger may be used to obtain certain assets, which are otherwise not available, such as patents⁷, or at least the transaction costs will be reduced.

Particularly in high technology markets it is regarded as important to acquire the necessary know-how rapidly. The acquisition of existing firms with their immaterial assets like patents may be the only possible

1) Mueller, in: Mueller (ed.), Determinants and Effects, p. 302.

2) Cowling et al., Mergers and economic performance, p. 370.

3) Spellman, Europe, Dec. 88, p. 26.

4) Fairburn/ Kay (eds.), Mergers and Merger Policy, introduction p. 1; cf. Meeks, Disappointing Marriage, p. 35.

5) Hughes, in: Fairburn/Kay (eds.), Mergers and Merger Policy, p. 57.

6) Bühner, IFO-Studien 36/1990, p. 22.

7) OECD, p. 13.

entrance to a high technology market. Firms following an acquisition-oriented policy should then be more successful in high technology markets¹. On the other side, it can not be stated that merger activity in high technology sectors is particularly high. For instance, according to the Commission's XXIst report on competition policy, out of 455 mergers involving one of the 1000 largest firms in 1990/91, only seven took place in the computer industry².

As for the economies of scale or scope, the empirical evidence for the assumed benefits of diversifying merger is not unambiguous. There is no clear evidence for a connection between merger activity and diversification processes³. Some studies show that in most cases the merger was not profitable, i. e. the firm was unable to recover the funds invested in the acquisition. They even seem to be less successful than horizontal mergers, although the same studies showed a failure rate of over 50% for the latter type⁴.

1.2.1.3 International merger

Merger is not only a way to new product markets, but may also be used to enter new geographical markets. Sometimes cross-border mergers are almost exclusively seen as a means to enter a new geographical market⁵. However, it might be expected that with the growing integration of the European markets the more "traditional" motives of securing economies of scale or entering new product markets will be of increasing importance also for cross-border mergers. A small survey of cross-border mergers in July 1990 showed that in 35 cases (out of a total of 44) of cross-border mergers "geographical expansion" was mentioned as a motive. But nevertheless in 10 cases "efficiency/economies of scale" were also mentioned⁶. Sometimes a company considering external growth

1) Bühner, IFO-Studien 36/1990, p. 21 et seq.

2) Commission of the EC, XXIst Report on Competition Policy, p. 418.

3) Hughes, in: Fairburn/Kay (eds.), Mergers and Merger Policy, p. 58.

4) Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 14.

5) Kay, in: LBS (ed.), Continental Mergers, p. 2.

6) Davis, in: LBS (ed.), Continental Mergers, p. 49.

may find that its domestic market is too small for further growth. Especially in smaller countries like the Benelux countries in some sectors the optimum size of a firm may already be too large for the domestic market¹. Similar problems arise when a firm wishes to grow externally, but does not find suitable partners in its domestic market. This may lead to cross-border mergers as a continuation and expansion of domestic merger². Moreover, this type of merger activity may be beneficial in terms of public welfare: instead of forming large national firms, each dominating its home market and using its influence to protect this market, cross-border mergers should lead to a pattern of Europe-wide operating firms competing in all or most of the national markets³.

Only a small amount of empirical evidence exists for cross-border mergers. But there seems to be a closer link between multinational diversity and profitability than between product diversity and profitability⁴.

1.2.1.4 The impact on shareholders' wealth

The positive or negative effects of a merger for the participating firms should be reflected by the market value of the firm and thus directly affect the shareholders' wealth. Not only the value of their shares may be influenced, but the very quality of their investment. A shareholder with a significant share in a promising small high-tech company may end up after a merger as one of thousands of small shareholders in a large corporation. The impact of merger on the shareholders of the participating firms deserves therefore special attention.

A take-over attempt should increase the wealth of the shareholders of the acquiree, since the acquiring company is likely to offer a price above the actual market price. Historical estimates about stock price increases as a consequence of a take-over attempt are about 20% and in

1) Cooke, *International Mergers and Acquisitions*, p. 12.

2) cf. Geroski/Vlassopoulos, in: LBS (ed.), *Continental Mergers*, p. 44.

3) Layton, *Cross Frontier Mergers*, pp. 8 - 10.

4) Davis, in: LBS (ed.), *Continental Mergers*, p. 53.

recent cases this increase could be as high as 50%¹. Acquiring firms are likely to pay a "premium" to the shareholders of the acquiree because they expect an increase in value of the acquired firm due to the realization of synergies. However, if the expectations about the synergy effects prove to be wrong, the shareholders of the acquirer are bearing the risk. Their company paid too much for the value it actually achieved, so that it suffered a net loss².

The empirical data about the impact of mergers on the benefits for the shareholders of the acquiring company is unclear. Sometimes it is stated that in general mergers tend to have neutral or even negative effects on shareholder benefits³. Some empirical studies suggest that there are some short-term positive effects on the share price, but that they are outweighed in the longer run by negative effects⁴. From a theoretical point of view, this result is not surprising, since long-term effects of both types of expansion, internal and external, should be equal⁵.

Other studies found no evidence for losses, but some evidence for an increased market value of the firm, thus arriving at the conclusion that mergers in general are value-creating⁶. Studies suggesting overall gains for shareholders show that most of the gains are reaped by the acquiree shareholders⁷.

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- 1) King, in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 111; Ruback, in: Auerbach (ed.), *Mergers and acquisitions*, p. 49.
 - 2) Bühner/Spindler, *Betrieb* 1986, p. 602.
 - 3) Franks/Harris, in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 154-155.
 - 4) Hughes, in: Fairburn/Kay, *Mergers and Merger Policy*, p. 92; cf. also King, in: Fairburn/Kay, *Mergers and Merger Policy*, p. 111 for the short-term effects.
 - 5) Hughes, in: Fairburn/ Kay, *Mergers and Merger Policy*, p. 97.
 - 6) Dennis/McConnell, *Journal of Financial Economics* 2/1986, p. 185; Littlechild, in: Fairburn/ Kay (eds.), *Mergers and Merger Policy*, pp. 306-311.
 - 7) Franks/Harris, in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 158.

1.2.1.5 Alternative motives for merger

At least some economists seem to be convinced that mergers are detrimental rather than beneficial for the participating firms. Obviously they have to offer a different explanation for the "merger mania" unless they want us to believe that the whole phenomenon is completely irrational. Basically, two alternative explanations can be distinguished, neither of them throwing a particularly favourable light on merger activities.

A first group of motives is of a speculative nature: a takeover is likely to take place when the price of the acquired company is lower than the costs of new investment¹. The objective of buying a supposedly undervalued company may be the construction of a conglomerate, but also the breaking up and selling of the acquiree to realize the hidden reserves, the so-called practice of "asset-stripping"². Moreover, it has been suggested that the huge gains for investment banks generated by the financing of mergers and acquisitions are among the most important causes for the increased activities³.

Another theory sees the most important cause for merger activities in "managerial" motives. It argues that most managers do not hold any or only a small share of their company, so that their primary interest is not the maximization of profits, but "a quiet life". Managers of large firms have some advantages; they enjoy not only more power and prestige, but also a quieter life, as a large firm will have a more stable performance and is more immune to take-over. Therefore it is argued that managers have a strong motive to increase the size of their firm by merger⁴.

But these theories work only if product and capital markets are not sufficiently competitive. If they are, an inefficiently operating firm will be forced to adjust or disappear. Since there does not seem to be any evidence for a significantly higher mortality rate of merged firms, the conclusion must be either that the markets are ineffective or at least

1) Golbe/White, in: Auerbach (ed.), Mergers and acquisitions, p. 40.

2) Otto, Betrieb Beil. 12/88, p. 3.

3) Wessel, Rivista internazionale 1990, pp. 636-637.

4) cf. Meeks, Disappointing Marriage, p. 34.

that mergers do not lead to inefficient firms¹.

1.2.2 The public welfare aspect

Even if mergers may be beneficial for the participating firms, many economists point out that from the point of view of the economy as a whole, mergers lead to undesirable consequences, of which reduced competition is only one. However, the evidence for positive effects for public welfare seems to be as strong (or, better, as weak) as the evidence for the impact of merger on the participating companies.

For horizontal mergers, the wish to enlarge the market share is one of the main incentives². The mergers of the early 20th century quite often had the outright intention of reducing competition³. But this very effect with the resulting reduction of the level of competition is also the main concern from the point of view of public welfare⁴.

Besides the reduction of competition, which is problematic as such, a higher degree of concentration facilitates collusion⁵. For example, in recent time a growing number of "strategic alliances", in particular between American and Japanese firms, have been observed. It is suspected that these alliances have the hidden objective of decreasing competition. In any case, they are a result of the merger wave of the 1980s, which has left over in some markets only a small number of large firms, which are said to be more inclined towards such agreements limiting competition⁶.

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- 1) van Hulle, Tijdschrift voor Economie 1986, pp. 422-423;
cf. also Kaulmann, in: Bamberg/Spremann (eds.), Agency theory, pp. 447 -456.
 - 2) Benzie, Bank of England Quarterly Bulletin 1989 No. 1, p. 80;
van Hulle, Tijdschrift voor Economie 1986, p. 420.
 - 3) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 1.
 - 4) Auerbach/Reishus, in: Auerbach (ed.), Mergers and acquisitions, p. 69;
van Hulle, Tijdschrift voor Economie 1986, p. 422;
Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 16.
 - 5) Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 16;
Hughes/Mueller/Singh, in: Mueller (ed.), Determinants and Effects, p. 29.
 - 6) The Economist, Vol. 234 No. 7777, September 1992.

Vertical and diversifying mergers might be seen in a more favourable light, since they do not necessarily lead to increased market power¹. However, this does not mean that they are completely harmless from the point of view of public welfare². Firstly, there is the danger of imposing reciprocal buying pressures. For instance, a supplier might be pressed to buy inputs from another subsidiary of the same conglomerate³. Secondly, a conglomerate might be tempted to use predatory pricing in one of its markets, using its financial power to cross-subsidize its activities in this market⁴. Thirdly, the fact that a large firm is already active in a certain market may deter other possible entrants, thus erecting barriers to entry⁵. An additional threat to competition arises when the diversifying merger eliminates a possible entrant into a certain market⁶. However, empirical evidence for these anti-competition effects of diversifying mergers seems to be rather small⁷.

The classical point of view holds that mergers lead to increased concentration and thus to a lesser degree of competition within an industry. Although they are not the only means of achieving market power, they are as important a tool as internal growth of building up a market position and for maintaining this position⁸.

However, a close analysis of merger activities in the UK did not show a clear connection between merger activity and the concentration process. On the one hand, mergers have played an important role in the

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- 1) Fairburn/Kay (eds.), *Mergers and Merger Policy*, introduction p. 16; Meeks, *Disappointing Marriage*, p. 35.
 - 2) Cowling et al., *Mergers and economic performance*, p. 30; Hughes/Mueller/Singh, in: Mueller (ed.), *Determinants and Effects*, p. 30; Williamson, *Markets and hierarchies*, p. 258 et seq.
 - 3) Bühner/Spindler, *Betrieb* 1986, p. 604; cf. also Cowling et al., *Mergers and economic performance*, p. 31; Hughes/Mueller/Singh, in: Mueller (ed.), *Determinants and Effects*, p. 30.
 - 4) Bühner/Spindler, *Betrieb* 1986, pp. 603-604.
 - 5) Hughes/Mueller/Singh, in: Mueller (ed.), *Determinants and Effects*, p. 29.
 - 6) Cowling et al., *Mergers and economic performance*, p. 31.
 - 7) Cowling et al., *Mergers and economic performance*, p. 31.
 - 8) Cowling et al., *Mergers and economic performance*, p. 9-12; Hughes/Singh, in: Mueller (ed.), *Determinants and Effects of Mergers*, p. 23.

development of many great firms and in the emergence and maintenance of present market structures. But on the other hand, the merger wave of the 1960s was not accompanied by a significant increase of concentration¹.

In general, it is no longer the prevailing view among economists that increased concentration in an industry necessarily enables this industry to extract supranormal profits. On the one hand, there seem to be a lot more problems in organizing effective collusion than formerly suggested, and on the other hand an hierarchical organization may produce more effective results than feeble competition². The overall attitude towards mergers has become less critical in recent years³.

As with the evaluation of domestic mergers, the overall evaluation of cross-border mergers is to a certain extent ambiguous. Quite often their purpose is to facilitate cooperation, if not collusion, and to decrease international competition⁴. But on the other hand, they may have the effect of increasing the level of competition. This is especially true, when the acquired company serves as a "foothold" company for the entry of a foreign firm of superior efficiency into a concentrated domestic market. In some cases, a cross-border merger may be the only way to introduce competition into a domestic market⁵. As with the evaluation of mergers in general, there is no consensus about the public welfare effects of international mergers⁶.

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- 1) Hughes, in: Fairburn/Kay (eds.), Mergers and Merger Policy, pp. 56-57.
 - 2) Williamson, Markets and hierarchies, pp. 258 et seq.
 - 3) Hay/Nydam, in: Fairburn/Kay (eds.), Mergers and Merger Policy, p. 232;
Littlechild, in: Fairburn/Kay (eds.), Mergers and Merger Policy, pp. 305-306;
Möschel, RabelsZ 48 (1984), p. 560;
critical on this shift George, in: Jacquemin et al., Merger and Competition Policy, pp. 75-77.
 - 4) cf. Cooke, International Mergers and Acquisitions, pp. 8-9.
 - 5) OECD, p. 14.
 - 6) OECD, p. 14.

1.2.3 The market for corporate control

So far we have treated merger as an instrument to create larger company structures - be it because larger companies offer economic advantages, or because they offer egoistic individuals better opportunities to pursue their self-seeking interests. However, there exists a concept according to which merger is not primarily conceived as an instrument to create larger economic entities, but to transfer the control of a company to a new management. American and British economists in particular stress the importance of mergers and acquisitions as a possibility to replace poor management¹. Sometimes this effect is even regarded as the most important positive consequence of mergers².

The mechanism can be described in a simplified way as follows: due to poor management, a company performs weakly. Some disappointed shareholders sell their shares with the effect of reducing share prices. The market estimation of the firm decreases. As soon as a potential buyer sees the chance to buy the firm at a price lower than the value of its assets, a take-over bid will be triggered. The disappointed shareholders use the opportunity to sell their shares at a higher price, and the offerer takes over the firm, replacing the management³.

However, it is not quite clear to what degree this effect exists:

- Fairburn/Kay⁴ state that the overall evaluation of this type of merger is positive. In their view, in most cases the quality of management was increased after the take-over, and in some cases even the pure threat of take-over caused management improvements.
- On the other hand, Hughes⁵ found no empirical evidence that mergers

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- 1) Auerbach/Reishus, in: Auerbach (ed.), Mergers and acquisitions, p. 69;
Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 16;
Littlechild, in: Fairburn/Kay (eds.), Mergers and Merger Policy, pp. 306-311.
 - 2) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 16.
 - 3) Fairburn/Kay (eds.), Mergers and Merger Policy, introduction p. 18;
Reekie, Industrial economics, p. 188.
 - 4) Mergers and Merger Policy, introduction p. 21;
see also Ball, National Westminster Bank Quarterly Review August 1991, p. 23 et seq.
 - 5) in: Fairburn/Kay (eds.), Mergers and Merger Policy, p. 75.

lead on average to efficiency gains, although some mergers had this effect.

- There is also no empirical evidence that weak performance necessarily increases the risk of being taken over. At least, this risk depends also on many other factors, such as the size of the company, the structure of its shareholders, etc.¹

Even supporters of this mechanism of the "market for corporate control" admit that it is a "decidedly imperfect mechanism ... expensive and inefficient"². At least it should be supported by an effective internal control of the management (as opposed to external control through the risk of hostile take-overs)³. The mechanism is only of relevance where other types of management control are not sufficiently effective. In general, it is restricted to the US and the UK⁴. The EC member states can be divided into three groups. The first group consists only of the UK, where contested bids and hostile take-overs are regarded as a normal business procedure. The second group takes the contrary position: in countries like Germany or the Netherlands, contested bids are for various reasons practically impossible⁵. The third group is formed by countries like France and Belgium, where a contested bid is theoretically possible, but of uncertain outcome and infrequent⁶.

1.2.4 Legal vs. economic merger

1.2.4.1 General observations

Up to now, it was not necessary to distinguish between merger in the economic sense of the term on the one side and in the legal sense on the other side. As we have already noted, there are other legal

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- 1) Hughes, in: Fairburn/Kay (eds.), p. 73;
Meeks, *Disappointing Marriage*, pp. 12-13.
 - 2) Fairburn/Kay (eds.), *Mergers and Merger Policy*, introduction p. 29.
 - 3) King, in: Fairburn/Kay (eds.), *Mergers and Merger Policy*, p. 113-115.
 - 4) Fairburn/Kay (eds.), *Mergers and Merger Policy*, introduction p. 21.
 - 5) Hart, *Corporate governance*, p. 5 et seq.
 - 6) de Jong, in: Jacquemin et al., *Merger and Competition Policy*, pp. 60-61;
cf. OECD, p. 12.

instruments such as the takeover or the purchase of assets that have almost the same economic effect as a full legal merger. Merger is one form of acquisition, but not the only one. Usually the acquisition is the condition for carrying out a merger, but it need not necessarily be followed by a merger. It is estimated that for every legal merger there have been seven or eight economic mergers in Germany. Even the acquisition of a controlling interest of 100% is not necessarily followed by a legal merger¹. So what are the reasons to take the second step of a merger, once the first step of the acquisition is made? What is the economic *raison d'être* of the legal institution "the merger"?

Basically the legal merger creates a legal unity. It seems to be appropriate that the creation of an economic entity should be followed by the creation of a legal entity: "...it is essential to ensure as far as possible that the economic unit and the legal unit of business in Europe coincide"². The amalgamation is described as the ideal way to merge two companies "since it replaces two or more existing legal persons by a single one, thus making the legal unity and the economic unity of the undertaking coincide"³.

Within a homogenous legal structure, the reallocation of any resources should produce the least transaction costs of all possible types of structure. A combination of two firms which does not amount to full integration requires a kind of trading relations between the firms, so that transaction costs arise. The full legal merger minimizes these costs and ensures the most stable and reliable relationship.

1.2.4.2 Leveraged buy-outs

In many cases of merger the acquirer depends on outside capital. The debt can amount to such dimensions that the dividends of the acquired shares are not sufficient to balance the interest, even if the whole profit of the acquired company was to be distributed. By the

1) Cable/Palfrey/Runge, in: Mueller (ed.), *Determinants and Effects*, p. 99.

2) Commission, *Bulletin of the EC*, Suppl. 13/73, p. 2.

3) Commission, *Bulletin of the EC*, Suppl. 13/73, p. 32.

amalgamation of the two companies, the debt of the acquirer becomes the debt of the unified company, thus allowing recourse to the cash-flow and the hidden reserves of the ex-acquiree. This technique is called "leveraged buy-out" (LBO)¹. In cases of private persons as acquirers, they will firstly form a new company with the sole objective of carrying out the acquisition. This company obtains the necessary financial resources and takes over the target. Then follows the amalgamation².

Apart from recourse to the cash-flow and the hidden reserves, another means to reduce the debt is the selling of assets. These may include "non-strategic" assets or even the most valuable assets, the so-called "crown jewels"³. Also sale-and-lease-back operations may be used⁴. Moreover, the merged company can deduct the interest payments from its gross profits and thus gain tax advantages⁵.

The importance of LBOs has greatly increased in recent years⁶. They are an important means to finance mergers which would be impossible otherwise, thus allowing the acquisition of large companies by relatively small ones (therefore the term "leveraged" buy-out). Even investors almost without financial resources are enabled to take over large businesses. This possibility led to the development of "management buy-outs", whereby the incumbent management takes over the company⁷.

The main problem arising from LBO operations is the enormous increase of the debt of the acquired company. It will be more difficult, in any case more expensive for the company to get additional capital to finance necessary investments⁸. If the expected synergies are more difficult to realize than was originally calculated, or if problems emerge in the process of harmonizing the different organisations, the cumulated

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- 1) Otto, Betrieb Beil. 12/88, p. 2;
Lutter/Wahlers, Aktiengesellschaft 1989, pp. 1-2.
 - 2) Banca Commerciale, Selected Issues, Aug. 1990, p. 2.
 - 3) Lutter/Wahlers, Aktiengesellschaft 1989, pp. 1-2;
Perl, Reflets et Perspectives 1989, 408.
 - 4) Perl, Reflets et Perspectives 1989, p. 414.
 - 5) Perl, Reflets et Perspectives 1989, p. 406.
 - 6) Wessel, Rivista Internazionale 1990, p. 632.
 - 7) Banca Commerciale, Selected Issues, Aug. 1990, p. 1.
 - 8) Perl, Reflets et Perspectives 1989, p. 424.

debt may lead to severe financial problems¹. Obviously, the net value of the target company will decrease as a consequence of the increased financial strains. This fact creates a certain risk for remaining minority shareholders and the original creditors of the target. Whereas the shareholders of the acquiring company and the financiers of the LBO are protected by guarantees granted to them, the "old" shareholders and creditors may end up with a portfolio of higher risk values².

The technique of the LBO was developed in the United States and the United Kingdom, where the legal and fiscal conditions are most favourable to these operations. In the United States, a typical merger is financed on average by around 90% of outside capital. In the United Kingdom, this number is about 80%, whereas in other European countries it is in most cases below 75%³. Although they are not impossible in the other European countries, and a number of LBOs have already taken place⁴, the different levels of this activity are significant.

1.2.4.3 International legal merger

Regarding international activities, firms have shown a certain hesitation to enter into full legal mergers, although in recent years a trend has emerged of creating centrally managed firms covering the whole European market⁵. We shall see later that it is almost impossible to execute a full legal international merger for the time being, and that firms even if they wished to create a unified legal structure are forced to use makeshift constructions resulting in more or less tightly constructed international groups of companies. Therefore it does not seem to be unreasonable to assume that - once the possibility exists - the current international *economic* merger activity will also result in a significant number of *legal* mergers. To be sure, the existence of a

1) Bühner/Spindler, *Betrieb* 1986, pp. 605-606.

2) Aszkenazy, *Eurepargne* Dec. 1988, p. 55;
Banca Commerciale, *Selected Issues*, Aug. 1990, p. 5.

3) Aszkenazy, *Eurepargne*, Dec. 1988, p. 54;
Perl, *Reflets et Perspectives* 1989, p. 414.

4) Perl, *Reflets et Perspectives* 1989, p. 405.

5) Spellman, *Europe*, Dec. 88, p. 26.

framework for *legal* international merger is not absolutely necessary for an *economic* international merger:

"In this respect, the cross-border merger should be seen above all as a technique to simplify the procedures for creating or restructuring complex economic entities."¹

1.2.5 Merger and the structure of the firm

At the first view, the economic debate about the vices and virtues of mergers seems to be rather disappointing from a legal point of view, because it does not allow any clear-cut legal conclusions to be drawn. One possible explanation for the dissatisfying results could be a certain inadequacy of economic theory to explain real-world events², with the consequence that lawyers could proceed happily on their own without paying attention any more to the quarreling economists.

But one could also try to understand the reasons for these indecisive results. The fact that there is almost as much evidence for the negative evaluation of merger as for a positive evaluation suggests a basic ambiguity in the institution itself. If we understand it as a procedure or a tool to restructure business organization, this tool could be neutral in the sense that it may be used to the benefit of the firms and even of the economy as a whole, but it is equally well suited for more sinister purposes.

Given this situation, one might wonder how it is possible that at least in some cases individual actors - the managers - are able to pursue their self-seeking interests without regard to the interests of other participants. This study, of course, would not only be of theoretical interest, but would ideally also give some hints as to how the law could intervene to prevent mergers with negative results from taking place.

What is the function of managers within the structure of a firm?

1) Commission, Bulletin of the EC, Suppl. 3/85, p. 5.

2) This is not merely the sarcasm of a frustrated lawyer; that there exists a certain problem, is also recognized by economists: see e. g. Reekie, Industrial economics, pp. 153 et seq.

According to one branch of economic theory¹, the central problem of every team production is "shirking". It is difficult, at least costly, to measure the part each team member has in the common output of the team. Under these circumstances, there exists an incentive to "shirk", i. e. to work less than the other team members. The final outcome would be that the output of the team decreases because of common "shirking".

The solution is to employ a specialized "monitor" who prevents the team members from excessive shirking. But who monitors the monitor, i. e. prevents *him* from shirking? - By giving him the residual product, i. e. the net earnings of the team, net of the payments to the other team members. Thus the monitor has an interest in the general performance of the team, which can be upheld only by effective monitoring. This central monitoring agent is the owner of the firm.

A possible objection could be that it should be sufficient to distribute the residual income between the team members, thus giving them an interest in the general output of the team and eliminating the need for a specialized monitor. The answer is that profit sharing leads at least in large teams to higher costs. If the residual income is distributed among a large team, each shirking team member bears only a small part of the losses caused by his behaviour.

If we try to apply this theory to the problems of the merger of large corporations, the first and evident problem is the ownership structure of large public companies. Instead of one or only a few central agents there is usually a large group of shareholders with obvious consequences for the effectiveness of the control. The central controlling agent is replaced by a two-level structure. The functions of monitoring are exercised by a small team (the management), which in turn is itself monitored by the shareholders. However, the imperfect control by the split-up shareholders leads to a certain exploitation of the shareholders by the management². And this is exactly the "defect" in the company's structure which allows the managers to take merger decisions that have no positive effects for the company's shareholders.

At first view, the consequence for legal regulations on merger should

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- 1) The following passage is based on the famous article by Alchian/Demsetz, *American Economic Review* LXII (1972), p. 779 et seq.
 - 2) Schüller, in: Schüller (ed.), *Property rights*, p. 169; cf. Kaulmann, in: Bamberg/Spremann (eds.), *Agency theory*, p. 445.

be to stress the role of the shareholders. As the ultimate monitoring agents, they should be given the necessary legal instruments to fulfil this task. The central element in any merger regulation would then be these monitoring instruments, for instance information rights for the shareholders. If this position of the shareholders would impede mergers, all the better: this theory maintains a rather sceptical position with regard to large corporations with their split-up and ineffective control structures¹.

Since in this model the separation of ownership and control does not lead to satisfying results, the capital market is introduced as an instrument to evaluate management performance. This is the theoretical foundation for the market for corporate control: if the management performs weakly, this triggers the takeover mechanism, which temporarily reforms the ownership structure of the firm by concentrating the diffused ownership into decisive power blocks². *De lege ferenda*, it is advocated to strengthen the position of the shareholders as the ultimate holders of the property rights, and thus to re-establish via the detour of the capital markets their controlling functions³.

Another, closely related approach is the "agency theory" which deals with principal-agent-relations, i. e. relations where one party (the agent) takes decisions that have a direct impact for another person (the principal), and where the agent possesses better information than the principal. The shareholder-manager-relation is a classical example of a principal-agent-relation, the shareholders being the principals, directly affected by the actions of the management, but lacking the information of the management. This asymmetrical information situation offers the managers the opportunity to pursue their own purposes, even to the detriment of the shareholders⁴.

This is exactly the same problem that produced some difficulties for

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- 1) Schüller, in: Schüller (ed.), Property rights, pp. 176 - 177.
 - 2) Alchian/Demsetz, American Economic Review LXII (1972), p. 788; Kaulmann, in: Bamberg/Spremann (eds.), Agency theory, p. 446; Reekie, Industrial economics, p. 161.
 - 3) Schüller, in: Schüller (ed.), Property rights, pp. 176 et seq.
 - 4) Milde, in: Bamberg/Spremann (eds.), Agency theory, p. 40; Reekie, Industrial economics, p. 191.

the first approach. One answer could be to attempt to mitigate the information asymmetry by information rights for shareholders, disclosure requirements, or accounting standards¹. However, even the most detailed legislation in its field (which has disadvantages as well as advantages²) will not remove the basic asymmetry of the shareholder-manager-relation.

Agency theory therefore has to introduce additional incentives for the agent-managers to act not only in their own interest. These incentives are, again, offered by the capital market: if the agents neglect the interests of their principals too much, the principals will end the relation³. This is, again, the market for corporate control. It provides via the mechanism of share prices the shareholders with additional information about the management's performance, thus decreasing the information asymmetry⁴.

After introducing the capital market as an external control for the management, we are almost at the same point where we started: if the capital market works properly, there should be no room for self-seeking, i. e. inefficient management practices. Why, then, do mergers occur which are not in the interest of the participating firms? The answer is provided by the observation that the capital market, like any market, does not work perfectly: "...returning funds to and reallocating funds by the capital market incurs nontrivial transaction costs"⁵. The discussion about the empirical evidence for the market for corporate control has already shown some of the imperfections of the capital market: the sheer size of a company may make it immune to hostile takeovers, and the whole mechanism will perhaps give advantages to short-term oriented firms and prevent sensible long-term orientation.

These theoretical considerations seem to lead to two main conclusions: to limit the effects of asymmetric information, shareholders have to be provided with a certain set of mandatory information rights, and, secondly, the transaction costs of re-allocating investment funds to firms with efficient management should be minimized by law.

1) cf. Fricke, in: Bamberg/Spremann (eds.), Agency theory, pp. 311 et seq.

2) Fricke, in: Bamberg/Spremann (eds.), Agency theory, pp. 319 et seq.

3) Kaulmann, in: Bamberg/Spremann (eds.), Agency theory, p. 446.

4) Reekie, Industrial economics, p. 188.

5) Williamson, Markets and hierarchies, p. 259.

1.3 The political context - Reactions of public policy

1.3.1 Political assessment of merger: an overview

Given the contradictory statements of economists, it is not surprising that the political opinions about the assessment of merger are deeply divided. Somewhat surprising is only the fact that attackers and defenders can be found on both sides of the political spectrum:

- The advocates of laissez-faire are in a certain dilemma about merger. On the one hand, restricting merger means restricting the acquisition and use of property. Moreover, mergers can be seen as a means of selecting the most efficient firms, which will takeover their less efficient brethren¹. But on the other hand, it cannot be denied that merger poses a serious danger for the ideal of perfect competition as an important goal of liberalism².

- On the other side of the political spectrum, the problems caused by merger for public welfare will lead to a prohibitive approach. But then, merger may also be regarded as a tool for government intervention and structural policy, as happened in the UK during the 1970s merger wave. The main promotor of this policy, the IRC, was set up by the Labour Government in the late 1960s, with the explicit objective to encourage mergers which would otherwise not occur³; and it was abolished by a Conservative Government which thought industrial restructuring should be left to market forces⁴. One of the most important mergers in Germany, the VEBA/Gelsenberg merger, was actively supported by the social democratic government, which held over 40% of the VEBA shares⁵. In Sweden, the Socialist government pursued a laissez-faire policy towards mergers, whereas the non-socialist parties favoured a more restrictive approach⁶.

International mergers may cause additional problems. Even if the

1) Hughes/Mueller/ Singh, in: Mueller (ed.), Determinants and Effects, p. 28.

2) Meeks, Disappointing Marriage, p. 9.

3) Meeks, Disappointing Marriage, p. 13 fn. 16.

4) Layton, Cross Frontier Mergers, p. 87.

5) Bühner, ZgS 140 (1984), p. 261.

6) Rydén/Edberg, in: Mueller (ed.), Determinants and Effects, p. 197.

government in question is willing to support mergers in general, it may be reluctant to do so when a foreign firm attempts to take over a national firm in a supposedly "strategic" industry. "Strategic" industries need not be defence-related industries, but may also include industries which are considered as capable of achieving competitive advantages in the future, such as consumer electronics¹.

1.3.2 EC policy towards merger

It would be far beyond the scope of this thesis to give even an overview of the different merger policies of the EC member states and the EC itself. This passage shall only provide some examples of changing attitudes in merger policies. But first of all, it should be stated that no member state prohibits merger outright, though there are statements to be found advocating a strict ban of merger activities, since merger would offer only small gains in the best of cases, but substantial losses in the worst case². However, the mainstream of economic science and current policy on national as well as on European level is not in favour of such radical measures. In fact, no European state has an entirely negative attitude towards merger.

Regarding the EC policy towards merger, the general impression is that the EC maintains a rather positive attitude towards merger³. In 1965, the Commission stated explicitly that it was in favour of concentration processes in the Community⁴. In more recent statements, it has adopted a more cautious approach, but the positive tendency remained unaltered. Mergers are seen as a means to restructure the European markets in view of the internal market⁵. Economies of scale are one of the main arguments for the internal market⁶, and in practice

1) Hannah, in: LBS (ed.), *Continental Mergers*, pp. 164-167.

2) Cowling et al., *Mergers and economic performance*, p. 372.

3) Hauschka, *Wirtschaft und Wettbewerb* 3/1990, p. 212.

4) Commission, *Memorandum on industrial concentration in the Common Market*, *Revue trimestrielle de droit européen* 1966, p. 651.

5) Jacquemin, in: Jacquemin et al., *Merger and Competition Policy*, p. 35.

6) cf. Cecchini Report, pp. 73, 77-78.

mergers are regarded as the fastest way to economies of scale¹: "For many firms, continental mergers and acquisitions are the essence of what 1992 is about"². In its XXIst report on competition policy, the Commission stated:

"Mergers may be carried out in the interests of economic efficiency, permitting improved exploitation of economies of scale and the pooling of expertise, and may thus help Community industry adjust its structure to the challenge posed by the integration of the internal market and the internationalization of the economy."³

There can be stated to be a certain tendency in the EC to encourage cross-border merger activities as a response to increased global competition, particularly in fields where high technology is involved⁴. It is almost a commonplace that within their respective national markets European firms cannot achieve sufficient size to compete effectively with their Japanese and US counterparts⁵. Similarly, it is almost impossible to find any statement of the Commission or of its officials dealing with merger affairs that does not mention at least once competition with the US and Japan and the necessity to support European firms in this struggle⁶. This sentiment can be traced back as far as 1957, when the inclusion of art. 220 in the treaty was perhaps due to the fear of "the American challenge"⁷. "The American challenge" also played its role in the initiative to create a European company⁸. The merger issue is only

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- 1) Geroski/Vlassopoulos, in: LBS (ed.), Continental Mergers, p. 23; Cecchini Report, p. 87.
 - 2) Kay, in: LBS (ed.), Continental Mergers, p. 20.
 - 3) Commission of the EC, XXIst report on competition policy, par. 5, p. 18.
 - 4) c. f. e. g. Jacquemin, in: Jacquemin et al., Merger and Competition Policy, p. 23.
 - 5) Geroski/Vlassopoulos, in: LBS (ed.), Continental Mergers, p. 22; cf. the Cecchini Report, p. 89.
 - 6) e. g. Parliament, opinion on the proposal for a 10th Directive, OJ No C 303 of 25 November 1985, p. 27; Saß, Betrieb 1990, p. 2340; Scrivener, intertax 4/1990, p. 207 s.; both on the merger taxation directive.
 - 7) Ganske, Betrieb 1985, 581; "the American challenge" was the title of a famous and influential book by Servan-Schreiber, "Le défi américain".
 - 8) Lutter, Aktiengesellschaft 1990, p. 413.

part of the EC's industrial policy aiming at the restructuring of the Community's firms to create a Community-wide "market of firms"¹.

In the field of company law, the EC's policy has been characterized as a "twin-track" approach. The idea is a trade-off between harmonized (and often stricter) protective regulations and the advantages of Community-wide freedom of establishment². Also in this context, merger is not only an end in itself, but part of a wider political program. The consequence is, however, that this policy is running into difficulties as soon as the freedom surplus is conceived as not equivalent to the establishment of new restrictions. This seems to be the case when employee co-determination is concerned. The very success of the harmonization of company law makes firms and some national governments unwilling to accept more regulative measures, because they consider the achieved freedom of establishment as sufficient and do not see the necessity of making further sacrifices for only marginal "freedom surpluses"³.

1.4 The legal context

Not only from an economic point of view is merger a powerful but two-edged tool. A legal merger implies the dissolution of at least one of the participating companies, for its organs the end of their function, for the employees the change of the employer, for the shareholders the exchange of their shares. Before discussing the legal techniques and instruments of merger, it is therefore necessary to try to analyze the position of these various groups in company law.

1.4.1 The underlying principles of company law

As a kind of working hypothesis, I would like to submit that there are three different basic models of company law, all of them with

1) Abeltshauser, Europäische Unternehmensverfassung, p. 21.

2) Robinson, European trends 4/1987, p. 67.

3) Robinson, European trends 4/1987, p. 67 s.

different consequences for the structure of companies and the positions and relations of the different basic elements of companies within this structure.

1.4.1.1 A monistic view of company law: The Anglo-American model

The first of these models, called sometimes the "classical" model, is characterized by the predominant position of the shareholders: the owner of the capital (or a group of investors sharing ownership) buys inputs like raw materials and labour, organizes the production, and finally sells the output. Directors represent the owner-organizers, and the interest of the owner-organizers is the only interest of the corporation¹. The main interest of shareholders is, as they are considered as rational businessmen, the maximization of profit. Consequently, the categorical imperative for the management is: maximize profit - or be fired. Because of the predominant position of the shareholder interest, this model may be called a monistic one.

This view seems to be rather simplifying, but it is the base of the Anglo-American company law model. The basic model of British company law is sometimes compared with a shareholders' "city state". The directors must act in the interest of the company, and this interest of the company is *not* a balance of various interest groups, but the interest of the present and future shareholders of the company, i. e. a balance between the short-term interests of the present members and the long-term interests of future members²: "Despite the separate personality of the company it is clear that directors are not expected to act on the basis what is for the economic advantage of the corporate entity, disregarding the interests of the members"³.

The model is, of course, a gross simplification. A debate also exists in the UK and the US about the "social responsibility" of corporations

1) cf. Coleman, in: Hopt/Teubner (eds.), *Corporate governance*, p. 80.

2) Gower, *Company law*, p. 577 et seq.;
Wedderburn, in: Hopt/Teubner (eds.), *Corporate governance*, p. 5.

3) Gower, p. 577.

or about "industrial democracy"¹. However, the present British company law is still based on the "city state"-model, and some tentative attempts to introduce interests other than the shareholders' interests into company law were undone in 1980 and 1981².

The monistic model is in a certain crisis. Its central problem is the separation of ownership and management. Modern shareholders, particularly in large public corporations, show only little interest in the management of the firm and are almost exclusively interested in the economic benefits they can derive from it. They feel no need to exercise a significant control over the management, since they can transfer their capital without incurring too much cost to a new investment. On the other hand, labour on all levels is increasingly seen as decisive factor. Labour can not be shifted from one the corporation to another without incurring significant costs, such as the loss of seniority benefits etc. And, in their new-won independence it is the top management which organizes the use of the production factors including capital. In this view, the management is not the representative of the shareholders, but of "the corporation", i. e. its employees³. These changes may reflect changes in the economic environment. When the classical model was developed in the last century, corporations faced a short supply of capital, but an almost unrestricted supply of labour. Company law therefore concentrated on the organization of capital supply. But with the development of the modern financial institutions, the situation was reversed, skilled and experienced human capital being more difficult to organize than financial capital⁴.

A further consequence of this system is that its supporters deny any social responsibility of corporations: "The social responsibility of

1) Mashaw, in: Hopt/Teubner (eds.), *Corporate governance*, pp. 55 - 68; Wedderburn, in: Hopt/Teubner (eds.), *Corporate governance*, 10 et seq.

2) Gower, *Company law*, p. 9; Wedderburn, in: in: Hopt/Teubner (eds.), *Corporate governance*, 7 with fn. 3.

3) Coleman, in: Hopt/Teubner (eds.), *Corporate governance*, pp. 80-81.

4) Schanze, in: Daintith/Teubner (eds.), *Contract and organisation*, pp. 210-211.

business is to increase its profits"¹. Any attempt to include a broader range of social goals is denounced as an attempt to transform business organizations into "agents for social engineering"².

1.4.1.2 The pluralistic antithesis: The continental model

If we apply the monistic model to continental company law systems, we will be left rather puzzled. Take as an example the German law on "*Aktiengesellschaften*". This law has developed the two-tier structure as an elaborated system to moderate direct shareholder influence on the management of the company, and it is exactly this system which is blamed for the non-existence of the market for corporate control in Germany. Obviously, the German system is designed to restrict shareholder influence - but to what purpose? Apart from the shareholders' interests, whose interests shall corporate management serve?

If we analyze the function of the management of a German public company, we shall find that it has a quite different role from its American counterpart. Instead of being the shareholders' representatives, it resembles sometimes a democratic government *en miniature*, that has to respect not only the interests of shareholders - the capital - but also of the firm's workforce and even the public interest. As a consequence, the workforce has its representatives in the management. In opposition to the monistic model with its predominant role of shareholder interest, this multiplicity of interests gives a pluralistic outlook to the continental model.

Thus we can understand the restraints imposed on shareholder influence. They are not seen as the all-powerful owners of the firm, but just as one of the firm's elements, i. e. the capital. The management is a kind of corporate government where different members represent different constituencies, basically capital and labour³.

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- 1) Dine, *European Law Review* 1989, p. 330;
Friedman, *New York Times Magazine* of 13 September 1970, p. 32.
 - 2) Dine, *European Law Review* 1989, p. 329 *et seq.*
 - 3) Coleman, in: Hopt/Teubner (eds.), *Corporate governance*, pp. 81-82.

The two models are based on different views of the "typical" shareholder. May we tentatively say that the Anglo-American model originally derived from an "entrepreneurial" shareholder who uses his company to take a more or less active part in economic life? The difficulties that lead to the market for corporate control are finally caused by a development towards a more passive, "investor-type" of shareholder. The German continental model would then presuppose more or less the shareholder with purely financial interests, or to use the terminology of Wiedemann¹, there is a qualitative difference between "Anlagebeteiligung" and "Mitunternehmerschaft", between "investorship" and "co-entrepreneurship", the German "Aktiengesellschaft" being based on the former. And, for Wiedemann it is essential that the investor-shareholder has "disclaimed" his influence on the management of the company:

"Der Anlageaktionär muß nach der Organisation der Aktiengesellschaft als Massenverband notwendig auf einen Einfluß in der Unternehmensleitung verzichten..."

This observation could be supported by the fact that German law provides with the "GmbH" a legal form especially designed for the more "entrepreneurial" investor. And in a "GmbH", the predominance of shareholder interests is clearly established².

German legislation can be interpreted as a reaction to the separation of ownership and control in large corporations. Indeed, the separation of property and management is seen as a characteristic element of the German *Aktiengesellschaft*³. One of the elements leading to the current constitution of the German *Aktiengesellschaft* was the lack of influence of the small shareholder and his resulting minimal interest in the company⁴. The result was the growing power of the large banking corporations, who held the proxy votes for the large numbers of small shareholders. They are one of the most important stabilizing elements in the German corporate culture, and their influence is indirectly

1) Zeitschrift für Gesellschaftsrecht 1978, p. 494.

2) Cf. Lane, Management and labour, p. 56.

3) Püttner, in: Eichhorn (ed.), Unternehmensverfassung, p. 22.

4) Püttner, in: Eichhorn (ed.), Unternehmensverfassung, p. 25.

recognized by the sect. 128 and 135 of the *Aktiengesetz*¹. The German stock-market is characterized, compared with the British market, by the predominance of institutional or corporate shareholders over individuals². Approximately only 30 *Aktiengesellschaften* are not dominated by parent companies, institutional shareholders, or families. One of the consequences is that German corporations are seen as more long-term interested than their British counterparts³.

Once it is recognized that the corporation is not the exclusive property of its shareholders, it is also possible to establish the representation of other "constituencies" than capital and labour within the corporation. The first to draw this conclusion in Germany were the National Socialists, who in 1937 included the public interest (as they understood it) in companies in sect. 70 of the *Aktiengesetz*: the board of directors should govern the company "*unter eigener Verantwortung gemäß dem Wohl des Betriebs, der Gefolgschaft und dem gemeinen Nutzen von Volk und Reich*"⁴. Today, it is quite common that a company's creditors, large customers or suppliers are represented in the *Aufsichtsrat*, even if this is not prescribed by law⁵.

However, a caveat is necessary. It is important to keep in mind that the two "models" as they are sketched here are rather theoretical abstractions than faithful descriptions of existing legal systems. Even the most pure implementations of these models, e. g. the British company law and the German "*Aktiengesetz*", certainly contain some elements of the opposite model, especially if we take into consideration that in reality the German model consists of a combination of both the "continental" and the "Anglo-American" model, the latter being provided by the "GmbH". This is even more true of the other European systems, which may be considered as points on a sliding scale somewhere between the two extremes.

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- 1) Lane, Management and labour, p. 57;
Püttner, in: Eichhorn (ed.), Unternehmensverfassung, p. 26.
 - 2) Lane, Management and labour, p. 60.
 - 3) Hart, Corporate governance, p. 5 et seq.
 - 4) Püttner, in: Eichhorn (ed.), Unternehmensverfassung, p. 25.
 - 5) Gotthold, in: Daintith/Teubner (eds.), Contract and organisation, p. 248.

1.4.1.3 Synthesis: The interest of the company in itself?

Legal theory has discovered a third model of company law, the model of the "corporation as such" ("*Unternehmen an sich*"¹). Whereas the monistic and pluralistic models are based on the interests of various groups in the company, this model suggests that the company has an interest in itself. It would be not an instrument for one or more groups of actors, but would be a corporate actor in its own right, independent from the interests of shareholders, employees or the public - it would be the "*Unternehmen an sich*", the "corporation as such"².

This theory of the interest of the company in itself considers the company not as a unit of shareholders or a unit of shareholders, employees and managers, but as a social, communicative system³. One consequence is the interest of this corporate actor in the continuation of its own existence - a slightly problematic result, since it may be in the interest of the economy as a whole that individual inefficient firms are eliminated. The interest of the firm in itself is therefore enriched with the interest of the society in the firm, in its functions for the securing of the future of the society and its current performance for the society. The actual determination of this interest is only possible by the means of a discursive coordination of the various underlying interests, the practical consequence of the whole theory then being the attempt to create and to safeguard the organizational structures for this discourse⁴.

As the question mark in the heading of this paragraph suggests, the merits of this model are disputed. It seems to be quite difficult to render this model operational for practical purposes, the main problem being the determination of the interest of the company. The pluralistic model requires the determination of the interests of the various interested groups in the company and then in a final step the balancing

1) Haussmann, Vom Aktienwesen, Mannheim, Berlin, Leipzig 1928, S. 27 (he invented the term).

2) Teubner, Zeitschrift für Handelsrecht 148 (1984), pp. 470 et seq.

3) Raiser, in: Eichhorn (ed.), Unternehmensverfassung, p. 44; Teubner, Zeitschrift für Handelsrecht 148 (1985), p. 471.

4) Teubner, Zeitschrift für Handelsrecht 148 (1985), p. 484 et seq.

of these interests, a procedure that is not without difficulties but for lawyers a well-established method. For the model of the company as such, no convincing method of determining the decisive interest of the company has been established so far¹. On the contrary, quite often the formula of the "firm's interest" is used to disguise the advancement of the interests of a specific group².

1.4.1.4 The crisis of the monistic model

Which of the three models should be taken as the base for future legislation? As already indicated, the monistic model finds itself in a certain crisis. The modern, large corporations can no longer be controlled effectively by their shareholders. The shareholders are split up into countless units and form an extremely heterogeneous group. It is one of the central elements of the new company law that property and control of the enterprise are separated³. Management developed more and more towards a bureaucratic unit, which in turn gave rise to its own dynamics. The growing independence of the firm, i. e. the firm's management, is of course also a certain danger⁴.

A consequence of this crisis is the discussion about the market for corporate control. We can interpret the model of the market for corporate control as an attempt to re-establish the mechanisms of our simple model in a more sophisticated way. Since in modern, large companies the share capital is too fragmented to exercise the direct control over management presupposed in the model, the direct control has to be replaced by the mechanism of the market for corporate control. The outcome should be the same: if the management is not maximizing profit and thus shareholder wealth, it will be replaced by a more effective (i. e. profit-concerned) management.

However, we have also seen that the market for corporate control works rather imperfectly - perhaps it must work imperfectly, given the

1) cf. Teubner, *Zeitschrift für Handelsrecht* 148 (1984), p. 485.

2) Kirchner, *Aktiengesellschaft* 1985, p. 101.

3) Raiser, in: Eichhorn (ed.), *Unternehmensverfassung*, p. 35.

4) Püttner, in: Eichhorn (ed.), *Unternehmensverfassung*, p. 22.

existence of significant transaction costs on the capital market. If the shareholders are no longer able to fulfil their controlling functions, the legitimacy of offering them the decisive influence vanishes more and more, and it is only natural that other interests also come to be represented in the company's management¹.

Moreover, there are some signs that the economic performance of companies is affected. The monistic model with its predominance of shareholders' interests establishes a very close relation between the company and the capital market, and allegedly the capital market is more interested in short-term results than in long-term perspectives. Consequently British firms are described as being short-term oriented on all levels, e. g. in the fields of investment policy, research and development, and employee training². Even if the reality of the "short-termism" phenomenon is disputed³, there is some evidence that British managers *think* their shareholders are short-term oriented and consequently opt for short-term strategies to avoid hostile take-overs: a 1992 survey of major British firms showed that most managers thought the British system of corporate governance would favour short-term results over long-term considerations⁴. It is a widely held opinion that the UK's economic problems are at least partly caused by the British system of corporate governance⁵.

Whereas in the monistic model, the only purpose of the enterprise is to make profits, the advocates of a pluralistic concept tend to define the ultimate purpose of companies as the economic production of goods, i. e. a public interest⁶. The management is then seen as a kind of corporate government where different members represent different constituencies, basically capital and labour. This conception is the theoretical foundation of the German rules on co-determination⁷. In this view of corporate

1) cf. Schüller, in: Schüller (ed.), Property rights, p. 171.

2) Lane, Management and labour, p. 121.

3) Cf. the contrasting opinions of Ball and Williams in National Westminster Bank Quarterly Review August 1991, pp. 20 - 38.

4) Hart, Corporate governance, pp. 1 et seq.

5) Hart, Corporate governance, p. 1.

6) Raiser, in: Eichhorn (ed.), Unternehmensverfassung, p. 38.

7) Coleman, in: Hopt/Teubner (eds.), Corporate governance, pp. 81-82.

governance, there is no need for preferring short-term results over long-term considerations. Even if the capital market would press for short-term results (and the view even exists that German institutional shareholders are less short-term interested than their British counterparts¹), the greater independence of the management in a pluralistic system would allow this pressure to be balanced against other interests.

At the present time, the pluralistic conceptions are basically occupied with the representation of the "internal" interests of the corporation, i. e. capital and labour. But there are even discussions about the necessity and expediency of including representatives of external interests in the board, for example consumers' or neighbours' representatives². Consequently, there exists the tendency to include also "outside" interests (in contrast to the "inside" interests of shareholders, employees, management) in the corporate structure of the enterprise³. In fact, in many German supervisory boards representatives of "outside interests" like banks, insurers, customers and suppliers have already obtained positions⁴.

The interest of the firm in itself as the third alternative is basically the interest in the continuing existence of the firm and its capacities to serve the interests of shareholders, employees, clients, creditors, consumers, state and society⁵. However, we have already seen that it is very difficult to operate on a practical level with this extremely complex concept. At least the mere existence of this model can be taken as a sign of the tendency to detach the public company from its shareholders. To close this section with an outlook, we might even be tempted to say that the problems of the monistic Anglo-American model indicate that its preconditions no longer exist. The capital requirements of modern firms are so enormous that hardly any individual or group of individuals can

1) Lane, Management and labour, p. 57.

2) cf. Coleman, in: Hopt/Teubner (eds.), Corporate governance, pp. 83 et seq.;
Hart, Corporate governance, p. 1.

3) Raiser, in: Eichhorn (ed.), Unternehmensverfassung, p. 43.

4) Gotthold, in: Daintith/Teubner (eds.), Contract and organisation, p. 248.

5) Raiser, in: Eichhorn (ed.), Unternehmensverfassung, p. 44.

satisfy them. Even in the UK, today most shares are held by institutional shareholders like insurance companies or pension funds, rather than by individuals¹. If we are in fact living in an age of large institutional shareholders with prevailing financial interests, the pluralistic continental model seems to be better suited for the modern complex corporation. The discussion about the "company as such" is then just a further indication that the simple idea of the company as a mere undertaking of its shareholders alone is no longer adequate.

1.4.1.5 The company law models and economic theory

The outline of the different models of company law may give rise to the question about their relation to the economic theories concerning the structure of the firm. As we have seen, economic theory tends to stress the central role of the shareholders as the "central agents" or the "principals" of the firm. It seems to be difficult to reconcile this view with the tendency towards corporate pluralism stated above. Indeed, many economists are in doubt about the merits of corporate pluralism: if one starts with the assumption that the owner, i. e. the shareholders, have the task of monitoring and coordinating the activities of the firm's participants, employee co-determination as a "dilution" of the property rights will lead to a lesser degree of effective allocation. The fact that employee co-determination had to be introduced by law and was not voluntarily established is used as evidence for the decrease of efficiency². However, if one sees the capacities of the employees as a specific production factor that can not be easily transferred to other firms, the employees are in a way also "owners" with an interest in the success of the firm, and it is even necessary to introduce co-determination to maximize efficiency³.

The transaction costs-approach leads to a similar dilemma. On the

1) Hart, Corporate governance, p. 4.

2) Furubotn, Zeitschrift für die gesamte Staatswissenschaft 137 (1981), p. 705; for a critique, see Gotthold, in: Daintith/Teubner (eds.), Contract and organisation, p. 248 et seq.

3) Gerum, in: Eichhorn (ed.), Unternehmensverfassung, p. 51.

first view, mandatory co-determination is not efficient, since it restricts contractual liberty and thus limits the search for optimal (i. e. cost-efficient) organizational structures. Moreover, the granting of decisive powers to the employees leads to more complicated and more costly decision-making processes, thus increasing transaction costs. But on the second view, employee co-determination might lead to the institutionalization of inevitable conflicts and thus minimize frictions and transaction costs¹.

Agency theory leads to similar results. Better coordination within the principal-agent relation of employer and employee as a result of mandatory co-determination could eliminate frictions and thus increase efficiency².

Obviously, law is not the only decisive factor. The economic performance of an enterprise depends on many interdependent factors, like financial environment, management styles, training systems, etc. Company law is only one, albeit important, aspect of the complex problem.

1.4.2 The position of legal merger in the context of company law

Most British firms still prefer the simple take-over to the full legal merger. According to a study quoted by Welch³, since 1976 only six orders under the relevant sections of the Companies Act could be found. An obvious reason is the legal procedure, which is criticized as both cumbersome and expensive⁴. However, one might wonder if there are not deeper reasons why British firms prefer the take-over by exchanging shares to the "continental style merger"⁵.

The most simple explanation would be that in the British system it is just not necessary to complete a take-over by a merger. Since in the

1) Cf. Gerum, in: Eichhorn (ed.), Unternehmensverfassung, p. 53.

2) Gerum, in: Eichhorn (ed.), Unternehmensverfassung, p. 54.

3) 7 Company Lawyer 69.

4) Stanton-Reid/Ruparelia, in: Cougnon, The EEC merger and parent-subsidiary directives, p. 186;
Welch, 7 Company lawyer 69.

5) Stanton-Reid/Ruparelia, in: Cougnon, The EEC merger and parent-subsidiary directives, p. 186.

British system shareholder influence is dominating, the acquisition of a controlling interest in a company is sufficient to exercise full control over that company. In a continental system, things are not that simple. Since here shareholders are considered as only one of the different components of a company and shareholder influence is more mediated, even the acquisition of a large majority may not be sufficient to gain full control over a firm. Therefore a merger as the complete integration of the acquired firm has in a continental system a significant advantage compared with the mere takeover.

Again, it is necessary to keep in mind that the two models are extreme points on a sliding scale. For example, the Dutch system, which is clearly a continental system, did not know the "continental" type of merger until the implementation of the Third Directive in 1983 and this transaction is still not very common¹.

1.4.3 Merger and shareholder interests

Obviously a merger with its sometimes enormous financial implications can jeopardize the very existence of the companies. But even apart from the possibility of a disastrous outcome, any merger deeply affects the position of the shareholders of the participating companies. The effect is almost the same as if they had sold their shares and bought shares of a different firm - and the legal procedure actually involves an exchange of shares. But this change is independent of the individual shareholder's will, since it is based on a majority decision. The individual shareholder may well find himself involved in a merger which he rejects as incompatible with his interests. A merger may be one of the most fundamental decisions in the life of a company, only to be compared with the decision to liquidate the company. In any case it is a serious encroachment in the property position of the individual shareholders.

It is therefore not surprising that one of the focal points of merger legislation is the field of shareholder protection:

"...it is particularly important that the shareholders of merging companies be kept adequately informed in as objective a manner

1) Maeijer, *Company law system*, p. 276;
Schmit, in: Schmit/van der Beek/Raap, *Dutch Business Law*, p. 206.

as possible and that their rights be suitably protected"¹.

1.4.3.1 The legal context of shareholder protection

The questions of shareholder protection are dependent on the underlying ideas of company law. For the monistic model, the central problem is how to overcome or at least to mitigate the separation between ownership and control. Company law has to try to reestablish the predominance of shareholders' influence, and if this is not possible, it has to facilitate the working of the market for corporate control.

From a pluralistic point of view, however, the situation is more complicated. In the context of this model, law has to try to balance the different interests in the firm against each other. This means in practice that the influence of shareholders in the firm has to be protected against exploitation by a too independent management, but on the other hand this protection has to consider also the other interests in the firm. Under certain circumstances, this may have the consequence that other interests have to prevail over shareholders' influence - an almost unthinkable thing in the context of a monistic model!

The model of the interest of the company in itself should lead to similar practical consequences, i. e. shareholder protection balanced against other interests, perhaps with a certain stress on procedural questions. However, for the time being the supporters of this model seem to have some difficulties in showing the practical consequences of their theory.

The problem is further complicated, regardless of the choice of the company law "model", by the fact that "the shareholder" does not exist. Obviously, there are many different types of shareholders, ranging from large institutional shareholders through firms holding shares as an element of business strategy to the private shareholder who invests his savings in some shares. Shareholder protection has to take these

1) Preamble of the Third Directive, OJ No L 295, 20. 10. 1978, p. 36; see also Priester, *Neue Juristische Wochenschrift* 1983, p. 1459; Hoffmann-Becking, in: Goerdeler et al., *Festschrift für Hans-Joachim Fleck*, p. 105.

different types, all with potentially different interests, into account¹. The institutional shareholder will demand a different type of protective instrument than the small individual shareholder with an active interest in his company's policy.

This is still a quite abstract approach. However, I shall return to it on a more down-to-earth level when analyzing the existing legal regulations on international merger. Then there will be the opportunity to show the consequences of the "three-model-approach" in the form of concrete legal problems (see *infra*, 2.4).

1.4.3.2 David vs. Goliath: Protection of shareholder minorities

When speaking of shareholder protection, in particular in the field of merger law, quite often we have to read: protection of minority shareholders². Is it necessary to justify the protection of shareholder minorities? The question seems to be almost heretical: the word "minority" alone appeals to the protective instincts of every lawyer, who immediately thinks of small shareholders, who have invested their meagre savings in the shares of some firm and who are now ruthlessly exploited by some big capitalists...

As usual, things are not that simple. Nothing prevents the big capitalists from pursuing a potentially disastrous business strategy; nothing prevents them from even liquidating the whole enterprise; or to take a perhaps more realistic example, from embarking on a long-term strategy which will take years before becoming profitable, in the meantime depriving all shareholders of their dividends. Why, then, special protection of minorities in the case of merger?

Usually, the law relies on the self-interest of majority shareholders. If they risk the company, they risk at the same time their own wealth. It seems to be reasonable to rely on the sound economic judgement of majority shareholders. Who, if not the majority shareholders, shall decide on the fate of the firm? The only necessary safeguard is to enforce the

1) Lutter, *Zeitschrift für Gesellschaftsrecht* 1992, p. 440.

2) Cf. for instance Lutter, *Zeitschrift für Gesellschaftsrecht* 1992, p. 440.

principle of shareholder equality, to prevent the majority from directing all profits to their own pockets.

However, the law can only rely on the majority's self-interest if this self-interest is identical with the interest of all shareholders. The situation is completely different if there is a conflict of interests for the majority shareholders. Merger is one of the cases in which such a conflict of interests exists almost as a rule. More often than not, the majority shareholders of the merging firms are identical; or the acquiring firm actually is the majority shareholder of the transferor. Usually, the acquirer has therefore an interest to pay as little as possible for the transferor, i. e. the acquirer will try to keep the exchange rate for the transferor's shares down. However, this is not necessarily the case. If there is a group of companies, consisting of the dominating company A and two subsidiaries B and C, whose share majorities are held by A, and A decides to merge B and C, a quite different pattern of interests may arise. If A decides to let B be absorbed by C, but wants to increase its share in C, it will set the exchange rate as high as possible, thus getting more shares of C in exchange for its shares in B. In this case, the interest of the minority shareholders of the acquirer (C) is at stake, because their company pays too much for the acquisition¹. In any case, the temptation to favour one firm above the other at the cost of its minority is almost inevitable, and this is the reason why the law has to introduce additional protective provisions to complete the "self-regulating" mechanism which is usually sufficient for the protection of the minority.

Moreover, even without any malicious intentions on the side of the acquirer, the position of the minority may deteriorate as a consequence of the merger. In the newly formed company, their influence will be automatically reduced. Thus, they may be deprived of minority rights or may lose the position of an obstructive minority². This effect may also be instrumentalized: sometimes the possibility to "reposition" minority shareholders of the acquired company is seen as one of the main advantages of full legal merger compared with the mere takeover³.

1) Bayer, Aktiengesellschaft, 1988, p. 324.

2) Bayer, Aktiengesellschaft, 1988, p. 323;
Timm, Aktiengesellschaft, 1982, p. 98.

3) Schmit, in: Schmit/van der Beek/Raap, Dutch Business Law, p. 211.

Finally, it should be noted that the problems of minority protection are basically independent from the model of shareholder participation to which one adheres. In the continental model, the minority may find some support from the more independent management which is supposed to respect the interests of all shareholders. However, the continental model considers the shareholders as one block with homogenous interests that have to be balanced against the other interests in the firm. This shareholder interest is democratically defined by the majority, so that we arrive at the same problems as with the Anglo-American model.

1.4.3.3 International merger and shareholder interests

I submit that in cases of international merger shareholders ought to enjoy even better protection than in purely national transactions. The need for increased shareholder protection has some quite trivial reasons, such as geographical distance. Most company laws require the personal attendance of the shareholder or his representative at the general meeting, absentee voting is not allowed. For small shareholders, this may be a real problem. There is a significant difference whether the general meeting takes place in Frankfurt/Main or in Madrid, and the higher travel expenses may be sufficient to prevent him from exercising his rights in person¹. In general, a shareholder will find it more costly and more difficult to exercise his rights under a foreign legal regime unknown to him².

A possible objection against any stronger protection for international procedures is the harmonization of company law. With the harmonization and unification achieved by the EC, there ought to be basically no differences between a national and an international transaction. Even if the nationality of the company changes, the shareholder will be subject to an equivalent company law, which provides in every European country the same protective standard³.

1) Lutter, in: Lutter (ed.), Europäische Aktiengesellschaft, p. 56 fn. 3.

2) Grossfeld, Rechtsprobleme multinationaler Unternehmen, p. 138.

3) cf. Beitzke, Zeitschrift für Handelsrecht 1965, p. 42;
undecided Lutter, Zeitschrift für Gesellschaftsrecht 1992, p. 447 et seq. and p. 450.

This is a rather idealistic view. It is, however, shared by the Commission, which wants to prohibit explicitly any differentiation between national and international mergers, for the reason that "...the legal mechanics of national and cross-border mergers are identical"¹. This was not always the case: Some years ago, even the Commission acknowledged that harmonization of company law is not sufficient to remove all the problems². In fact, the harmonization of company law is far from being completed. Even in the harmonized parts of company law significant differences between the company regimes in the member states remain³. Even if this was not the case, the political and economic environment varies from member state to member state, notwithstanding the fundamental differences between the different company law models we have discussed⁴.

Part 2: The existing legal framework

"1992 prompts unprecedented wave of mergers"⁵. Today, this statement seems to be somewhat exaggerated. But a certain increase of merger activity seems to be likely, and obviously EC policy is not hostile towards this trend. But even if the economic and political conditions are favourable, it remains to be examined if this is also true for the legal framework.

2.1 The Third Directive and its provisions for shareholder protection

Every discussion of legal context of merger has to start with the already mentioned Third Directive⁶, concerning the merger of public

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- 1) Commission, Bulletin of the EC, Suppl. 3/85, p. 6; cf. artt. 5 (1), 7, 9 (2), 15 (2) of the proposed Tenth Directive.
 - 2) Commission, Bulletin of the EC, Suppl. 13/73, p. 35.
 - 3) Dine, *European Law Review* 1989, p. 328; Lutter, *Aktiengesellschaft* 1990, p. 417.
 - 4) cf. Wiedemann, *Zeitschrift für Gesellschaftsrecht* 1978, p. 489.
 - 5) Spellman, *Europe*, Dec. 88, p. 26.
 - 6) Directive 78/855/EEC, OJ No L 295 20.10.1978, pp. 36 et seq.

companies. This EC directive set the framework for the national company laws governing merger, in particular with regard to the problems of shareholder protection.

2.1.1 General features

Even without exhaustive studies of the different European company laws it is *prima facie* clear that differences in the legal regimes of companies will put obstacles in the way of merging these companies. In fact, the different national corporate regimes are sometimes seen as the most important obstacle to any cross-border merger¹. Consequently, it was recognized by the EC from the very beginning that a common or single market would require legal structures that are independent from national legal systems².

The first efforts towards the aim of harmonizing the national merger regimes by a directive started in 1970. However, the adoption of the directive was delayed because of controversy about the protection of employee rights³. It took until 1978 to complete the work, the Council adopted the directive finally on 9 October 1978⁴.

The directive pursued two objectives:

- Firstly, it was seen as necessary to establish a common protective standard for shareholders, employees or creditors, especially if those persons had their domicile in a different member state⁵.
- Secondly, it was planned as a step towards a regulation of cross-frontier mergers, since a basic condition for any regulation of this type was the harmonization of the different national legal merger regimes⁶.

1) Behrens, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 13; Campbell, in: Campbell/Garbus (eds.), *Mergers and Acquisitions*, p. 4; Layton, *Cross Frontier Mergers*, pp. 12-18.

2) Gleichmann, *Aktiengesellschaft* 1988, p. 159.

3) Woolridge, *Company law*, p. 36.

4) Morera, *Foro Italiano* 1987, parte IV, column 250.

5) Commission, *La droit des sociétés*, p. 5; Ganske, *Betrieb* 1981, p. 1551.

6) Parliament, opinion on the proposal for a 10th Directive, OJ No C 303 of 25 November 1985, p. 27; Ganske, *Betrieb* 1981, p. 1551;

But the directive itself deals only with mergers of companies of the same member state, i. e. there are no provisions for cross-border mergers. These are up to now left to the discretion of the member states.

Having the second point in mind, it is not without irony that the Commission now uses the adoption of the Third Directive as an argument for the necessity of a directive on international mergers¹. The taking of the first preparatory step is now quoted as an independent reason to take the second one!

The legal foundation for the Third Directive is provided by art. 54 (3) (g) of the EEC treaty², which deals with the harmonization of protective rules in company law. Since the directive had as its first purpose the establishment of a common protective standard, the validity of this legal foundation can not be doubted. However, one might ask if the introduction of a legal regime for international merger is also within the scope of art. 54 (3) (g). Any legislative measure with the latter as its primary objective would face some difficulties if based on art. 53 (3) (g).

With regard to its material contents, the directive followed the pattern of the French merger regulations, but was also influenced by German and Italian law³. The central element of the directive is the total transfer of all assets and liabilities to the acquiring company (or the newly created company in the case of a consolidation) without winding up the transferring company or companies. Thus, the continuity of the legal relations is provided, which is of special importance for the creditors and employees of the transferring companies⁴. The shareholders of the transferor company are compensated by shares of the acquiring company. Their membership in the dissolved transferor company comes to an end, and they become shareholders of the

Girolami, *Diritto Comunitario* 1-2 1983, p. 347;
 Priester, *Neue Juristische Wochenschrift* 1983, p. 1459;
 cf. Woolrdige, *Company law*, p. 38.

- 1) Commission, *Bulletin of the EC*, Suppl. 3/85, p. 6.
- 2) Preamble of the Third Directive, *OJ No L 295*, 20. 10. 1978, p. 36.
- 3) Ganske, *Betrieb* 1981, p. 1552;
 Priester, *Neue Juristische Wochenschrift* 1983, p. 1459;
 Woolrdige, *Company Law*, p. 34.
- 4) Ffrench, *International Law III*, p. 11.

acquiring company (Third Directive, art. 19). The procedure of the total transfer (German "*Universalsukzession*") without winding up the companies and exchange of shares reconstructs in legal terms the economic transaction of merger, by which the economic entities are united without liquidating them.

As already mentioned, there are basically two types of merger: the merger by the formation of a new company (Third Directive, art. 3), and the merger by acquisition (Third Directive, art. 4). For various reasons, the latter type is more common. Since no new company is founded, it is usually less costly. Moreover, this type of merger has the advantage that the goodwill of at least one of the companies is saved. The merger by formation of a new company may be preferred if the merging companies are of equal size and for reasons of prestige shall be treated equally. But since the *economic* merger usually takes the form of an acquisition or a takeover, its legal counterpart - the merger by acquisition (or "absorption") - is more important. Consequently, most legal regulations deal mainly with this type and contain only a few special provisions for merger by formation of a new company (the only exception was the proposal for a convention on international merger, which dedicated its whole chapter III to this subject). For the purpose of this thesis I can restrict myself therefore to the more common type of absorption.

One of the central problems of the whole procedure is obviously the calculation of the exchange rate of the shares. It is not only of greatest interest to the shareholders, but poses at the same time considerable practical problems, since it requires the valuation of the two companies. It would not be sufficient just to rely on the market values of the shares, because usually the market price is biased as a consequence of pre-merger purchases of the transferor company's shares. This procedure is further complicated by the fact that there is no generally acknowledged method to value a company¹.

1) Becker, Aktiengesellschaft 1988, p. 226.

2.1.2 The system of shareholder protection

The central point of the Third Directive was the strengthening of shareholders protection¹. Its protective mechanisms are divided in two groups, one being effective *a priori*, the other one *a posteriori*². The *a priori* protection consists of rights of information and requirements of approval by the general meeting; the *a posteriori* protection is provided by a claim to judicial control of the whole procedure. The central issue in this field is the balance between the protective measures on the one side and the legitimate interests of the merging companies on the other side. The information rights must not be too far-reaching, so that the companies are not forced to reveal important business secrets; and too far-reaching judicial control may prevent a merger from coming into force for years.

2.1.2.1 *A priori* protection by the directive

The outlines of the protective system *a priori* can be summed up as follows: in general, no merger is possible without the consent of the shareholders. They have to be informed about the underlying economic facts and considerations. The compliance with these provisions is safeguarded by a double check: independent experts have to examine the economic side of the proposed transaction, and some form of legal control secures the legality of the whole procedure.

The central element of the *a priori* protection is the requirement of the approval of a qualified majority of the shareholders in a general meeting (art. 7). The approval is dispensable in some cases, e. g. when the acquiring company already holds 90 percent or more of the shares

1) Preamble of the Third Directive, OJ No L 295, 20. 10. 1978, p. 36;
Priester, *Neue Juristische Wochenschrift* 1983, p. 1459;
Hoffmann-Becking, in: Goerdeler et al., *Festschrift für Hans-Joachim Fleck*, p. 105.

2) Ganske, *Betrieb* 1981, 1552;
cf. Girolami, *Diritto Comunitario* 1983, p. 360.
The terminology of "a priori" and "a posteriori" protection can be traced back to the report on the proposal for a convention on international mergers, where it was applied to the system of creditor protection, Commission, *Bulletin of the EC*, Suppl. 13/73, p. 57 *et seq.*

of the acquired company (artt. 27 - 29). The high majority required reflects the fact that a merger usually takes place within an established group of companies, i. e. the acquirer is already the majority shareholder of the transferor¹. And from a dogmatic point of view, it is needed to justify the encroachment on the shareholders' property rights.

Requirements of approval are only an effective protective measure if the shareholders get a true and fair view of the proposed merger. Therefore, rights of information belong to the core of the *a priori* protection². As a basis for the decision of the general meeting, the draft terms of the envisaged merger have to be drawn up by the managements. Art. 5 of the directive provides a fairly detailed catalogue of the compulsory contents of this draft. In the same article, the directive demands the publication of the draft terms of the merger at least one month before the general meeting, which has to decide about the merger. Furthermore, the administrative or management bodies of the involved companies have, according to art. 9, to draw up a report explaining the legal and economic motives of the merger.

The directive does not only rely on the goodwill of the managements to provide the shareholders with as objective information as possible. Art. 10 requires an expert's report examining the draft terms of the merger as an independent check of the economic aspects of the proposed transaction. The final statement of the report must contain a valuation of the exchange rate for the transferor company's shares - an understandable requirement, considering the importance of this exchange rate for the shareholders. Although this provision also protects the company's creditors, its primary objective is shareholder protection³. All these reports must be made available to the shareholders at least one month before the date of the general meeting, together with some additional documents such as annual accounts of the merging companies.

The examination by independent experts should secure the reliability of the economic information given to the shareholders. The legal validity of the proposed transaction is also subject to some form of independent

1) Bayer, Aktiengesellschaft 1988, p. 323.

2) Bayer, Aktiengesellschaft 1988, p. 325;
Guyon, Droit des affaires I, p. 626.

3) Morera, Foro italiano 1987, parte IV, column 254.

control. Either there has to be a preliminary judicial or administrative control, or the legal instruments have to be drawn up and certified in due legal form. In the latter case the certifying authority is explicitly required to check the validity of the certified acts (art. 16).

2.1.2.2 *A posteriori* protection

The *a posteriori* protection by judicial review of the merger is left to regulation by the member states. The only provision of the directive in this regard deals with the conditions under which a completed merger may be nullified (art. 22). This is of course a point of central importance for all involved parties: the management of the merged companies, the shareholders, the creditors and the employees¹.

An additional element is the civil liability of the administrative or management bodies and the experts who draw up the reports. They may be sued by the shareholders for misconduct during the preparation of the merger (artt. 20, 21). However, the practical importance of this civil liability should not be overestimated.

We will have to come back to the Third Directive when we have examined its implementation in the major EC member states. Then it will be possible to judge if the directive has achieved its purpose to lay the base for international merger legislation by harmonizing the different national company law systems (see *infra*, 3.1.1).

2.2 Specific national regulations concerning cross-border merger

Even in its field of application the Third Directive left some leeway for the individual company law regimes, so that some member states could develop additional measures for shareholder protection. And international merger is governed so far exclusively by national legislation, if it is governed at all. The following outline of the national merger laws will attach special importance to the situations in Germany

1) Girolami, *Diritto Comunitario* 1983, p. 367.

and the UK as the legal systems closest to the two models of company law mentioned in the first part.

2.2.1 Germany

As we have already seen in the first part, in the "continental" system mergers play a more prominent role than in the Anglo-American system. It is therefore not surprising that Germany possesses fairly detailed merger legislation.

2.2.1.1 Implementation of the Third Directive

Mergers of public companies (*Verschmelzung von Aktiengesellschaften*) are regulated by sect. 339 - 358 of the Stock Companies Act (*Aktiengesetz - AktG*). The Third Directive was implemented by the law of October 25, 1982¹. The approval of the merger requires at least a majority of three fourths of the represented shares (sect. 340c AktG), thereby exceeding the requirements of the Third Directive. In the field of *a priori* protection, there are no substantial additions to the framework provided by the Third Directive. Of a certain interest is only the additional protection provided by the procedure according to sect. 132, 340d (4) AktG, by which shareholders may enforce their rights to information².

Finally, it should be noted that there exists a project to reform the law of mergers and transformations of commercial companies. A draft statute on the transformation of companies (*Entwurf eines Umwandlungsgesetzes*) including also merger has been submitted in 1988³. However, the draft does not provide any substantially new proposals regarding merger, in particular it does not provide any

1) BGBl. 1982 I, p. 1425 et seq.

2) Becker, *Aktiengesellschaft* 1988, p. 224.

3) "Diskussionsentwurf eines Gesetzes zur Bereinigung des Umwandlungsrechts", *Bundesanzeiger* 1988, Nr. 214 a.

regulations on cross-border mergers¹. As a consequence of the legal problems of reunification, the work on the project has been interrupted.

2.2.1.2 The procedure according to sect. 352c AktG

In Germany, the legal discussion concentrated on the *a posteriori* protection, which was only briefly touched by the Third Directive². A *posteriori* protection means mainly judicial review of the merger procedure; and the German legislator used the freedom left in this field by the Third Directive to introduce a peculiar additional protective procedure not required by the Third Directive³. Sect. 352c and 353 (I) AktG provide a special procedure for judicial review of the conditions of the share exchange, after the merger came into effect. By this procedure, the judge can order an additional offsetting cash payment to the shareholders of the transferor company. It is meant to offer a sensible compromise between the protection of shareholders and the interest of the companies, and enabled the legislator to exclude the contestation of the merger approval on grounds of an insufficient exchange rate, thus removing the most important reason for the judicial challenge of the merger procedure⁴.

However, this German particularity has been criticized for various reasons: first of all, it is restricted to the shareholders of the transferor company, although minority shareholders of the acquiring company may have a legitimate interest to use this procedure if they estimate the exchange rate as too high⁵. The legislative reason was that only the shareholders of the transferor company suffer a change in their membership. Moreover, the procedure shall provide a possibility to correct the exchange rate, which is only relevant for the shareholders

1) Ebenroth/Wilken, *Juristenzeitung* 1991, p. 1119.

2) Priester, *Neue Juristische Wochenschrift* 1983, p. 1460;
Timm, *Juristenzeitung* 1982, 407.

3) Ffrench, *International Law III*, p. 87;
Priester, *Neue Juristische Wochenschrift* 1983, p. 1463.

4) Sect. 352c (1) (1) AktG;
Priester, *Neue Juristische Wochenschrift* 1983, p. 1463.

5) Priester, *Neue Juristische Wochenschrift* 1983, p. 1463.

of the transferor company¹. But on the other hand, sometimes it is just a matter of chance which company plays the role of transferor and which the role of acquirer².

But even for the shareholders of the transferor company, the right is subject to some restrictions. Only the shareholders who protested against the merger in the general meeting may claim compensation³. Moreover, each shareholder has to apply individually for compensation, otherwise he will not benefit from this procedure. Both restraints are criticized. They are meant to exclude windfall profits; but in a very similar procedure provided by the sect. 305, 306 AktG (concerning the formation of a group), these restraints do not exist⁴. And their only effect may be to induce shareholders to protest against the merger as a merely precautionary measure.

Furthermore, there exists a deadline of two months after the entering of the merger in the business register (sect. 352c (2) (2) AktG), which is criticized as an unfair and unreasonable restraint⁵.

2.2.1.3 Judicial review of merger decisions

The introduction of the procedure according to sect. 352 AktG covered only a part, although a very important part, of the field of judicial review of merger. By this procedure, the courts may review not only whether the formal requirements of the merging procedure were met, but also whether the substantive decision (about the exchange ratio) was justified. The same question arises for all judicial decisions about the merger: are the courts restricted to controlling formal compliance with the relevant provisions, or may they extend their control to the necessity and the expediency of the decision? This question is, of course, not restricted to merger decisions, but because of their

1) Bundestags-Drucksache 9/1065, p. 20.

2) Priester, Neue Juristische Wochenschrift 1983, p. 1463; Timm, Juristenzeitung 1982, p. 410.

3) Sect. 352c (2) (1), 245 No. 1 AktG.

4) Priester, Neue Juristische Wochenschrift 1983, p. 1463.

5) Ffrench, International Law III, p. 87.

fundamental effects it is of particular importance here¹. The legislator could - and did - not answer the question in the context of merger legislation, so that the discussion will have to continue².

On the general question of nullification of a merger, the German implementation went beyond the requirements of the Third Directive. Once the merger has been entered into the business register, it can not be declared void (sect. 352a AktG). Any defects of the procedure lead after this moment only to compensatory claims³. At the first view, this seems to be a very company-friendly provision; but there exists also a public interest in the stability of an executed merger⁴. And at least the majority shareholders supporting the merger will not be in favour of excessive litigation. However, before the merger is entered into the business register, it may be challenged. The judicial procedure may have the consequence that it is impossible to enter the merger into the business register, thus preventing the merger from coming into force for years. Merger legislation faces the problem here that it cannot rely on the majority interests to protect the shareholders as a whole because of the possible structural conflicts between majority and minority, when the majority is tempted to pursue extra-firm interests. The situation is not facilitated by the fact that certain minority shareholders may in turn use their protected position as an efficient instrument to blackmail the firm.

2.2.1.4 Cross-border merger

With regard to cross-border mergers, two cases must be distinguished: the acquisition of a foreign company by a German one, and the acquisition of a German company by a foreign one⁵.

1) Timm, Aktiengesellschaft 1982, pp. 106 et seq.;
cf. Bundesgerichtshof, Z 70, 117 "Mannesmann" and Z 71, 40 "Kali und Salz";
against any material review Lutter, Zeitschrift für Gesellschaftsrecht 1981, p. 180.

- 2) Priester, Neue Juristische Wochenschrift 1983, p. 1464.
- 3) Priester, Neue Juristische Wochenschrift 1983, p. 1465.
- 4) Priester, Neue Juristische Wochenschrift 1983, p. 1465.
- 5) Grossfeld, Rechtsprobleme multinationaler Unternehmen, p. 137.

According to some commentators, neither the first nor second type of operation is possible under German law¹. But the prevailing opinion is at least in principle in favour of the absorption of a foreign firm². There are no general objections against this procedure, since the effects for the German company in this case should not be different from a purely domestic operation³, as long as the transferor company fulfills the information requirements of German law. However, this is likely to become a quite difficult task. The foreign transferor company has to fulfill all the requirements of German merger legislation; i. e. the merger agreement and the necessary reports have to be drafted in German language; the experts' report must be drawn up by a German chartered accountant, and so on⁴. Moreover, the domicile law of the transferor company must allow the whole operation⁵. This means, it has to allow the second type of cross-border merger, the absorption of a national company by a foreign one. Because the German law cannot order the universal succession and the dissolution without the winding up of the foreign company, the foreign legal system has to provide the appropriate regulations⁶.

The real difficulties start when we come to the second type of international merger, i. e. the absorption of a domestic company by a foreign one. According to the almost unanimous view of German jurisprudence, German merger law does not allow the absorption of a German company by a foreign one⁷. This is true of almost all EC merger law systems. Technically this would mean the transfer of the company

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- 1) Baumbach/Hueck (eds.), Aktiengesetz, vor § 339 AktG Rn. 7; cf. Lutter, Gutachten H zum 48. DJT, p. 17.
 - 2) Grossfeld/Jasper, *RabelsZ* 53 (1989), pp. 64 - 69; Schilling/Zutt, in: Hachenburg (ed.), *Kommentar zum GmbHG*, § 77 Anh. II Rn. 20; Heckschen, *Rheinische Notarkammer* 1989, p. 110; Kraft, in: Zöllner (ed.), *Aktiengesetz*, § 339 AktG Rn. 26 - 32.
 - 3) Grossfeld, *Rechtsprobleme multinationaler Unternehmen*, p. 137 et seq.
 - 4) Ebenroth/Wilken, *Juristenzeitung* 1991, p. 1120; Grossfeld/Jasper, *RabelsZ* 53 (1989), pp. 64 - 69.
 - 5) Grossfeld/Jasper, *RabelsZ* 53 (1989), p. 69.
 - 6) Lutter, *Gutachten H zum 48. DJT*, p. 17.
 - 7) Ebenroth/Wilken, *Juristenzeitung* 1991, p. 1120 with a minor exception; Grossfeld/Jasper, *RabelsZ* 53 (1989), p. 70.

domicile abroad. According to almost all company law systems of the EC (the only exception being Italy) this has the consequence of the dissolution and winding up of the company¹.

The central argument against the admissibility of this type of merger is the suspicion that shareholders, creditors and employees of the German company might suffer legal shortcomings when their company is absorbed by a foreign company². It might be questioned if this suspicion is justified, at least with regard to the protection of shareholders and creditors. Within the EC, the Third Directive has set a common protective standard. But there remain the numerous problems of international transactions mentioned earlier (see *supra*, 1.4.3.3). As an additional difficulty, the problem of German employee co-determination is not resolved.

2.2.2 United Kingdom

Considering the fundamental differences between the British and the continental legal systems in general and the company law systems in particular, it is not surprising to find in the UK a completely different legal framework for mergers. Until 1987, there existed no special provisions for legal mergers. Only the implementation of the Third Directive changed this situation.

Sect. 425 of the Companies Act (C. A.) 1985 provides a general regulation for arrangements or compromises between a company and either

- its creditors
- its members
- any combination of creditors and members or classes of them. These arrangements may be used to restructure the capital of a company, and in this way to effect a merger. The schemes under this provision require the sanction of a court to enter into force, and the effect is

"to supply, by recourse to the procedure thereby prescribed, the absence of that individual agreement by every member of the class to be bound by the scheme which would otherwise be

1) Lutter, Gutachten H zum 48. DJT, p. 17.

2) Heckschen, Rheinische Notarkammer 1989, p. 110.

necessary to give it validity"¹.

In my view it is significant that for British law a merger is essentially seen as an instrument to restructure the capital of a company, not, as in continental legal systems, as a method to unite two independent legal entities.

Special regulations for mergers of public companies are provided by the sections 427 and 427A, introduced to implement the Third Directive². Apart from the procedure as foreseen by the directive, these sections give the court special powers to facilitate the scheme. Of particular importance is sect. 427 (3) (d) that empowers the court to order the dissolution of the transferor company without following the procedure of winding up.

Regarding international mergers, it is decisive that sections 427 and 427A are not applicable if the acquiring company is a foreign one³, i. e. an international merger is possible only under the general rule of sect. 425. Thus, in the absence of any provision like sect. 427 (3) (d) the transferor has to be wound up. It is the well-known pattern: international mergers are only possible when a foreign firm is transferor, not vice versa.

Important for shareholder protection is the role of the court. It has a certain discretion whether to sanction the scheme or not - "the court is not a mere rubber stamp". For example, it will not sanction a scheme when a minority was coerced by the majority⁴.

Moreover, when there is such an objection that "any reasonable man of business" might say he would not approve the scheme, it will not be sanctioned by the court⁵. However, what seems to be the complete judicial review of the necessity and expediency of the merger, turns out to be a rather formal control of the merger procedure: it is unlikely that a court will not confirm a scheme when the correct procedure has been

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- 1) *Per Younger J. in Re Guardian Assurance Co* [1917] 1 Ch. 431, 441.
 - 2) The Companies (Mergers and Divisions) Regulations 1987, S. I. no. 1991 of 1987.
 - 3) Schmitthoff, in Palmer's company law, para. 12.004.
 - 4) Schmitthoff, in: Palmer's company law, para 12.028.
 - 5) Schmitthoff, in: Palmer's company law, para. 12030; example: *Re N. F. U. Development Trust Ltd.* [1972] 1 W. L. R. 1548.

followed and a high majority approval has been obtained¹.

However, these provisions are of a rather academic interest, since most British firms still prefer the simple take-over to the full legal merger. An obvious reason is the necessity to obtain a court order, which is both cumbersome and expensive². But apart from this procedural problem, we have already seen that because of the stronger position of shareholders in the British company law system it is sufficient to acquire the majority of shares to exert control, whereas in the continental systems full control can only be achieved by integrating the structures of the companies (see *supra* 1.4.2).

2.2.3 Belgium

As late as 1992, Belgium had not implemented the Third Directive. Only a draft bill has been submitted to parliament in the 1989-90 session, although the European Court of Justice had already condemned Belgium in 1989 for not having implemented the Third Directive (and the Sixth Directive on divisions)³. Until the final implementation, the only legal framework available is provided by art. 182 L. C. S. (*Lois coordonnées sur les sociétés commerciales*), dealing with the powers of the liquidator of a *société anonyme*:

"Ils peuvent, mais seulement avec l'autorisation de l'assemblée générale des associés, donnée conformément à l'article 179, ... faire apport de l'avoir social dans d'autres sociétés."

This article is used as a legal basis for absorptions and divisions⁴. Thus we find the surprising situation that although the concept of merger is well known in Belgium, there are no explicit rules for this transaction⁵.

According to the prevailing view among Belgian lawyers, a merger requires that the merging companies must have identical nationalities, i.

1) Schmitthoff, in: Palmer's company law, para 12.030.

2) Stanton-Reid/Ruparelia, in: Cougnon, The EEC merger and parent-subsubsidiary directives, p. 186.

3) Cougnon, The EEC merger and parent-subsubsidiary directives, p. 25; van Hille, La société anonyme, p. 630.

4) van Hille, La société anonyme, p. 364 et seq.

5) Rodière, La fusion, p. 2 fn. 1.

e. a merger is only allowed between Belgian companies¹. The Belgian parliament stated that it expected this rule to be "strictly respected"².

2.2.4 Denmark

Mergers (*fusion*) are governed by sect. 134 - 134l of the Public Limited Companies Act (*aktieselskabsloven*). The Third Directive was implemented by the law no. 282 of 9 June 1982, Lovtidene A 1982, 649.

The Danish merger law provides a procedure quite similar to the German procedure according to sect. 352c AktG: dissenting shareholders may claim compensation within 14 days after the approval of the merger plan if they consider the proposed payment as too low. This provision replaced the right of withdrawal, which was abolished by the law implementing the Third Directive³.

The regulations apply only to Danish companies, so that a merger between a foreign and a Danish company is only possible by purchasing all the assets and debts⁴.

2.2.5 France

The most important regulations can be found in the Law of July 24, 1966, artt. 371-389. It was amended to implement the Third Directive in 1988⁵. The French legislator kept an additional protective instrument in art. 373. This norm requires the consent of all shareholders if their burdens are increased, e. g. when a "*société anonyme*" is absorbed by

1) Ffrench, International Law III, p. 53.

2) Chambre de Représentants, Parliamentary Documents, Session 1956-57, No. 641-2.

3) sect. 134f;
Ffrench, International Law III, p. 308;
Gomard, Aktieselskaber, p. 303 et seq.

4) Ffrench, International Law III, p. 312;
Gomard, Aktieselskaber, p. 298.

5) Loi du 5 janvier 1988 relative aux fusions et aux scissions de sociétés commerciales et modifiant la loi n° 66-537 du 24 juillet 1966 sur les sociétés commerciales.

a "*société en nom collectif*", the shareholders thus being deprived of their limited liability. Since such cases are rather infrequent, the regulation is not considered as very important¹.

The international absorption of one company by another one of different nationality is regarded as impossible².

2.2.6 Greece

Mergers are governed by artt. 68 and 69 of Legislative Decree 174/1963. The Third Directive was implemented by Presidential Decree no. 498/87, Journal Officiel 236 of 31 December 1987.

2.2.7 Ireland

Mergers are regulated by sections 201-204 of the Companies Act of 1963³. The Third Directive was implemented by Statutory instrument No. 137 of 1987, Official Gazette 29 May 1987, p. 829.

2.2.8 Italy

Mergers are regulated by artt. 2501-2504^{sexies} of the Codice Civile. There are no special provisions for the necessary approval of the merger. Since the merger is seen as a modification of the statutes of the companies, the special rules for the alteration of the statute apply (art.

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- 1) Guyon, Droit des affaires I, p. 627;
cf. Ffrench, International Law III, p. 135.
 - 2) Bruneau, Gazette du Palais, 29. Oct. 1991, Doctrine p. 622;
Kahn, in: Cougnon, The EEC merger and parent-subsidiary directives,
p. 73;
Guyon, Droit des affaires I, p. 634: "*Les fusions internationales ne sont donc pas pour demain.*";
Synvet, Droit européen 1990, p. 261.
 - 3) Ffrench, International Law III, p. 63.

2365)¹. It is not clear if nonconsenting shareholders have a right of withdrawal from a share company in case of a merger (cf. art. 2347)².

International mergers are allowed, according to art. 16 of the Introductory Provisions of the Civil Code, thus making Italy the only exception to the general rule that the absorption of a domestic company by a foreign one is not allowed³. However, at least a part of Italian doctrine considers that in this case the dissenting minority has a right of withdrawal according to art. 2347 - and there does not seem to be a single case of international merger⁴!

2.2.9 Luxembourg

The Third Directive was implemented by the law of 7 September 1987, Memorial A-77 of 15 September 1987, p. 1792.

2.2.10 The Netherlands

The full legal merger (*fusie*) is not very common in the Netherlands. Until the implementation of the Third Directive by the Law of January 19, 1983 (Staatsblad 1983, no. 59) no special regulations for merger were provided⁵. As late as 1985, its fiscal consequences were not fully clear⁶. As usual, no provisions for international mergers exist⁷.

1) Ffrench, International Law IV, p. 40;
Girolami, Diritto Comunitario 1983, p. 355.

2) Ffrench, International Law IV, p. 48.

3) Lutter, Gutachten H zum 48. DJT, p. 17.

4) Commission, Bulletin of the EC, Suppl. 13/73, p. 33.

5) Maeijer, Company law system, p. 276;
Schmit, in: Schmit/van der Beek/Raap, Dutch Business Law, p. 206.

6) Ffrench, International Law III, p. 160.

7) van der Lande/Bellingwout, in: Cougnon, The EEC merger and parent-subsidiary directives, p. 163;
Schmit, in: Schmit/van der Beek/Raap, Dutch Business Law, p. 210.

2.2.11 Portugal

The Third Directive was implemented by Decree Law no. 262/86 of 2 September 1986.

2.2.12 Spain

The central provision is art. 142 of the Stock Company Law (*Ley de Sociedades Anónimas*) from 1951, as amended by Law 19/1989 of 25 July 1989, Boletín Oficial del Estado 27 July 1989 and Decree Law 1564/1989 of 22 December 1989, Boletín Oficial del Estado, 27 December 1989 to implement the Third Directive. Nonconsenting shareholders may withdraw from a participating stock company (art. 1 of Law 83/December 5, 1968). They can claim reimbursement for their shares based on the average quotations of the company. The right must be exercised within one month after the publication of the merger agreement¹.

2.3 How to achieve the results of merger without merging: International merger in practice

The most important result of the previous section is not very encouraging. With the exception of Italy, no EC member state allows the absorption of a domestic company by a foreign one, and the Italian exception seems to be of a rather theoretical nature.

From the point of view of the German law, one possibility is provided by sect. 359 AktG, which provides for the transfer of all the assets of a stock company. The participating companies form a new company and transfer their assets to this company. However, this procedure is somewhat cumbersome and expensive².

As long as it is almost impossible to cross European borders with a full legal merger, an international group of companies created by cross-border takeovers may be the second best solution. Some large

1) Ffrench, *International Law IV*, p. 72-73.

2) Heckschen, *Rheinische Notarkammer* 1989, p. 111.

enterprises are run in this way; for example Ford Europe, which is a management company incorporated in the US State of Delaware, but operating in Britain. However, this solution is not optimal; the transfer of funds between the different national operating units meets fiscal barriers, to name only one main problem¹.

There are various possibilities to create such an international group of companies. One possibility is a contractual cooperation. International consortia or international sub-contracting are at least since the 1960s well-established instruments, in particular in the defence and aircraft industries. Examples are the Concorde project and the Airbus Industries. However, these contractual cooperations seem to be most effective when designed for a single project, but for a long-term combination of resources the cooperation is too weak and the frictions are too high². At least, neither the Concorde nor the Airbus have shown significant advantages over their single-firm US competitors.

The next step in cross-border cooperation can be the establishment of a joint subsidiary. An example is Panavia, a joint subsidiary set up by BAC (British Aircraft Corporation Ltd. - UK), MBB (Messerschmitt-Bölkow-Blohm - Germany) and Fiat (Italy) producing the Tornado fighter aircraft. Another joint subsidiary was set up in 1970 by the computer manufacturers ICL (International Computers Ltd. - UK), Compagnie Internationale pour l'Informatique (F) and Control Data Corporation (US). The subsidiary, Multinational Data, was designed to coordinate research and development activities and to work out common standards for the participating firms as an alternative to the emerging IBM standard³. A cursory glance at the present computer market reveals the outcome of this multinational attempt to compete with IBM. Some of the frictions of a merely contractual cooperation are avoided, but the joint subsidiary is unable to coordinate the whole range of activities of its parents and is completely dependent on the strategy pursued by them⁴.

Companies may choose to run all their operations as something like joint subsidiaries. Dunlop (UK) and Pirelli (I) each acquired large

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- 1) Layton, Cross Frontier Mergers, p. 19.
 - 2) Layton, Cross Frontier Mergers, pp. 20-22.
 - 3) Layton, Cross Frontier Mergers, p. 32.
 - 4) Layton, Cross Frontier Mergers, pp. 21-23.

minority stakes in all the operating subsidiaries of the other firm; a joint management committee was set up to ensure the coordination of the activities¹. This case goes beyond mere contractual cooperation and leads to constructions with the purpose of creating something like an integrated firm. European companies have more or less successfully tested various constructions to circumvent the problem posed by the absence of a cross-border merger.

The first possibility is the creation of a unified management of the separated firms. The Unilever conglomerate may serve as an example. Unilever Ltd. (UK) and Unilever N. V. (Netherlands) were incorporated under their respective national company law, but their boards of directors, each consisting of 25 members, were filled up identically, and the two firms agreed to treat their shareholders equally². The agreement between the two holdings tried to create a legal situation as if the two holdings were subsidiaries of a single super-holding. To secure the agreement a subsidiary of each holding acquired shares of the other holding with the right to designate the members of the board of directors³.

A more sophisticated construction was the Agfa-Gevaert operation. It came into existence in 1964 as a response to the challenge of the overwhelming competition by the US Kodak company. The Belgian Gevaert Photo-Produktion N. V. and the German Agfa AG established two subsidiaries, Gevaert-Agfa N. V. in Belgium and Agfa-Gevaert AG in Germany, in which they each held 50 % of the shares, and both of them were run by an almost identical board of directors. Complete identity of the boards of directors was not possible as a consequence of German rules on co-determination. However, this construction was not only caused by the problems of cross-border combination of resources, but also by the peculiar ownership structures of the companies involved. Whereas Gevaert was owned by a large number of individual shareholders, Agfa's single shareholder was the German company Bayer-Leverkusen. A more integrated structure had led almost automatically to

1) Layton, Cross Frontier Mergers, pp. 28-29.

2) Layton, Cross Frontier Mergers, pp. 23-24.

3) Grossfeld, Rechtsprobleme multinationalen Unternehmen, p. 143.

the predominance of Bayer as the largest shareholder in the construction¹. Thus, Agfa-Gevaert illustrates also the potential dangers of a merger for the shareholders: they may end up in a company with a completely different ownership structure. In the end, the attempt failed for tax reasons: it was impossible to set off the losses of the German activities against the profits of the Belgian branch².

Even more intricate was the Fokker-VFW (Vereinigte Flugtechnische Werke) company. Here, the two original companies each held 50 % of the shares of a single subsidiary company, which in turn owned the assets of two national subsidiaries, Fokker-VFW N. V. (NL) and VFW-Fokker GmbH (D). The case had an interesting background: originally, VFW planned to take over Fokker, which was not accepted by Fokker, insisting on an equally based cooperation. Obviously, considerations of prestige played an important role. However, VFW maintained a slight advantage, because the joint holding company ("Zentralgesellschaft VFW-Fokker GmbH") was incorporated in Germany. Both firms agreed that they would transform the holding in a European Company as soon as this form was available³.

A similar construction was chosen in the case of "Hoesch/Hoogovens". The two companies, Hoesch AG and Koninklijke Nederlandse Hoogovens en Staalfabrieken N. V. each created a subsidiary to which they transferred their assets, the Hoesch-Werke AG and the Hoogovens Ijmuiden B. V. The next step was to create a new Dutch company, ESTEL N. V. Hoesch/Hoogovens. Finally, they transferred the shares of the operating subsidiaries to the ESTEL N. V. in exchange for 50% of the shares of the ESTEL N. V. each. The managements of the resulting five companies are as closely interlocked as possible. This model is also interesting because Hoesch/Hoogovens tried to create something like international co-determination: the supervisory board of ESTEL N. V. consisted of 24 directors, three shareholder representatives, three employee representatives and three neutral members of each nation. This construction also broke down under rather spectacular circumstances⁴.

1) Grossfeld, *Rechtsprobleme multinationaler Unternehmen*, p. 140; Layton, *Cross Frontier Mergers*, pp. 25-26.

2) *Financial Times* of 15 May 1989, p. 6.

3) Layton, *Cross Frontier Mergers*, p. 26.

4) *Financial Times* of 15 May 1989, p. 6.

Different constructions are necessary if the combination of the companies is not based on equality. An example is the absorption of a French *société anonyme* by a British public limited company. The "normal" procedure would have been the transfer of the assets of the French company to the British company in exchange for shares of the latter. Due to the impossibility of an international legal merger, the French company would continue to exist, albeit reduced to a pure holding company. However, this solution would have had an additional disadvantage: the only source of income of the French holding would have been a foreign one, its participation in the British company - and the resulting transfer of profits would have led to fiscal disadvantages. The solution chosen was the following: the French company transferred its assets to a newly formed French company. 99% of the shares of the new company were then transferred to the British company, in exchange for 39% of its shares. Only 1% of the shares was kept by the French parent, but they were designed as preferred shares (*actions de priorité*). The French parent then renounced its claim to the dividends of the British company, which agreed to pay an equivalent sum as dividend on the preferred shares of the new French subsidiary. Thus, the French company held a right of participation in the British company, but the dividend it received was of French origin, so that no fiscal problems arose¹.

We may conclude by saying that all the mentioned examples have two features in common:

- Firstly, the difficult balance between equality and stability. Equality seems to be a driving force behind most of the agreements; each partner tries to prevent the other one from gaining predominance in the joint enterprise, and even if only in matters of status and prestige. The examples of Agfa-Gevaert and Unilever show constructions of cross-border synergy combination of a perfect symmetry, but their keystone - the identical boards of directors - is also their weak point. It is only by sophisticated arrangements that the appointment of identical boards can be ensured, which are further complicated by differing national company laws. The problem becomes even more intricate if the

1) Case Arjomari-Wiggins, Bruneau, Gazette du Palais, 29. Oct. 1991, Doctrine 624.

appointment of the management is not completely controlled by the shareholders, as under the rules of German co-determination. Even if the same persons are appointed, their management is subject to different national company laws. In general, the 50/50 constructions did not prove to be very stable¹.

The second problem is connected with the core problem of cross border merger: shareholder protection. If everything goes well, the two companies are run like a single company, but the sophisticated constructions almost inevitably limit the influence of the shareholders. Their situation closely resembles the situation of shareholders of merging companies, but without the safeguards provided by merger law. The management of the cooperating firms may well be tempted to pursue a policy of "divide et impera" as a reaction to the annoyance of having to deal with two shareholder assemblies instead of one.

To sum up, the makeshift solutions for cross-border combination of resources are at worst complicated mechanisms with a vast range of frictions and possible sources of failure, and at best effective international management structures without an adequate structure of shareholder protection and control.

2.4 International merger and legal instruments for shareholder protection

2.4.1 Are information rights sufficient?

The shareholder protection provided by the Third Directive was exposed to some criticism for rather technical reasons. For instance, the elaborated regime provided by the directive for shareholder information is from the point of view of the managements (and eventual majority shareholders) perhaps a little bit cumbersome ("un peu lourd")².

A second problem is to find the correct balance between information rights for minority shareholders and the equally legitimate interest of the participating companies not to reveal their business secrets. The balancing of these two interests is left to the courts; and it is not surprising that the courts are frequently occupied with this delicate

1) Financial Times of 15 May 1989, p. 6.

2) Le Fèvre, *Revue des Sociétés*, 2/1988, p. 219;
cf. also Wooldridge, *Company law*, p. 38.

task¹. In fact, in Germany most actions of avoidance concerning merger decisions are based on grounds of insufficient information or a too low exchange rate for the shareholders². The problem is only the more delicate, because if the court reaches the decision that the information was insufficient it may declare the whole merger void.

Apart from this rather technical criticism, one might wonder if there are not more fundamental reasons for criticism. The Third Directive relies heavily on a *a priori* protection, providing the shareholders with a vast range of detailed information rights³. It is somewhat surprising that a *a posteriori* protection is rather neglected by the directive. A possible explanation might be the enormous difficulties arising when undoing an already completed merger (it is like undoing an omelette to re-create the eggs). Furthermore, the far-reaching consequences of a merger are hardly compatible with judicial procedures lasting for years⁴. Another point to be taken into consideration is the possible misuse of judicial procedure by minority shareholders. In some cases, minority shareholders threatened to block the whole merger procedure by bringing an action on the grounds of alleged infringement of protective measures, unless the participating companies agreed to pay considerable "compensation"⁵. For these reasons it probably seemed sensible to the EC legislator to concentrate on a *a priori* protection to avoid these problems of a *a posteriori* protection.

According to the economic considerations sketched in the first part⁶, the central function of the "owner" of a firm is to monitor the inputs of the individual participants to prevent them from "shirking". In the

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- 1) cf. e. g. Bundesgerichtshof, Betriebsberater 1982, p. 1134; Bundesgerichtshof, Wertpapier-Mitteilungen 1989, pp. 1129 - 1131; cf. further Bayer, Aktiengesellschaft 1988, pp. 325 - 330.
 - 2) Bayer, Aktiengesellschaft 1988, p. 323.
 - 3) Girolami, Diritto Comunitario 1983, p. 360.
 - 4) Hoffmann-Becking, in: Goerdeler et al., Festschrift für Hans-Joachim Fleck, p. 105.
 - 5) Heckschen, Rheinische Notarkammer 1989, pp. 102 - 103; Hirte, Betriebs-Berater 1988, pp. 1469 - 1470 with some typical examples; cf. as a further example Bundesgerichtshof, Wertpapier-Mitteilungen 1989, p. 1133.
 - 6) See above 1.2.5.

context of a corporation, this means that the shareholders have at least to monitor the firm's management. The basic problem of this construction is the information asymmetry between the shareholders and the management, so that information rights for shareholders to mitigate this asymmetry would be a central element of any merger legislation. From this point of view, the model of the Third Directive is perfectly understandable.

But who will benefit from rights to information? The underlying ideal is the responsible shareholder with enough economic knowledge to evaluate the information and sufficient influence to have a decisive say in the approval procedure. Obviously, most small shareholders do not fit this image. They will neither bother to read the elaborate reports and usually not appear at the general meeting. We might say that the shareholder who is able to fulfil the monitoring function of the property rights approach and who will benefit from the *a priori* protection is rather the large institutional shareholder.

It is of great importance to take into consideration that in most cases the acquiring company will already control the transferor. Sometimes the impression is inevitable that legislators tend to think of the standard case of merger as the merger between two independent companies and that the merger within a group of companies is an exception. Unfortunately, the reality is quite different: most mergers are in fact only the last step in a long-term development and are preceded by the acquisition of a controlling interest. If this fact is ignored, "[t]out l'appareil de protection que constitue la législation des sociétés risque de tourner dans le vide"¹. If the acquirer has already gained a controlling majority, the approval of the general meeting of the transferor will be a mere formality. Information rights will not be a very effective protection for the remaining minority shareholders of the transferor. Turning to the acquiring company, we find a similar situation. Even the most detailed information will not be a sufficient protection for minority shareholders. According to Wiedemann² the problem is that the protection comes too late. The decisive point is not the full legal merger, but the acquisition of a controlling interest.

1) so already Rodière, *La fusion des sociétés*, p. iii.

2) *Zeitschrift für Gesellschaftsrecht* 1978, p. 487.

There remains the protection of the majority shareholder(s) of the acquirer as justification for the *a priori*-protection. But is it a realistic view to expect that the management will confront the majority shareholders with a *fait accompli* by presenting them with an elaborate merger prospect? It seems to be more realistic that the management will contact its most important shareholders before taking the initiative to start any negotiations¹.

Also from a more theoretical point of view, it seems plausible that information rights alone are not sufficient. Even the most detailed information rights cannot alter the basic asymmetry of the information structure, the management as the agent of the principal-agent-relation will have always an informative advantage compared with the shareholders. Legal rules may strengthen the shareholder's position to a certain extent, but they cannot reverse the structure of the principal-agent-relation. To "tame" the management, additional incentives are necessary.

This is not to say that rights to information are superfluous. The basic consideration of the property rights approach that monitoring will erect at least a certain barrier against excessive managerial misbehaviour has its value. Furthermore, there may be situations where the approval by the general meeting actually depends on the information given to the shareholders. But more important, the *a priori* protective provisions force the management to justify its merger decision. This information will serve as an important basis for any judicial review of the merger. Rights to information are essential for effective shareholder protection, but they are far from being sufficient. What are, then, the necessary complements? From the point of view of economic theory, the mechanism restraining the management's independence is the capital market acting as the market for corporate control. Its problem, however, is the fact that transactions on this market are not costless: transaction costs prevent the capital market from being the perfect instrument to control corporate managers. The law should therefore try to reduce these transaction costs.

1) cf. in a different context Rittner, in: Lutter (ed.), Europäische Aktiengesellschaft, p. 95.

2.4.2 Financial protection for investors: The German model

As we have seen, German (and Danish) company law provides an interesting additional protective instrument for the case of an unjustified low exchange rate of a merger. The shareholder cannot claim the nullification of the merger on this ground, but can demand compensation in cash.

Since the German law basically follows the pluralistic idea, and the relation between shareholder and his company is designed not to allow active participation of the shareholder in the management of "his" company, but rather to provide him with a sophisticated instrument of investment, the procedure is an almost ingenious invention. It is highly unlikely that a shareholder attacking the merger decision because he considers the exchange rate as too low is motivated by altruistic reasons. (If shareholders start to invoke altruistic motivations, we are usually confronted with a case of more or less subtle blackmail; see *supra*, 2.4.1). The *a posteriori* control of the exchange rate with possible cash compensations serves the interests of all parties: the interest of the transferor's shareholders, who are compensated for their financial losses, and the interest of the remaining participants who are not confronted with the frightening possibility of an *ex tunc*-nullification of their elaborated merger procedure. At least if one accepts a pluralistic company law model as the underlying idea of international merger legislation, this procedure should form part of it.

However, it does not strengthen the instruments of the capital market. The shareholders get financial compensation, but they remain shareholders of the company. Although the existence of this procedure may serve to deter the management from paying too little interest to the shareholders' financial interests, it does not reduce the transaction costs of the market for corporate control.

2.4.3 The right to withdraw

For an investor-shareholder the procedure described above should be sufficient to safeguard his essentially financial interests. The situation is completely different for the co-entrepreneurial shareholder,

who has more than financial interests in his company. If the company changes completely its structure by a merger, this shareholder most probably will not be satisfied with just an additional cash payment. If he cannot prevent the change, he may well wish to withdraw completely from the company.

And in fact, U. S. company law has developed a right to withdraw (appraisal or dissenter's right) in case of merger¹. The shareholder can claim compensation equivalent to the objective value of his share at the moment of the "triggering transaction", i. e. the merger in our case. The reasons for this right are interesting: "... the minority should not be forced to continue in an enterprise radically different from the venture on which they originally embarked, or in an essentially altered status"². For a co-entrepreneurial shareholder, the loss of the position of an obstructive minority as a consequence of a merger (see *supra*, 1.4.3.2) is of a different quality compared with an investor-shareholder in the same situation.

However, the right is in some cases not applicable for shareholders in quoted companies or when there is a sufficient market for the company's shares. A further exception is made for the shareholders of the acquiring company, when it had previously held all or almost all the shares of the transferor (90 - 95 %) ("short form merger"). In this case the situation of the acquirer's shareholders is not modified, so that there is no necessity for a right to withdrawal.

The main problem is the calculation of the compensation - the problem is so important that the name of the right ("appraisal right") is derived from it. The market value alone is not a suitable base. Especially in the cases where the appraisal right is important, i. e. when there is no sufficient market for the shares, the market value - if it can be determined - may be manipulated. Thus it is acknowledged that the value of the company's assets and its future profits have to be taken into consideration. The appraisal right was sufficiently inconvenient for the companies to develop circumvention strategies.

A further question is the relation to other provisions for shareholder protection, in particular the "fairness test" of the merger decision that

1) Wiedemann, Zeitschrift für Gesellschaftsrecht 1978, p. 478.

2) quoted by Wiedemann, Zeitschrift für Gesellschaftsrecht 1978, p. 478.

is possible under US law. Some state laws provide explicitly that the appraisal right is an exclusive remedy, but most allow both remedies.

The British Company Act acknowledges a right to withdrawal after a take-over because of a tender offer (sect. 209 (2) C. A. 1967). It is important to remember in this context that the British practice favours the take-over instead of the amalgamation!

The right to withdraw is not completely unknown to continental legal systems. Danish law recognized until 1982 this right in the case of merger, and the Italian Codice Civile provides a right to withdraw in the case of the transfer of the corporate domicile abroad (art. 2347 C. c.). At least a part of the doctrine considers that this provision is applicable in the case of international mergers¹. During the law making process, the Council stated that the Third Directive did not prevent member states establishing a right to withdraw for minority shareholders². During the preparation of the proposal for a convention on international merger (see *infra*, 3.2.1), the working group discussed a right to withdraw, but it was not included in the proposal³.

This type of shareholder protection was also discussed in Germany⁴. However, it was not implemented, although it is not unknown to German company law. In the case of merger of cooperatives, the German Act on Cooperative Societies (*Genossenschaftsgesetz* - GenG) provides a right of withdrawal in sect. 93k. For *GmbHs* the right to withdraw in case of fundamental changes of the company is recognized. Also in the case of the transformation of a stock company (AG) into a limited company (*GmbH*) the *Aktiengesetz* provides a right to withdrawal (sect. 375 (1) AktG). Further cases of the right to withdrawal are provided by sect. 320 AktG and sect. 12 *Umwandlungsgesetz*.

One might say that German law acknowledges the right to withdrawal only in the law of groups of companies, but not in merger law. In the European context, we find almost the same situation: whereas the first draft of the statute for a *Societas Europaea* provided in art. 228 a right

1) Commission, Bulletin of the EC, Suppl. 13/73, p. 33.

2) Proceedings of the Council, quoted by Ganske, *Betrieb* 1981, p. 1556 fn. 43.

3) Commission, Bulletin of the EC, Suppl. 13/73, p. 33 fn. 6.

4) Priester, *Neue Juristische Wochenschrift* 1983, p. 1460; Timm, *Aktiengesellschaft* 1982, p. 98.

to withdrawal in the case of formation of a group, this right is not discussed in the context of the merger provisions¹.

The central argument against this right is always that it is not absolutely necessary in the case of public companies, as the shareholder is free to sell his shares, although exceptions are possible². On the other hand, this right is a certain drain on the company's capital. The interest of the shareholder is given greater weight than the interest of the company in an undiminished share capital.

Again, we have to think about the relation between this type of shareholder protection and the model of shareholder presupposed - investor or co-entrepreneur? According to Wiedemann, the right to withdrawal is independent of the two models³. But we should be careful to transfer a model developed in the U. S. for co-entrepreneurial shareholders to the continental investor-shareholders. The view that the right of withdrawal is the consequence of an entrepreneurial model is supported by the fact that German law acknowledges this right mainly for the co-entrepreneurial structures of GmbH and "Genossenschaft". It is not necessarily a lacuna that there is no general principle of withdrawal in the law of public companies.

On the contrary, the interests of investor-shareholders may be protected in a way less detrimental to the interests of the company. The right to claim an additional cash compensation does not strain the company's resources as much as the right to withdraw, since in the former case the company has only to pay out the difference between the value of the new and the old shares and not the whole capital represented by the shares. The method of the German and Danish merger laws seems to be more compatible with the underlying idea of a pluralistic company law regime.

However, these considerations are only valid if the quality of the investment is not changed as a result of the process. Again, German law can provide us with examples: as already mentioned, it allows the withdrawal from an "Aktiengesellschaft" if the company is transformed into a "GmbH", or to put it in a more abstract way, if an investor-

1) Wiedemann, *Zeitschrift für Gesellschaftsrecht* 1978, p. 486.

2) Timm, *Aktiengesellschaft* 1982, p. 106.

3) *Zeitschrift für Gesellschaftsrecht* 1978, p. 494.

company is transformed in a co-entrepreneurial company. In this case, the quality of the shares changes and the shareholder, who ought not to be forced into a co-entrepreneurial company, has the right to withdraw. Similar situations may occur in the field of international merger. If, for instance, a German *Aktiengesellschaft* was to be absorbed by a British public limited company, we would have basically the same situation: an investor-company would be transformed into a more co-entrepreneurial company.

We might even say that whenever the corporate domicile is transferred abroad, the quality of the investment is affected. As we have seen, an international merger has the consequence that not only the legal framework, but also the economic and political circumstances of the investment are altered. It is therefore perfectly in line with the idea of a pluralistic company law if the Italian Codice Civile provides a right to withdraw in this situation¹. The consequence for any legislation on international merger should be that at least the shareholders whose company is absorbed by a foreign one should have a right to withdraw. The procedure should not pose insoluble problems, since the calculation of the exchange rate already requires a valuation of the companies. This valuation can serve as the basis for the compensation of the withdrawing shareholder.

2.4.4 Judicial review of merger decisions in the interest of the company

As a further element of shareholder protection it might be possible to introduce the necessity and expediency of the merger as material requirements for the merger decision², or at least it might be possible to check if the majority shareholders of the companies have infringed a fiduciary duty by taking the merger decision³.

Of course it would be in the interest of minority shareholders to have a full judicial review of the merger decision; but the question is, to what extent the courts have the capacity to decide on such a complex

1) Cf. Lutter, *Zeitschrift für Gesellschaftsrecht* 1992, p. 449.

2) Cf. Timm, *Aktiengesellschaft* 1982, p. 107.

3) Becker, *Aktiengesellschaft* 1988, pp. 227 - 228.

decision as a merger. Furthermore, undefined legal terms like necessity and expediency are likely to render the results of a possible judicial review even more uncertain¹.

In the context of the underlying principles of company law, this legal instrument could be related to the theory of the "company as such". The compensatory procedure and the right to withdraw try to protect the interests of a certain group, namely the minority shareholders. The instrument of judicial review can be used to emphasize the interest of the company as such. Taking this model as a basis, law cannot restrict itself to protecting the interest of certain groups as the interest of the company in itself requires an evaluation of the whole merger procedure by an independent institution. Judicial review of the necessity and expediency of the merger could provide exactly this evaluation.

However, the practical problems of judicial review reveal the basic problem of the model of the company as such. As there is for the time being no satisfying method to determine the interest of the company in itself, it is impossible to provide the courts with standards for the necessary evaluation. Is the prevailing interest of the company its survival? Or is it possible to run certain risks in order to increase profits? Should the company maximize the profits of its employees or of its shareholders? Or does the interest of the company in itself require it to save as much of the profits as possible? As long as legal doctrine has not discovered a way to make the interest of the company in itself an operationable criterion, the determination of this interest should be left exclusively to the competent organs of the company, but should not be used to legitimize judicial interference with the company's affairs.

Part 3: EC regulations on international merger

3.1 Existing regulations

3.1.1 Harmonization with dissonances: The Third Directive revisited

The Third Directive had not only the purpose to harmonize national merger laws, but also to lay the foundations for a directive on inter-

1) Heckschen, Rheinische Notarkammer 1989, p. 76.

national merger¹. It had the effect that all European company laws provide at least a technical procedure for carrying out a legal merger, combined with some provisions for the protection of shareholders and creditors. However, it has not eliminated any distortion of competition resulting from the different company law regimes, even on the technical level. For instance, a merger will require in many cases an increase of the capital of the acquiring company in order to obtain the shares needed for the compensation of the transferor's shareholders. The Third Directive does not provide any regulation of this often decisive procedure².

The adoption of the directive was delayed because of controversy about the protection of employee rights³. Here we meet for the first time one of the major obstacles for the enactment of international merger regulations. Firstly, it will soon emerge that this problem is of the highest importance for the political prospects of any legislative measure in the field of legislation on international mergers. Secondly, there is a direct relation between employee participation and shareholders' rights. Any increased influence of the employees' and their representatives has necessarily the consequence of a decreased shareholder influence. Both problems, employee participation and shareholders' rights, are only parts of the larger issue of the underlying company law model.

An example of the political difficulties this question poses is the so-called "Vredeling" directive on employee participation⁴. In particular the United Kingdom was strongly opposed to any kind of legislative interference in this area⁵. Also of great interest are the international reactions from outside the EC: the Japanese business organization Kaidanren criticized the proposal for the directive and predicted "a restrictive effect on the growth of Japanese investment in Europe and

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- 1) see above 2.1.1;
Girolami, *Diritto Comunitario*, 1-2 1983, p. 347;
Priester, *Neue Juristische Wochenschrift*, 1983, p. 1459;
for Woolridge, *Company law*, p. 38, this is even the main merit of the directive.
 - 2) Le Fèvre, *Revue des Sociétés*, 2/1988, p. 221.
 - 3) Woolridge, *Company law*, p. 36.
 - 4) CEE 77/187;
cf. Kolvenbach, *Betrieb* 1986, p. 1976 et seq.
 - 5) Robinson, *European trends* 4/1987, p. 69.

future industrial cooperation between our two regions"¹. The American reaction was even more violent²: In one particular incident, a representative of several major US firms reportedly threatened the reduction not only of US investments in Europe, but also of US defence commitments to NATO³. According to Kolvenbach (p. 1977) this reaction was quite understandable due to the totally different capital-labour relations in the US. We may conclude that the EC attempted here to introduce regulations that reflected a more continental, "pluralistic" model of public companies. No wonder that the supporters of the "monistic" model were not satisfied.

These discussions, although not directly related to the problem of international merger, show clearly the difficulties EC legislation meets if it tries to cover fields where the fundamental principles of the respective company law are touched. They do not point only to the political obstacles legislation has to overcome, but also to the central importance of the differences between the various company law cultures.

3.1.2 Pro-merger legislation through the backdoor: The directive on merger taxation⁴

It may be surprising to find in the context of a discussion of company law regulations a section about a directive on the harmonization of direct taxes. However, one of the most effective obstacles, perhaps even the most effective, to international mergers was not erected by company law, but by tax law. Usually domestic mergers are facilitated by tax law. The absorption of the transferor company without winding it up allows the transfer of the hidden reserves of the transferor to the

1) Handelsblatt of 31 May 1983, p. 9;
Kolvenbach, Betrieb 1986, p. 1977.

2) Kolvenbach, Betrieb 1986, p. 1977.

3) Wall Street Journal of 2 December 1982, p. 34.

4) OJ No L 226 of 20. 8. 1990, p. 6 et seq.: "Council Directive on the common system of taxation applicable to mergers, divisions, transfer of assets and exchange of shares concerning companies of different Member States". Usually this directive is called the "merger directive". To avoid confusion with the Third and Tenth Directives, I prefer to call it "merger taxation directive".

acquiring company. However, if the acquiring company had its corporate domicile abroad, almost all tax laws ordered the hidden reserves to be revealed and taxed¹. The result was that an international merger was also for fiscal reasons almost impossible².

It was therefore only natural that parallel to the first projects on pro-merger legislation deliberations for a fiscal regime for these transactions started³. The first proposal dates back to 1967, when the "Programme for the harmonization of direct taxes" recommended fiscal measures to facilitate international mergers⁴. In 1969, the Commission submitted the draft of the merger taxation directive⁵. But it took over 20 years before the Council finally adopted it. This delay, unusual even for EC legislation, shows the difficulties of EC interference in the field of taxation, which is regarded as belonging to the core of member state sovereignty.

The directive is part of a package of three measures, the other two being a directive concerning the transfer of dividends from a subsidiary to a parent company and a multilateral convention on arbitration concerning the attribution of profits from international transactions. Obviously, all three measures pursued the objective of facilitating cooperation between European companies⁶.

At the same time, the directive is seen not only as a necessary complementary measure to the company law initiatives, but also as one of the first steps towards the ambitious goal of harmonizing corporate

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- 1) cf. as example §§ 14, 15 (1) of the German Corporate Income Tax Act - *Körperschaftsteuergesetz*, Rieger/Füger, in: Cougnon, The EEC merger and parent-subsidiary directives, p. 112 s.
 - 2) Debatin, Betriebs-Berater 1991, p. 948; Grossfeld, Rechtsprobleme multinationalen Unternehmen, p. 138.
 - 3) Parliament, opinion on the proposal for the merger taxation directive, OJ No C 51 of 29 April 1970, p. 12; cf. also Commission, Bulletin of the EC, Suppl. 13/73, p. 35.
 - 4) Cougnon, The EEC merger and parent-subsidiary directives, p. 11.
 - 5) Cougnon, The EEC merger and parent-subsidiary directives, p. 11.
 - 6) Debatin, Betriebs-Berater 1991, p. 947; Scrivener, intertax 4/1990, p. 207.

taxation in the EC¹. However, for the time being the Commission acknowledges that this aim is out of reach. Officially, the reason is the principle of subsidiarity²; a more realistic view is that the member states simply "did not want it"³.

As the long-winded official name suggests, the Directive concerns mergers not only in the legal sense of the word, but also tries to cover the economic sense of the term⁴.

The directive did not resolve all the problems. Basically, an international merger faces two types of fiscal problems. Firstly, there are short-term, "one-off" costs, such as the taxation of hidden reserves etc. Secondly, there are long-term costs: what result has the merger on the tax burden on the combined profits of the merged firms? Usually national tax laws are not favourable towards international corporate structures, so that the tax burden on the combined profits is likely to increase. The "Agfa-Gevaert" operation failed exactly because of the impossibility of transferring profits from one part of the construction to the other⁵. The merger directive attempts only to solve the first problem and leaves the second untackled⁶. However, even a critical observer came to the conclusion that the implementation of the directive may well have the effect of increasing the number of international amalgamations⁷. Technically, the directive solves the problem by delaying the taxation of hidden reserves (art. 4).

As a fiscal measure, the directive required an unanimous approval by the Council⁸. It is therefore somewhat surprising that this directive was enacted (although not without political disputes and in particular German

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- 1) Parliament, opinion on the proposal for the merger taxation directive, OJ No C 51 of 29 April 1970, p. 12; Scrivener, *intertax* 4/1990, p. 207.
 - 2) Scrivener, *intertax* 4/1990, p. 207.
 - 3) Cougnon, *The EEC merger and parent-subsidary directives*, p. 9.
 - 4) Saß, *Betrieb* 1990, p. 2342.
 - 5) *Financial Times*, 15 May 1989, p. 6.
 - 6) Chown, *intertax* 10/1990, pp. 409 et seq.; cf. also Commission, *Guidelines on company taxation*, *intertax* 10/1990, p. 488.
 - 7) Chown, *intertax* 10/1990, p. 411.
 - 8) Scrivener, *intertax* 4/1990, p. 207.

resistance)¹, whereas the complementary company law measures are facing extreme difficulties. The price for German approval of the directive can be found in art. 11 (1) (b), which allows to safeguard co-determination by not applying the rules of the directive if employee co-determination would be endangered². However, the German resistance was directed mainly against the parent-subsidiary directive that seemed to jeopardize the whole system of German corporate taxation³.

One almost gets the impression here that pro-merger legislation was introduced through the backdoor, far away from any public vigilance and lobbying pressures. However, German legislation countered adequately: "widely unnoticed" the coalition groups presented in parliament a proposal of a "Mitbestimmungs-Beibehaltungsgesetz" (co-determination retention act) that denies the fiscal benefits provided by the merger taxation directive to companies if the application of co-determination provisions is endangered⁴. But it is not only German co-determination supporters who are worried by a directive they might interpret as a hidden attack on co-determination. A British commentator feared just the contrary: "...yet another attempt to slip this one [co-determination] in by the back door. Germans accepted the principle as part of a post-war political compromise, and now seem to want to lumber their competitors with it"⁵. Parallel to the noisy discussions about the company law measure, there seems to be a silent, almost subterranean, but no less decisive struggle on the field of fiscal law... But it is encouraging that it was at least possible to enact legislation on international merger, although it is far from solving all the problems.

3.2 Proposed regulations

3.2.1 The first attempt: The draft convention on cross-frontier merger

Art. 220 of the Treaty of Rome provides the legal basis for a

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- 1) cf. Scrivener, *intertax* 4/1990, p. 207.
 - 2) Commission, *Bulletin of the EC*, Suppl. 3/85, p. 6; Widmann, *intertax* 10/1990, p. 413.
 - 3) Saß, *Betrieb* 1990, p. 2346.
 - 4) *Frankfurter Allgemeine Zeitung*, 5 October 1992.
 - 5) Chown, *intertax* 10/1990, p. 410.

convention on cross-border mergers. It took the Commission until 1972 to present a proposal for this convention, but the negotiations ceased in 1980, because the co-determination problem turned out to be insurmountable¹. A further reason was that it did not seem to be reasonable to elaborate rules for international mergers as long as the fiscal problems were not solved². From the very beginning it was clear that employee participation would be a problem. In the proposal presented by the Commission, a whole section (no 6) was left blank for provisions concerning this problem³, but the gap was never filled.

Regarding the material contents, the proposal contains basically the same provisions as the other instruments discussed in this thesis: the draft terms of merger (called "merger plan", artt. 8 *et seq.*), its examination by independent experts (art. 12), its communication to the shareholders (art. 13), the merger decision (art. 16 *et seq.*), liability of management organs and experts (art. 33, which was however only a rule of conflict) and nullity of the merger (art. 34 *et seq.*, containing a very elaborate regime).

Art. 17 stated that the majority required for the merger decision must not exceed three-quarters of the votes. Obviously the authors of the proposal feared that an unreasonably high majority might be required in an attempt to prevent international mergers. It is a striking feature that both the draft convention and the explanatory report do not pay much attention to the problems of shareholder protection. Perhaps this omission is attributable to the fact that the convention was drafted in a time more euphoric with regard to mergers than the present time.

3.2.2 As a phoenix from its ashes: The Tenth Directive

Only five years after the final breakdown of the Merger Convention, the project to create legislation on international mergers was again put on the agenda. The Commission decided to try a different way: instead

1) Commission, Bulletin of the EC, Suppl. 3/85, p. 5;
Welch, 7 Company Lawyer 69;
Woolridge, Company law, p. 41.

2) Kolvenbach, Betrieb 1986, p. 1975.

3) Commission, Bulletin of the EC, Suppl. 13/73, p. 62.

of the late Convention, it proposed a directive based on art. 54. Perhaps the Commission was encouraged by the comparatively smooth success of the Third Directive.

The legal basis for the Tenth Directive is not beyond any doubts. The Commission quotes art. 54 (3) (g) as the legal basis, but this article deals with the harmonization of protective rules in company law, whereas the proposal is meant to create a new institution of company law. It is therefore not entirely clear if the objective of the Tenth Directive is within the scope of this provision. Moreover, art. 220 third indent states that the member states shall conclude a *treaty* concerning cross-border mergers¹. However, the confinement to the harmonization of protective rules seems not to be very effective². Moreover, since the directive refers in art. 1 (4) to the directive on the rights of employees 77/187/EEC, it might be argued that this provision for workers' protection is beyond the scope of art. 54 (3) (g) of the Treaty³. An alternative legal basis could be found in art. 100 (1)⁴.

It is argued that the form of a directive has some significant advantages, compared with the proposed convention:

Firstly, the law making procedure for a directive ensures that the interests of the important social groups are taken into consideration, which was not the case with a multilateral convention⁵.

Secondly, it is argued that only a directive was within the competence of the Court of Justice⁶. However, the proposal for the convention also contained provisions which allowed its interpretation by the Court of Justice (art. 57 - 60).

The real reason, though never explicitly mentioned, seems to be quite

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- 1) The Commission does not see any problem at this point, cf. Proposal for a Tenth Directive, OJ No C 23 of 23 January 1985, p. 11.
 - 2) Hauschka, Zeitschrift für Rechtspolitik 1990, p. 181.
 - 3) Beschluß des Deutschen Bundesrates, BR-Drucks. 56/85, p. 2.
 - 4) Behrens, Europäische Zeitschrift für Wirtschaftsrecht, 1990, pp. 13-14;
Beschluß des Deutschen Bundesrates, BR-Drucks. 56/85, p. 2.
 - 5) Economic and Social Committee, opinion on the proposal for a 10th Directive, OJ No C 303 of 25 November 1985, p. 27.
 - 6) Commission, Bulletin of the EC, Suppl. 3/85, p. 6;
Economic and Social Committee, opinion on the proposal for a 10th Directive, OJ No C 303 of 25 November 1985, p. 27.

evident: Whereas the convention required the consent of all member states, a directive based on art. 54 (3) (g) requires only a qualified majority in the Council¹. Moreover, even if an agreement could have been reached, a convention had to be ratified by all the member states which would have caused further delay².

Regarding its material contents, the Tenth Directive is based on the Third Directive³. The directive will be applicable to mergers involving companies from two or more different member states (artt. 3 and 4).

There are only some minor differences between the provisions of the Third and the Tenth Directives. The main points where the Commission saw the necessity of a further "synchronization" of the merger procedures are⁴:

- (a) the draft terms of the merger,
- (b) the protective rules for creditors,
- (c) the date on which the merger becomes effective,
- (d) the reasons for nullification of a merger.

Whereas the Third Directive left the question of the date on which the merger becomes effective to the legislation of the member states (art. 17), the Tenth Directive rules on this point that the law of the domicile of the acquiring company shall decide. A further difference concerns the conditions for nullification of the completed merger (art. 15 Tenth Directive).

A questionable provision is art. 7 which states that the majority required for the merger decision must not be larger than the majority for a national merger. However, from the point of view of shareholder protection an international merger has compared with a national transaction some additional risks. It is not convincing that the directive does not take into account this different situation by introducing further protective measures.

A certain inconsistency can be found in art. 5 (1), which deals with

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- 1) art. 54 (2); Ganske, *Betrieb* 1985, 581.
 - 2) Welch, 7 *Company Lawyer* 69.
 - 3) Commission, *Bulletin of the EC*, Suppl. 3/85, p. 6; Ganske, *Betrieb* 1985, 581; Morera, *Foro italiano* 1987, parte IV, column 260.
 - 4) Commission, *Bulletin of the EC*, Suppl. 3/85, p. 7.

the contents of the draft merger terms. It refers to art. 5 (2) of the Third Directive which stipulates certain minimum requirements for this document. According to art. 5 (1), member states may not require more information to be given than is required by the Third Directive. If a member state does not want to apply stricter rules for domestic mergers than for international operations, it has to renounce the discretion left by the Third Directive¹. The Commission justified this provision with the necessity of avoiding conflicts between different laws². However, a mere rule of conflict would have been sufficient to avoid this problem.

Besides, the technique employed by the directive which refers to the Third Directive instead of giving its own substantive provisions is criticized as somewhat confusing³.

The Tenth Directive has not come into force yet, although the Commission had originally suggested its enactment before 1988 (cf. art. 16). The main obstacle is the different attitudes regarding co-determination. The German "*Minister für Arbeit und Sozialordnung*" (minister for labour and social order) saw in the proposal for a tenth directive "a serious threat to our system of co-determination"⁴. His basic position is that German co-determination shall not be changed by any EC measure. The problem is particularly sensitive when it would be possible for a co-determined company to be absorbed by a non-co-determined company⁵. To exclude at least this situation, the proposal contains in its art. 1 (3) a provision that allows a member state not to apply the directive if this resulted in co-determination problems. This provision is modeled on art. 11 (1) (b) of the merger taxation directive, which allows more or less an "opting-out" to safeguard co-determination. According to the Commission, this is only a temporary solution until the proposed Fifth Directive on the board structure and worker participation in public

1) Welch, 7 Company Lawyer 70.

2) Commission, Bulletin of the EC, Suppl. 3/85, p. 8.

3) Beschluß des Deutschen Bundesrates, BR-Drucks. 56/85, p. 3 s.; for a detailed critique, see Ganske, Betrieb 1985, 582.

4) "*Gefährdung des Bestands unserer Mitbestimmung*", note of 5 June 1986, quoted by Kolvenbach, Betrieb 1986, p. 1973.

5) Ganske, Betrieb 1985, p. 583; Gleichmann, Aktiengesellschaft 1988, p. 161.

companies solves the problem once and for all¹.

However, the proposal does not satisfy the German trade unions. In a certain way, their fears are shared by business organizations: they fear serious disadvantages if art. 1 (3) results in the non-application of the directive only with regard to German enterprises, whereas all other European firms would enjoy the possibility of international merger². Even from a non-German point of view, this could be a handicap: whereas German firms could absorb foreign firms by merger, they would be immune to such undertakings³.

Apart from these German fears, the proposed "solution" of the co-determination problem is criticized because it prevents a real harmonization⁴. The reservation in art. 1 (3) which refers implicitly to the much-discussed Fifth Directive on company structures ("...pending subsequent coordination...") may well have the consequence that Germany will never apply the directive, since it is not at all clear whether the Fifth Directive will ever come into force. Considering the heated discussion about the Fifth Directive, the temporary solution envisaged by the Commission could turn out to be a rather permanent one⁵. This problem jeopardizes the whole harmonizing effect and thus puts in question the admissibility of a directive which has the purpose to harmonize company law but that is unable to fulfill this purpose⁶.

In its opinion, the Economic and Social Committee proposed to drop art. 1 (3) and to introduce instead far-reaching co-determinative

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- 1) Commission, Bulletin of the EC, Suppl. 3/85, p. 6;
Behrens, Europäische Zeitschrift für Wirtschaftsrecht, 1990, p. 17;
Gleichmann, Aktiengesellschaft 1988, p. 161;
cf. Kolvenbach, Betrieb 1989, p. 1957.
 - 2) Ganske, Betrieb 1985, p. 583;
Kolvenbach, Betrieb 1986, p. 1975 et seq.;
cf. the motion made by Hessen and Nordrhein-Westfalen in the
Bundesrat, BR-Drucks. 56/2/85, p. 2.
 - 3) Ganske, Betrieb 1985, p. 583.
 - 4) Economic and Social Committee, opinion on the proposal for a 10th
Directive, OJ No C 303 of 25 November 1985, p. 28;
Kolvenbach, Betrieb 1986, p. 1976;
Morera, Foro italiano 1987, parte IV, column 260, fn. 72.
 - 5) Ganske, Betrieb 1985, p. 583;
Welch, 7 Company Lawyer 69.
 - 6) Beschluß des Deutschen Bundesrates, BR-Drucks. 56/85, p. 3.

provisions in the directive¹. The result would be a directive that is an instrument for the Europe-wide implementation of a pluralistic model of public companies. The Ecosoc is not only worried about employee co-determination, but would also like to introduce some provisions to safeguard consumer protection (No 3.8.3 of the opinion). Apart from the question whether the EEC has the competence to impose a specific model for public companies on its member states, and apart from the further question if a directive on international mergers is the most suitable instrument to start such an enterprise, the proposed amendments seem to me the most efficient way to eliminate the chances of the directive being enacted once and for all.

In December 1989, the Parliament voted against the proposal. The main objection seems to have been the very provision of art. 1 (3) that tried to provide a solution to the co-determination problem². Nevertheless, the Commission seemed to be optimistic about the future of the project. If Germany finally swallowed the merger taxation directive with its "opting-out" clause, why should this not also be possible for this directive? But the main difference seems to be the public attention paid to the two instruments: whereas the merger taxation directive was enacted almost unnoticed, the Tenth Directive provoked more attention.

3.2.3 Competitive legislation: The statute for the *Societas Europaea* (SE)

3.2.3.1 Background and history of the project

An international merger according to the rules of the Tenth Directive could result in a company of European dimensions. However, this company would be a national company, incorporated in one of the member states. In the Fokker/VFW case this became a problem, since the choice of the future corporate domicile involved a question of status. The participants agreed it would be best if there was the possibility to create a company on a European level, above the national legislations.

Apart from matters of status, there are some solid legal and fiscal reasons for a company with activities in different member states to look

1) OJ No C 303 of 25 November 1985, p. 28 No 3.8.2.

2) Woolridge, Company law, p. 42.

for a unified European company law. These reasons are illustrated by a more recent case. "ES2" (European Silicon Structures) was planned as a small trans-European high-technology enterprise. Various legal and fiscal problems led to the following solution:

"After spending Ecus 200,000, no small sum for an operation with no initial income, ES2 has ended up ... as a Luxembourg holding company controlling a Dutch holding company that owns five Dutch subsidiaries which, in turn, own a German subsidiary and (along with the Dutch holding company and one other shareholder) a French subsidiary"¹

Further comments are superfluous, except for the fact that there exists a further subsidiary in the UK, owned by the Dutch holding. The response of the EC is the "*societas europaea*", "*le serpent de mer du droit communautaire. Matière inépuisable de projets, institution en perpétuelle gestation*"².

As long ago as 1897, the Italian lawyer Fedozzi proposed an international company statute based on a "uniform law"³. In 1949, the Council of Europe discussed a project for a statute for "European companies"⁴. The EURATOM treaty contains in its art. 45 - 51 provisions for "common enterprises". However, an attempt to create a regulation based on these provisions failed finally in 1976 for political reasons⁵.

The first appearance of the idea in the context of the EC can be traced back to 1959. It was then the French government who took up the idea in 1965 with the idea to create a legal structure for large cross-border enterprises, like the famous experiments of Agfa-Gevaert and Hoesch-Hoogovens. The difficulties of the Agfa/Gevaert project played a role as well as some important takeovers of European enterprises by US firms⁶.

The first proposal for a regulation was presented by the Commission in 1970. It can be seen in relation to the proposal of the convention concerning the cross-border merger of public companies: the negotiations

1) Financial Times of 15 May 1989, p. 6.

2) Synvet, Droit européen 1990, p. 253.

3) Poitrinal, Banque 1992, p. 181.

4) Synvet, Droit européen 1990, p. 253.

5) Hauschka, Aktiengesellschaft 1990, p. 86 et seq.

6) Gleichmann, Aktiengesellschaft, 1988, p. 165;
Lutter (ed.), Europäische Aktiengesellschaft, p. v.

took place at the same time as the discussions of the Merger Convention¹. After extensive discussion, the Commission presented an amended and even more detailed second proposal to the Council in 1975, but the project stalled finally in 1982, after the negotiations had come to a standstill in 1980. Once again, one of the reasons was the co-determination problem². In this case, the breakdown was perhaps inevitable. Under trade union influence, the Commission proposed a compulsory co-determination model which would have been beyond even the standard German co-determination³. According to the first proposal, co-determination was compulsory for every SE with more than 1000 employees and the supervisory board of the SE had consisted of equal groups of shareholder representatives, employee representatives and neutral members (in Germany, there is no neutral group, and the shareholders enjoy a slight preponderance).

Three years after the project on international merger had arisen from its ashes, in 1988, the Commission decided also to make an attempt to revive the SE. It presented a new proposal⁴. The fresh attempt was perhaps initiated by a passage in the final communiqué of the EC summit in Brussels on June 29-30, 1987: the heads of government called for "swift progress with regard to company law adjustments required for the creation of a European company", although it is not clear if they really had the SE in mind⁵. In any case, this statement found its way into the preamble of the proposed statute:

"Whereas the Statute for a European company (SE) is among the measures to be adopted by the Council before 1992 listed in the Commission's White Paper on completing the internal market, approved by the European Council of June 1985 in Milan; whereas the European Council of 1987 in Brussels expressed the wish to see such a Statute created swiftly"⁶

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- 1) Merkt, Betriebs-Berater 1992, p. 652;
Morera, Foro italiano 1987, parte IV, column 260.
 - 2) Commission, Bulletin of the EC, Suppl. 3/85, p. 5;
Dreher, Europäische Zeitschrift für Wirtschaftsrecht 1990, p. 476.
 - 3) cf. Economic and Social Committee, OJ No C 23 of 30 January 1989, p. 38.
 - 4) Commission, La droit des sociétés, p. 10.
 - 5) Robinson, European trends 4/1987, p. 70.
 - 6) OJ No C 176 of 8 July 1991, p. 2 et seq.



3.2.3.2 General features of the proposal

The current proposal, which was presented in 1991¹, has the character of a regulation based on art. 100a of the EC treaty. It should be noted that the admissibility of this method is not beyond any doubt; the first projects actually were a multinational convention. The regulation is completed by a separate directive on worker participation, which is nevertheless, according to its art. 1 (2), "an essential supplement"². The statute is based on art. 100a, the supplementary directive on art. 54 of the Treaty. Whereas art. 100a and 54 deal with the harmonization of national law, the aim of the SE project is the creation of a new legal instrument beyond the existing national company laws³. However, even if one is prepared to accept art. 100a as the legal basis for the SE, it is not at all clear whether this legal basis allows a majority decision. According to paragraph 2 of art. 100a, the decision by qualified majority is not sufficient when the interests and rights of employees are concerned⁴.

This tortuous legislative technique seems to have the sole purpose of ensuring the applicability of the majority principle in the council. Art. 235 of the Treaty, on which the Commission based its first proposal, would require unanimity⁵. It requires a quite far-reaching interpretation of art. 54 to use it as a basis for introducing provisions for employee co-determination, and it speaks for itself that the Commission was so prudent as not to mention on which of the various provisions contained in art. 54 the proposal is based⁶. Moreover, the whole manoeuvre is desperately close to pure evasion of the unanimity requirement⁷. The

1) OJ No C 176, 8 July 1991, p. 1 et seq.

2) OJ No C 138 of 29 May 1991, p. 9.

3) Merkt, Betriebs-Berater 1992, p. 659.

4) Economic and Social Committee, OJ No C 23 of 30 January 1989, p. 37.

5) Kolvenbach, Betrieb 1989, p. 1961;
Poitrinal, Banque 1992, p. 182;
cf. Lindacher, in: Lutter (ed.), Europäische Aktiengesellschaft, p. 3.

6) Merkt, Betriebs-Berater 1992, p. 659.

7) Merkt, Betriebs-Berater 1992, p. 659;
Wahlers, Aktiengesellschaft 1990, p. 455.

price for a majority decision might well be a grave constitutional conflict within the Community¹.

The Commission argued that the progress in the harmonization of company law achieved since 1975 allowed it to cut the original proposal significantly (some 150 articles for the two proposed regulations instead of the more than 300 articles of the original proposal). The modified proposal of 1991 was further shortened. However, whereas the 1970/75 proposals were comprehensive and complete company laws, the current proposal relies heavily on referring to national law. This technique allowed the Commission to circumvent some difficult political questions, but resulted also in a far less innovative proposal². It resembles more a hybrid between substantive provisions and rules of conflict than a fully fledged company law³. On the other hand, this technique is more flexible and does not preclude further harmonisation⁴. A regime for the taxation of the SE is projected⁵.

As a solution for the co-determination problem, the complementary directive offers three "options": a "German" model with employee participation in the governing organ of the SE, a "French" model with a separate organ as employee representation, and a "Swedish" or "British" model based on a collective agreement⁶. In the first instance, the national legislator can decide on one of the models. If he does not exercise this option, the choice is left to the administrative organ of the new company⁷. Whereas the Commission claims that the three models offer an equal standard of employee participation, in reality the options range from a co-determination which exceeds even the German standards to mere rights of information and a right to be heard⁸.

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- 1) Lutter, *Aktiengesellschaft* 1990, p. 415.
 - 2) Lutter, *Aktiengesellschaft* 1990, p. 414.
 - 3) Merkt, *Betriebs-Berater* 1992, p. 654;
Synvet, *Droit européen* 1990, p. 255.
 - 4) Maitland-Walker, *European Competition Law Review* 1991, p. 99.
 - 5) Scrivener, *intertax* 4/1990, p. 208.
 - 6) Dreher, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 476;
Kolvenbach, *Betrieb* 1989, p. 1957.
 - 7) Dreher, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 476.
 - 8) Dreher, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 577;
v. Maydell, *Aktiengesellschaft* 1990, p. 446.

3.2.3.3 The SE and international merger

The proposed SE statute is of interest in the context of international merger since the SE may be used as an instrument to effect these procedures. The preamble of the statute names in the first place as a motive the necessity that companies "...should be able to plan and carry out the reorganization of their business on a Community scale"¹. The close relation between the proposals is underlined by their similar history². This connection with merger is established by the fact that merger is one of the four possible ways to establish an SE (art. 2 (1)), the others are establishing it as a holding, as a joint subsidiary, or by transforming a national company that is already active in different member states³. The main purpose of the SE would be a multinational holding⁴, so that the SE would be rather an instrument for the creation of groups of companies and for the restructuring of existing companies than for truly "public" companies with a wide-spread share capital⁵.

Moreover, since an SE can participate in a merger resulting in a national company (art. 132), the proposed statute opens a way for international mergers in the sense of the Tenth Directive⁶. It is therefore not surprising that sometimes the SE, and not the Tenth Directive, is seen as the commercial law complement of the merger taxation directive⁷. The consequence is that the relationship between the proposed Tenth Directive and the Statute is not entirely clear⁸: both instruments have the common purpose of allowing the cross-border formation of companies of a European scale. As a guideline, one might

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- 1) OJ No C 176 of 8 July 1991, p. 1 et seq.
 - 2) Merkt, Betriebs-Berater 1992, p. 652.
 - 3) Commission, Droit des sociétés, p. 10; in its Guidelines on company taxation, published in intertax 10/1990, p. 489, the Commission considers this even as the principal way to establish a SE.
 - 4) Saß, Betrieb 1990, p. 2340.
 - 5) Poitrinal, Banque 1992, p. 182; Rittner, in: Lutter (ed.), Europäische Aktiengesellschaft, p. 95 et seq.
 - 6) Synvet, Droit européen 1990, p. 263.
 - 7) Debatin, Betriebs-Berater 1991, p. 949.
 - 8) Merkt, Betriebs-Berater 1992, p. 661.

say that the Tenth Directive is better suited for the cross-border growth of enterprises that keep their national centre of gravity, whereas the SE would be the instrument for truly "multinational" enterprises.

The provisions governing mergers of the SE can be found in artt. 17 - 30 (formation of an SE by merger) and 132 (merger of two SEs within one member state). Art. 132 just refers to the Third Directive, but also the artt. 17 - 30 do not contain substantially new provisions compared with this directive, so that it was even suggested that they be replaced altogether by a reference to the Third Directive¹. In particular there are no provisions for better shareholder protection, which is, as already mentioned, not beyond any doubt.

Turning to the problems of minority protection, it is not without interest that the actual version of the proposal (art. 97) allows the modification of the statutes of the company by a majority of two-thirds of the votes cast, which is not an extraordinarily high barrier. The statutes may even require only a simple majority of votes cast (art. 97 (2)), whereas the German *Aktiengesetz*, for instance, requires three-fourths of the represented capital, § 179 (2).

In the 1989 proposal, the shareholders as a group enjoyed considerable influence. According to art. 81 of the 1989 proposal, a wide range of matters had to be decided by the general meeting, in particular such important questions of finance as the appropriation of the profit or loss - a competence not enjoyed by the shareholders of German *Aktiengesellschaften*². In the 1991 version, most of these competences were cancelled. Compared with the 1989 proposal, the current version contains considerably fewer and less detailed provisions concerning the position and the protection of the individual shareholder in its art. 88 - 100. The thresholds for minority rights in art. 83, 85 (10% of the subscribed capital) are quite high³.

From a German point of view, a provision in art. 5a (1) of the proposed statute is at least remarkable. This provision allows the transfer of the SE without winding it up - an impossible procedure for national companies according to German legal doctrine. Of course, it

1) Merkt, *Betriebs-Berater* 1992, p. 657.

2) Hommelhoff, *Aktiengesellschaft* 1990, p. 429 et seq.

3) Hommelhoff, *Aktiengesellschaft* 1990, p. 435.

would be somewhat strange if a "European" company could not transfer its registered office within the Community, but it is disappointing that there are no provisions covering the protection of shareholders in this case, considering the problems that may be caused by international transactions. The transfer of the registered office of an SE only requires the procedure for amending the company's statutes (art. 5a (2) of the 1991 proposal), thus allowing under certain circumstances the decision to be taken by a simple majority¹.

There may be two reasons for the tendency towards weaker shareholder protection: the Commission might wish to forestall criticism from member states with a liberal company law, and it might wish to make the statute as attractive as possible for firms - once again, a trade-off between economic advantages and the introduction of new structures, in this case employee participation on a European level. However, even if these concessions are necessary from a political point of view, the weakening of the shareholders' position is regrettable². Moreover, since the underlying idea seems to be that the SE is an instrument for existing national companies, the "typical shareholder" of an SE would be rather the corporative shareholder than the small investor. One might argue that for this reason provisions for shareholder protection are not as necessary as under national company regimes. However, there are no provisions to ensure that the SE is actually used only for the said purpose. On the contrary, if an SE is created by a merger of two companies with mainly small shareholders, the resulting SE will also be a company with a large body of small shareholders³.

3.2.3.4 Symbol of the single market or red herring?

The evaluation of the proposal varies between "a powerful symbol of the single market"⁴ and "red herring"⁵. Some great enterprises like

1) Trojan-Limmer, *Recht der internationalen Wirtschaft* 1991, p. 1015.

2) cf. Trojan-Limmer, *Recht der internationalen Wirtschaft* 1991, p. 1013.

3) Hommelhoff, *Aktiengesellschaft* 1990, pp. 429 et seq.

4) Gleichmann, *Aktiengesellschaft*, 1988, p. 165.

Ford or the Airbus Industries expressed interest in a legal structure of this type¹. The Commission seems to use it as an "ice-breaker" to free the stuck programme of the harmonization of company law². The SE would obviously be a powerful symbol of the internal market, and sometimes it is even claimed to be an economic necessity³. However, for the time being the skeptical voices are prevailing. Firms seem to acknowledge that an SE might have a certain public relations-effect, but not many more advantages⁴. Obviously, the seemingly endless discussion and the great number of necessary compromises has cooled down the initial enthusiasm.

Basically, the SE is also meant as an instrument for small and medium-size business. However, the only provision is the modification in the 1991 proposal which allows the formation of a holding-SE by GmbHs⁵. Even if access to the SE is technically possible, the whole instrument is too sophisticated and too expensive for these firms⁶.

The main advantage of the SE would be its non-compulsory character⁷. Instead of modifying the existing company law structures the SE statute would merely create an additional option alongside the existing national company laws⁸, thus reducing Community interference with national company law systems. Instead of enforcing the trade-off between Community-wide business opportunities and enhanced protective regulations, the non-compulsory character of the SE would leave the choice to business practice. Thus the SE seems to have greater chances

5) Chown, *intertax* 10/1990, p. 410.

1) Dine, *European Law Review* 1989, p. 323 - Airbus;
Financial Times, 15 May 1989, p. 6 - Ford.

2) Kolvenbach, *Betrieb* 1989, p. 1957.

3) Gleichmann, *Aktiengesellschaft* 1988, p. 165;
 Poitrinal, *Banque* 1992, p. 181.

4) Hauschka, *Aktiengesellschaft* 1990, p. 94 et seq.;
 Kallmeyer, *Aktiengesellschaft* 1990, pp. 103 et seq.;
 Lutter, *Zeitschrift für Gesellschaftsrecht* 1992, pp. 446 et seq.;
 Maitland, *European Competition Law .Review* 1991, p. 100.

5) Merkt, *Betriebs-Berater* 1992, p. 655.

6) Hommelhoff, *Aktiengesellschaft* 1990, p. 434;
 Merkt, *Betriebs-Berater* 1992, p. 655.

7) Commission, *Droit des sociétés*, p. 10;
 Robinson, *European trends* 4/1987, p. 71.

8) Economic and Social Committee, OJ No C 23 of 30 January 1989, p. 38.

of being accepted¹. Considering that the harmonization achieved by the Third Directive did not remove all the distortions resulting from different company laws, it is argued that it would be preferable to introduce a non-compulsory international regime instead of introducing minimum standards into the different national legal systems².

From the very beginning, the Commission stressed the importance of employee participation: "*...il n'y aura pas de société européenne sans participation des travailleurs*"³. The Commission seems to favour a rather pluralistic approach in company law. No wonder that the proposal meets with British scepticism⁴: the then British Trade Secretary, Lord Young, stated that he would resist any attempt to enact the SE statute because of its provisions for employee participation: "...what might be good for West Germany was not necessarily good for Britain"⁵. The result was that the Community was unable to meet its own deadline. On 1 January 1993, the SE was not yet available for European business.

However, the position of the Commission seems to be not unjustifiable. It is not only for ideological reasons or due to overwhelming German influence that the Commission insists on that point. The SE is meant to be typically a large and international firm with plants in different member states, involving a large amount of capital. It is at least not unreasonable to assume that such a complex organization cannot be run as a small enterprise where the owners have the decisive say⁶.

Unfortunately, the actual provisions for employee participation are one of the weakest points of the proposal. The fact that it allows a model of employee participation far below German standards reduces its chances of being accepted by Germany. Moreover, the option model jeopardizes the whole beneficial effect of the SE. Since the national legislators have the right to choose one of the models, it is almost

1) Robinson, *European trends* 4/1987, p. 71.

2) Le Fèvre, *Revue des Sociétés*, 2/1988, p. 221.

3) Commission, *Droit des sociétés*, p. 10;
Kolvenbach, *Betrieb* 1986, p. 2023.

4) cf. Robinson, *European trends* 4/87, p. 71.

5) *The Times* 31 January 1989, p. 21.

6) Lutter, in: Lutter (ed.), *Europäische Aktiengesellschaft*, p. 55;
Poitrinal, *Banque* 1992, p. 182.

inevitable that the "law of the SE" will be quite heterogeneous regarding employee participation, thus leaving the SE as a strange hybrid between a national and a supranational company¹. This danger is further increased also by the fact that the decision on the structure of the company's board (one-tier or two-tier board) is optional. Sometimes it is even feared that the outcome will be twelve different legal regimes for "European" companies². In particular in the case of the transfer of the corporate domicile of an SE or of a merger between two SEs the adopted solution causes difficult problems³. On the other hand, the combination of significant differences between the "national" versions of the SE and the possibility to transfer the registered office of the company may well produce a "Delaware" effect, i. e. the tendency for SE to move to the member state with the least restrictive legal regime for the SE⁴.

Although the SE undoubtedly has some great advantages, its success is not guaranteed even if the statute is enacted. The SE, though being a European company, would have to act within the different national political, legal and economic systems. We are facing again the problem that every EC measure necessarily concerns only a limited sector of the whole business environment. "The S. E.-statute is like the tip of an iceberg whose greater part is submerged in an ocean of municipal law and social and economic realities"⁵. One can only hope that this iceberg will not cause the future international enterprises of the Internal Market the fate of the *Titanic*.

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- 1) Dreher, *Europäische Zeitschrift für Wirtschaftsrecht* 1990, p. 477 et seq.;
Merkt, *Betriebs-Berater* 1992, p. 654;
Trojan-Limmer, *Recht der internationalen Wirtschaft* 1991, p. 1012;
the danger was already seen by Economic and Social Committee, OJ No C 23 of 30 January 1989, p. 40.
 - 2) Hahn, *Handelsblatt* of 28 June 1989, p. 6;
Poitrinal, *Banque* 1992, p. 188;
Lutter, *Aktiengesellschaft* 1990, p. 420, considering the various other options open to the individual SE, fears even 24 or 48 different legal regimes.
 - 3) Poitrinal, *Banque* 1992, p. 187.
 - 4) Synvet, *Droit européen* 1990, p. 258.
 - 5) Storm, *Common Market Law Review* 1967/68, p. 275;
cf. also Economic and Social Committee, OJ No C 23 of 30 January 1989, p. 38.

4 Conclusion

4.1 The EC, international merger, and the fundamental principles of company law

For the EC, one of the main barriers to European pro-merger legislation is the co-determination problem¹:

"In particular the same problem has hitherto prevented all regulation of cross-border mergers: the lack of the equivalent provisions concerning employee representation in the organs of public limited companies in the Community. Those Member States in whose legislation employee representation plays a large part feared that international mergers could be used as means of avoiding such laws."

It is not very difficult to imagine who is meant by the phrase "member states in whose legislation employee representation plays a large part". The quotation sums up quite correctly the basic line of German policy. Germany sees herself in a dilemma: if German firms are allowed to take part in international mergers, the result might well be that they escape co-determination. On the other hand, if Germany does not apply the directive, German firms could suffer a considerable competitive disadvantage, which would in the long term not only lead to the loss of co-determination, but to the loss of entire branches of industry. A further reason for German resistance must be taken into consideration. In particular the employers' associations are trying to prevent a renewal of the co-determination discussion in Germany which would be inevitable when the proposed directive had to be enacted².

Apart from the fear of evasion, in the early 1970s Germany also held the idealistic view of promoting its co-determination system by making it mandatory for all firms engaged in international mergers, even if none of the participating firms ever had a co-determination system prior to the merger. It is interesting to imagine the British reaction to such a proposal (of course, the UK did not take part in the discussions at that time), but even without the UK, the proposal met unanimous opposition

1) Commission, Bulletin of the EC, Suppl. 3/85, p. 5;
Economic and Social Committee, opinion on the proposal for a 10th Directive, OJ No C 303 of 25 November 1985, p. 27.

2) Hauschka, Europäische Zeitschrift für Wirtschaftsrecht 1990, p. 184.

by all the other member states¹.

In any case, the response of German policy seems to be the determined attempt to undermine any EC regulation on international merger, until the EC adopts the German model of co-determination - which meets the no less determined resistance of the UK as "an attempt to introduce corporate socialism into the Community through the back door"². The stalemate seems to be perfect.

It may be questioned if the German policy is really that promising. German policy cannot prevent other member states from individually allowing international mergers. Moreover, if German co-determination is so burdensome that the admissibility of international merger would result in an *en masse* exodus of German firms, it is anyway doomed to be a discontinued model. With the growing economic and political harmonization of Europe, nothing will prevent German investors from moving their capital towards less costly and more promising environments.

However, the lack of German self-confidence is somewhat astonishing. If the German model of capital-labour-relations and its symbol co-determination is really responsible for the undeniable economic success of postwar Germany, co-determination should be rather a competitive advantage than a disadvantage. The fear of evasive behaviour seems to be grossly exaggerated³. If co-determination lives up to its name and really results in an active interest of the employees in the firm, it should also lead to industrial peace, higher motivation and higher productivity⁴. In fact, many German employers and employees seem to agree that Germany's economic success is directly connected to the system of co-determination⁵. For similar reasons, the European Trade Union Confederation supports the proposal of an SE⁶.

The existing empirical studies of co-determination do not give a clear

1) Commission, Bulletin of the EC, Suppl. 13/73, p. 106.

2) Maitland-Walker, European Competition Law Review 1991, p. 97.

3) Kallmeyer, Aktiengesellschaft 1990, p. 106;
Lutter, Zeitschrift für Gesellschaftsrecht 1992, p. 451.

4) Coleman, in: Hopt/Teubner (eds.), Corporate governance, p. 78;
Dreher, Europäische Zeitschrift für Wirtschaftsrecht 1990, p. 478;
cf. Lutter, Zeitschrift für Gesellschaftsrecht 1992, p. 440.

5) Hart, Corporate governance, p. 10.

6) Kolvenbach, Betrieb 1989, p. 1957.

picture. At the utmost, they allow the conclusion that co-determination has at least no negative effects on the co-determined companies¹. Also from the point of view of economic theory, the evaluation of employee co-determination is ambiguous. We have already seen that economists do not agree about the valuation of corporate pluralism, or, more precisely, about the evaluation of co-determination (see *supra*, 1.4.1.5). The inconclusive economic debate shows at least that the whole discussion is not only about the merits of employee participation. The dispute about the position of the workforce within the company is nothing more than an aspect of the more fundamental question of the most efficient corporate structure, i. e. the underlying idea of company law. If we recall the basic company law models, it is quite clear that the "Anglo-American" model with the predominant position of the company's shareholders is incompatible with German-style employee co-determination, and consequently the UK is the fiercest opponent of any attempt in this direction. Whereas from the point of view of the "continental" model, it is quite natural to endow also the company's workforce with a position in the legal constitution of the company. Although Germany has the most far-reaching regulations in this field, provisions for employee participation are not unknown in other continental legal systems, for example in the Netherlands, Belgium or, to a lesser degree, in France².

The problem of international merger cannot be solved without reference to this issue and here the different ideas of company law are in direct confrontation. Therefore it may be doubted if the Tenth Directive offers an optimal solution. The directive tries to solve the problems of international merger in a rather technical way by trying to harmonize the different company laws. However, it is questionable whether it is really possible to harmonize the different company law ideas, or whether on the contrary, the differences are too great to be bridged by a harmonization of procedural rules.

1) Gerum, in: Eichhorn (ed.), Unternehmensverfassung, p. 57; Lane, Management and labour, p. 232.

2) Cf. Abeltshauser, Europäische Unternehmensverfassung, pp. 85 et seq and pp. 113 et seq.

4.2 The solution: a European company?

Instead of trying to harmonize fundamentally different legal regimes, it would perhaps be more sensible to create a unified legal regime for cross-border enterprises in Europe. This could be done, at least theoretically, by imposing a unified company law regime on all the member states. Apart from being politically impossible, it seems to me doubtful if such a unification of the whole body of European company laws would really be a fruitful enterprise. The existing legal regimes are adapted to the specific, historically grown situation in the different Member States, and the imposition of a unified system would be a setback.

The legal regime for European cross-border enterprises should not replace the national company laws, but coexist with them, with the result of a fruitful competition between the different systems¹. Obviously, this was exactly what the Commission had in mind when it presented the first proposals for the statute of the SE. However, the current proposal is far away from this ideal. In the attempt to please everybody so many "options" were introduced in the statute (the famous options for employee participation are only the most conspicuous example) that the result, if this statute was ever enacted, would be not one European company, but in all probability twelve of them². The basic idea of offering various options is in principle not unconvincing. But in the current proposal, the options would not lead to a cross-border competition of different models, but to the creation of "national" SE laws.

Instead of offering the options in the first instance to the member states, the options should be open for the individual companies. The options should not only cover the problem of employee participation, but the whole structure of the company. As a basis for the legal regime of European companies, there should be two basic options, a pluralistic and a monistic one, one model for large companies with investor-shareholders, another one for small and medium-sized businesses with a co-

1) Merkt, Betriebs-Berater 1992, p. 661.

2) Hahn, Handelsblatt of 28 June 1989, p. 6;
Poitrinal, Banque 1992, p. 188;
Lutter, Aktiengesellschaft 1990, p. 420, fears even 24 or 48 different legal regimes.

entrepreneurial structure.

In fact, the creation of a statute for small enterprises below the limits of German co-determination was suggested, thus avoiding the whole problem. This "small SE" could be used to collect experiences and thus form a basis for a renewed attempt to create a "large SE"¹. A similar position was held by the Union des Confédérations de l'Industrie et des Employeurs d'Europe (UNICE) which suggested enacting the statute for the present only for small enterprises with up to 1000 employees², resembling the solution adopted for the EEIG, which must not have more than 500 employees, a restriction introduced precisely to avoid the co-determination problem³.

Sometimes these proposals are seen just as a way out of the political problems of the SE debate by avoiding the co-determination problem. Of course, the "small SE" alone would not solve the problem of international merger. If merger is basically a means to grow, then a size limit is obviously counterproductive. However, the "small SE" would also have its merits in the field of international merger: at least it would allow international merging operations for small and medium size companies. Whereas large enterprises with their own legal divisions are better suited to overcome the existing legal obstacles by forming international cooperations, such operations are beyond the legal resources of typical small or medium-scale companies. As an illustration, it should be sufficient to refer to the "SE2"-case mentioned earlier. A "small SE" could solve some of these problems. This would produce the additional bonus that the EC would show its concern also for small and medium-scale business⁴.

Moreover, the "small SE" could be used even by large companies to establish subsidiaries or joint ventures. The existing EEIG (European economical interest group) can be used for such purposes, but has some structural disadvantages⁵. The main problem is that it is restricted to

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- 1) Kolvenbach, Betrieb 1989, p. 1962.
 - 2) cf. Kolvenbach, Betrieb 1989, p. 1958.
 - 3) Hauschka, Aktiengesellschaft 1990, p. 90.
 - 4) Hahn, Handelsblatt 28 June 1989, p. 6.
 - 5) Hahn, Handelsblatt 28 June 1989, p. 6.

"auxiliary" activities and cannot develop economic activities of its own¹. In the first two years of its existence, only 163 new enterprises of this type were recorded, and from a practical point of view, it is rather a failure².

But the "small SE" should not be just an SE with a workforce limitation. The whole structure could be simplified according to the needs of small and medium-size companies; a model could be provided in a certain way by the German "GmbH"³. The European law for cross-border enterprises would then offer companies two additional options besides the existing company law structures: the large, pluralistic SE, and a small or medium-sized European Limited Company. Whereas there should not be any great difficulties establishing regulations for the latter, the political outlook for the "real" SE remains not very bright. However, even in the UK a growing discussion fuelled by worries about the economic performance of British companies is reconsidering the value of the British system of corporate governance. In the long run, the perspectives for a pluralistic model in the single market might be better than they seem today. The pluralistic SE is, I admit, a development of the future - but not a mere utopia. The enactment of the SE statute will not level out all differences between the different corporate cultures, but it will be an important step on the way towards a single market for companies. And then, the definition of international merger as a cumulation of annoyances will no longer be valid.

1) Hauschka, Aktiengesellschaft 1990, p. 87.

2) Lutter, Zeitschrift für Gesellschaftsrecht 1992, p. 447;
Merkt, Betriebs-Berater 1992, p. 661.

3) Hahn, Handelsblatt 28 June 1989, p. 6.

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