Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks

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Abstract

The German Takeover Act on public securities offers and takeovers of December 20, 2001, in force since January 1st, 2002, does not solve important problems of secrecy and conflicts of interest of boards and banks. Secrecy before the offer does not follow from the Takeover Act, but from insider law and the general company law secrecy. The conflict between insider and takeover law might involve European law and the European Court of Justice. Instant disclosure of takeover plans is mandated under takeover law as well as securities law and presents a number of legal problems. The involvement of advisers and banks by the offeror is safe except for warehousing. It is less clear whether the offeror can freely approach various banks for financing or potential purchasers or offerors for forming a takeover offer consortium. Takeover plans made before final approval by the supervisory board present a special problem of the German two-tier board. It is highly controversial at what moment instant disclosure must be made of a decision that has been reached. Instant disclosure is usually a question for the offeror and not for the offeree. However, in rare cases, the offeree company may have its own duty of instant disclosure. Instant disclosure in group situations is highly controversial. Two fact patterns should be distinguished. In the first, the relevant information has an impact on the price of the securities of the group member. In the second, the parent had or could have had an influence on the nondisclosure by the subsidiary. Insider law should not prevent defensive measures by the offeree that are allowed under takeover law, i.e., working together with shareholders and banks in anticipation of a hostile bid as well as searching for a white knight. The European insider trading directive is not clear on this. If a prospective white knight has been allowed to inspect the books of the offeree company in a due diligence exercise, it is unclear under German law whether the same information must be given to the offeror. In Germany, inducement fees are not yet commonly known or discussed. The legal treatment is ambiguous.

The best way of dealing with conflicts of interest is to prevent them from coming into existence. This can be done by Chinese walls, the principle of general incompatibility, or rules of special incompatibility. Under German law and possibly also under UK law, at least after Bolkiah, establishing Chinese walls is not considered a safe haven in itself for the bank or another party subject to conflicts of interest. General and special incompatibility rules are problematic. It remains to try to solve the conflict of interests in a takeover when the offer is prepared or has already been made and questions arises as to how the bank and the bank deputy in the offeree company should behave. There seem to be at least four possibilities: abstaining from voting, exclusion from deliberation, stepping down, and revocation of office. As to the choice between rule of law and self-regulation, there are major differences in history, corporate governance, and financial culture between the UK and Germany. They are related to history or, as one says today, they are path-dependent.

Keywords: German takeover act, takeover law, information disclosure, conflicts of interests in takeovers, board structure, inducement fee, Chinese walls, all-purpose banks, self-regulation

JEL Classifications: G34, G38, K22

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I. The German Takeover Act on Public Securities Offers and Takeovers of December 20, 2001

1. General Observations on the New Rules of the Takeover Act and on their Relation to German Law of Groups of Companies

a) The Takeover Act, Post-Offer Defenses, and Other Changes

To talk in England about takeovers and takeover regulation is, to quote the Romans, carrying owls to Athens. My dictionary indicates that this translates into English with the phrase "carrying coals to Newcastle." But in view of the problems with coal and steel anywhere, I thought I had better stick to the original Roman saying. In any case, Germany has little experience with public takeovers and even less with hostile takeovers, and when we still had the German Takeover Code, this self-regulation was by no means a peer to the City Code. Therefore, it was the common opinion in Germany that a takeover act was badly needed. This Act has now been enacted and is in force since January 1st, 2002.[1]

At the final stage there was quite a hurry to pass the Act. This hurry seems strange in view of the fact that Germany has delayed this matter for decades. The first pleas for regulating takeovers in Germany were already being made in early 1975. But it was a series of events—including one of the first threat of a serious hostile takeover in the Krupp/Thyssen case in March 1997; pressures of the financial markets; competition of stock exchanges as evidenced in the failed merger of the German Stock Exchange in Frankfurt and the London Stock Exchange; and finally the successful bid of Vodafone for Mannesmann, which was first a hostile takeover, and later on a formally friendly one (October 1999 until through February 2000)—that finally convinced the legislators to move. Still the hurry is to be explained differently. The German Ministry of Finance, with the approval of the government, has agreed to a reform that nobody had ever expected, not from the former Christian-Democrats and even less so from the present Social-Democratic government: namely, leaving the proceeds from sales of participations in enterprises tax-free.

The traditional industrial scene in Germany has been described—without too much exaggeration—as Germany Incorporated. Not only a host of groups of companies, but an extensive web of direct and indirect cross-participations emerged after the beginning of the century. Tax law prevented the unbundling of this network because hidden reserves had accumulated in the participations, some of which dated from the beginning of German bank and industry symbiosis in the second half of the 19th century. Selling a participation would have meant opening up these hidden treasures and having the fisc tax away more than half of the profit. Now, as of January 1, 2002, this tax provision disappeared. It is expected that this will facilitate considerably sales and other restructurings of the interwoven German banks and industry. The merger of the Munich insurance giant Allianz, which already took over the Dresdner Bank, the second largest of the three German large banks (Großbanken), in anticipation of this tax reform in early 2001, is but a forerunner of what we might expect. In this situation, it became urgent to have a framework of rules for the mergers and acquisitions and the public takeovers that will occur in the coming years.

Hostile takeovers are still highly unpopular with many in Germany, particularly with trade unions and labor but also among large parts of German industry and the German press. As everywhere, politicians who live but for reelection reckon with such fears. Therefore, the German takeover act was prepared with great care. First, a so-called discussion draft was issued by the Ministry of Finance in order to prepare the field and to sound out the reactions. Then an unofficial draft (the ministerial draft) was prepared, taking into consideration the objections made at a public hearing in the Ministry of Finance. Once more a hearing was held. Finally, on July 11, 2001, the official governmental draft ("the draft act") was released. This official draft was held back until the outcome of the draft EC 13th directive on takeovers was clear. The Takeover Act as finally enacted differs substantially from the former drafts. The three major differences concern post-bid defenses, the regulation of general public securities offers, and the price to be offered in a mandatory offer.

Post-Bid Defences. It has been reported widely in the financial press how Volkswagen and the German trade unions got their way via the European Parliament and the Schröder connection in defeating the antifrustration rule contained in the Common Standpoint reached on the 13th directive in June 2000. I have already commented on this quite acidly in the Frankfurter Allgemeine Zeitung. For Germany, this has been worse than a Pyrrhic victory. Post-bid defenses are permissible under section 33 of the Takeover Act with the consent of the general assembly, which can be given in advance, or even with the mere consent of the supervisory board.[2]

The Regulation of General Public Securities Offers. The inclusion of general public securities offers in the act is a step forward and helps to lift German securities regulation up to international standards, though details are meeting with critique. This inclusion is reflected in the new name of the act, namely, the Act on Public Securities Offers and Takeovers (Wertpapiererwerbs- und Übernahmegesetz, WpÜG).

The Price to be Offered in a Mandatory Offer. The new price rules provide for a full price-sharing rule based on the price paid for the securities during a period of three months before the offer, without allowing a discount of up to 15 per cent as under the previous unofficial draft of the act.

b) Takeover Law and Groups of Companies Law: An Uneasy Relationship

The three differences just mentioned concern general, internationally known problems of each takeover regulation. Yet there are two further problems particular to German company and groups of companies law (Konzernrecht). The mandatory bid rule gives the minority shareholders an early right of exit in case of a control shift. Functionally speaking, it is therefore a part of the law of groups, more precisely of the formation of groups.[3] It is already protecting the minority shareholders at that stage. Other means of protection at that stage could be, for example, a mandatory resolution of the general shareholders meeting of the offeree on the control shift. Such a mandatory shareholder resolution rule was indeed proposed early in the German reform discussion on the takeover act, but it was rightly rejected. It appears in a modified form again in the context of the post-offer defenses, since section 33 subsection 2 of the Takeover Act allows frustrating actions of the managing board if they are based on a shareholder resolution in a general assembly. Of course, the particularity of section 33 is that such a resolution may empower the board before to take defensive action against a future hostile takeover. Traditional company lawyers and academics distrust the mandatory offer rule precisely because they think that in German company law, the problems of the group are dealt with by the provisions of the German Konzernrecht, i.e., mainly ex post when the group has come into existence and is active. A full-fledged control ex ante seems to them to be superfluous beside this set of rules; worse yet, it unbalances it. This fear is particularly acute since the Takeover Act has now made clear that the mandatory offer must be made not only to the shareholders of the offeree company, but also to the shareholders of all its direct and indirect subsidiaries, a rule that has met with harsh criticism from German business. In terms of German Konzernrecht, this means that the mandatory offer has to be made groupwide.

The second problem is closely interrelated to the first. Now that Germany has decided to have a mandatory offer rule—and I am convinced this was the right decision —the question is to be put the other way around: If the mandatory offer already protects minority shareholders at the stage of the formation of the group, are the very detailed and burdensome rules of Konzernrecht still justifiable in their entirety, or does the cumulative application of both sets of rules amount to an overregulation and lead to the plea for deregulating parts (not all) of the German Konzernrecht? Even if the answer were negative, there are a number of difficult harmonization problems between takeover and group law. In particular, it seems strange that the minority shareholders who choose an early exit are under a different protectionist regime, get a different price for their shares, and can avail themselves of a different procedure than those minority shareholders who remain in the group and get an exit right later on in case of the change into a contractual group or in case of a squeeze-out. In the first case, i.e., exit ex ante, the price is made by the stock market, while in the second, i.e., exit ex post, there is a complicated judicial procedure and the price is fixed by the court sometimes many years afterward on the basis of an evaluation given by an outside auditor. This discrepancy has been criticized widely in German law, but there are not yet convincing solutions in sight. Furthermore, it might be argued that granting an ex ante exit right implies granting also an ex post exit right to those minority shareholders who have remained in the company, at least if they end up being a tiny minority and are themselves subject to a squeeze-out. It then makes sense to give them the possibility of forestalling a squeeze-out by availing themselves of an exit right.[4]

2. Special Problems of How to Deal with Secrecy and Conflicts of Interest

When Roy Goode asked me to make some observations at this conference and suggested that I comment together with Paul Davies on equality of treatment of target shareholders, I wondered whether it would not be more interesting for you to tackle a slightly different problem area. Talking about traditional German company law, which denies such an equality, and saying that the Act more or less follows the British example as to pricing rules (one of the differences being the three-month period as compared with the English twelve-month period) was not an option that turned me on. Just presenting the content of the official German

Takeover Act (draft act at that time) would, of course, have been a possibility, but again a hardly challenging one. I decided, therefore, (with the agreement of Roy Goode and his steering group, for which I am grateful) to take up a complex of problems that is considered particularly delicate for German boards and banks, i.e., secrecy and conflicts of interests in takeovers. These problems have an additional acumen in Germany because of the two-tier board structure, the leadership role of the German management board in deciding what is good or bad for the shareholders, labor and the enterprise as a whole, and the traditional but quickly changing structure of the German banking system which is characterized by the full liberty of forming all-purpose banks, called the universal banking system. This may be a good topic for an Oxford Anglo-German Law Conference.

Yet even with this topic I had to learn that quite a number of the issues that are presently being debated in Germany as to secrecy and conflicts of interest in takeovers were already anticipated in the rules and practice of the London Takeover Panel. In addition, most of the secrecy and conflicts of interest problems are not being dealt with specifically in the German Takeover Act. They will remain to be solved either by the supervisory authority—which for takeovers is now the German Federal Supervisory Agency for Financial Services (Bundesanstalt für Finanzdienstleistungen, BAFin, formerly Federal Supervisory Office on Securities Trading, Bundesaufsichtsamt für den Wertpapierhandel, BAWe)—or suggestions for solutions will be given by German academics in their articles and commentaries. Ultimately it will be up the courts and, in the last instance, the second senate of the Federal Court of Last Instance (Bundesgerichtshof) to decide these questions and conflicts. Here we see a difference in history and legal and financial culture between the U.K. and Germany; in Germany, the legislators and the judiciary play a comparatively major role in setting the rules, whereas in your country self-regulatory bodies play a major role (is this still correct to say?) and in the context of takeovers there is much reluctance to involve the courts. Maybe I should come back to these differences for a few moments at the end of my lecture. But now I propose to take up a number of problems both as to secrecy and disclosure (part II) and as to conflicts of interest of boards and banks (part III).

II. Secrecy and Disclosure

1. Secrecy Before an Offer

It is generally agreed that absolute secrecy before an announcement of a takeover offer is of vital importance. Rule 2.1 of the City Code says this expressly and continues to impose secrecy on all persons privy to confidential information, particularly if it is price-sensitive. A similar duty of secrecy was contemplated by the German discussion draft, though there it was confined to the offeror and the persons acting in concert with him. An exception was made insofar as the offeror was permitted to discuss his plans with the offeree and the shareholders of the offeree. The offeree company and its shareholders were also bound to keep the secrecy. In the hearing, questions were posed about the offeree's permission to discuss the plans with its shareholders, and it was taken for granted that both the offeror and the offeree must be allowed to pass confidential information about the takeover plans on to lawyers, auditors, and banks. Unfortunately, instead of broadening the reach of the secrecy provision as in rule 2.1, the unofficial draft dropped the provision as did the final Act.

The consequence is not that under German law there is no rule on secrecy before the offer. But this is no longer a specific takeover rule. Instead, a similar rule follows from general company law and the law of obligations for the board and the professionals to whom the board passes on the information. In addition, the duty of secrecy follows from German insider law which, like the British insider law, is under the realm of the EC insider trading directive of 1989. In May 2001, the European Commission came out with a draft directive on market abuse which proposes new rules on market manipulation and is going to integrate the insider prohibition and market manipulation rules. Yet one should realize that the general law and the insider law rules on secrecy do not have the same content and reach as a specific takeover rule on pre-offer secrecy. Insider secrecy, for example, covers only price-sensitive information; takeover secrecy does also, but not necessarily, as rule 2.1 rightly shows. Therefore, it will be up to the Supervisory Authority or, in the last instance, the courts to develop a specific takeover law duty of the offeror, the offeree, and all persons concerned to keep secrecy before the offer.

In this context, it should be mentioned that it is regrettable that the relationship between insider law and takeover law has remained ambiguous under European law. The conflict between insider and takeover law is well known.[5] The temptation to insider trading—e.g., a quick purchase of shares of the target company before the general public, or a timely sale at the impending breakdown of negotiations, or informing third parties—seems especially irresistible at takeovers.[6] It is true that the EC insider trading directive contains a sentence in its preamble which indicates that insider law should be subordinated to takeover law. Yet the extent of this is by no means clear. This lack of clarification was already being criticized with regard to the insider trading directive of 1989, and there were hopes that the 13th directive would bring some clarifications.[7] Yet quite apart from the final failure of the directive, the common standpoint as well as the new draft 13th directive as of October 2, 2002 lack such clarifications. The draft market abuse directive of 2001 also remains silent in this respect, as does the German Takeover Act. It follows that passing on information in the context of takeovers—to possible co-bidders, for example—may not be safe under European insider law, and there may be cases in which the European Court of Justice might be called in by a referral to decide how far European inside law reaches in this respect. This is a perspective of European intervention for German as well as for British takeover law.

2. Instant Disclosure of Takeover Plans

a) Involvement of Advisers, Banks, and Co-offerors

One of the most extensively discussed questions about secrecy in the context of takeovers is the problem of mandatory instant disclosure under section 15 of the German securities trading act (WpHG). As in the U.K., instant disclosure is mandated by the EC stock exchange admission directive of 1979, which was modified inter alia by the insider trading directive of 1989. Art. 3 (a) of the directive covers the case of passing on inside information to an adviser or a similar professional "in the normal course of the exercise of his employment, profession, or duties." The draft market abuse directive has kept art. 3 (a) in a slightly different formulation, but with the same meaning. Accordingly, under English and German law there are also no problems with secrecy in takeovers as to these persons, including banks. This is different if the third party called in by the future bidder is to be rewarded for his services by early inside information on the upcoming offer which he can exploit at the market before the offer is actually made. This so-called warehousing, which has already been dealt with by Paul Davies in his contribution to our common European insider dealing book of 1991,[8] seems to be prohibited under the City Code. The same is true under German insider law.[9]

On the other side, it has remained unclear under the European insider trading directive as well as under German insider and instant disclosure law whether the prospective offeror is allowed to approach various banks for financing or potential purchasers or offerors for forming a takeover offer consortium. On the one side, he may not be able to mount the offer without the help of more than one bank and other consortium members. This is an argument for allowing this. Rule 2.2 of the City Code states in this context that an offeror wishing to approach a wider group—for example, in order to arrange financing for the offer (whether equity or debt), to seek irrevocable commitment, or to organize a consortium to make the offer—should consult the Panel. Under German law this would hardly be accepted as a solution; instead, a clear answer as to whether this is legally permissible or not would be asked for. In a related case, rule 2.2 is also clearer: An announcement is required when the board of a company is seeking one or more potential offerors and the number of the potential purchasers or offerors approached is about to be increased to include more than a very restricted number of persons. It should be kept in mind that these uncertainties can be traced back to the European insider trading directive, which implies that doubts as to the interpretation must in the end be referred to the European Court of Justice. It would not be the first time that the European Court of Justice would be asked to interpret the insider trading directive. The draft market fraud directive may bring some help. It contains an article 6 under which the member states must ensure that all issuers of financial instruments disclose inside information as soon as possible to the public, and that issuers and persons who pass on inside information in the normal course of the exercise of their employment, profession, or duties to a third party, pass on this information at the same time to the public. But article 6 goes on to exempt the issuer and the professionals from this obligation if the third person is obliged to the issuer to keep the secrecy.

b) Takeover Plans Made Before Final Approval by the Supervisory Board: A Special Problem of the German Two-Tier Board

The duty to see for instant disclosure is particularly relevant in the context of prospective takeover offers because of the German two-tier board system. It is obvious and common practice in mergers and acquisitions and in takeovers to prepare and take the decision of making an offer in a very small circle of persons. Usually this circle does not even comprise the whole management board. In the case of the merger of Daimler and Chrysler, a small group of persons of the German board flew over to the United States to meet their American colleagues without even informing the German supervisory board. Only later on, when the plan was agreed upon and ready, was it presented to the supervisory board in Stuttgart for decision. The question of whether the news of the planned merger or offer may be kept secret within the offeror company until the supervisory board has given its formal consent is one of the most controversial legal questions under section 15 WpHG. The two extreme answers given are, on the one side, that in cases of multi-layer or stretched decision-making processes, the decision is only made when the last body needed for legally finalizing the decision has agreed. After all, it still could disagree and then the decision could not be made. On the other side, the point is made that already the decision reached within the management board may have a substantial impact on the price of the share of the company quoted at the stock exchange. Under this view, what counts alone is the probable impact on the stock market. If there is such an impact, it is irrelevant whether the supervisory board has already agreed to or even been informed of the decision of the management board.

In my view, the correct answer is—as is so often the case—in the middle. In general, instant disclosure should be required only when a decision is final within both boards.[10] This is particularly compelling if it is a fundamental business decision that is to be taken by both boards, i.e., for which the management board needs the consent of the supervisory board. If the management board were forced to disclose its internal decision to the general public before, the competence of the supervisory board would be curtailed severely. For quite often after such a public disclosure, there is no way back without heavy financial consequences for the share price, the shareholders, and the enterprise as a whole. This is particularly relevant in view of German labor co-determination, because such an early instant disclosure could render meaningless labor's rights to co-decision on all matters that are up to the supervisory board to decide.

On the other side, there must be exceptions to this rule. Such an exception could be envisaged if the decision of the management board alone already has some legal relevance of its own, in addition to business relevance. A good example is the annual financial statements. It is up to the management board to prepare and complete them and to submit them to the supervisory board together with the proposal for appropriation of distributable profits; after consent of the supervisory board, this is to be presented to the shareholders' meeting. In this case, the fact that the management board has already completed the annual financial statements before passing them on to the supervisory board makes it a legally separate act that obviously may have a palpable impact on the stock price. It would be unwarranted to allow the company to keep this information secret until the consent of the supervisory board or, even less, until the shareholders had met and made up their mind as to the distribution of profits.

The opposite view, which treats every decision of the management board separately as a possibly relevant fact for instant disclosure, is faced with the problem of examining each and every decision of the management board for possible impacts on the stock price. If one looks closely at the criteria used, one finds that this view requires instant disclosure only if there is a high or totally prevailing or at last overwhelming probability that the decision, if made public, will have an important impact on the stock price. A further disadvantage of the opposite view is its consequence that if the supervisory board refuses to give its consent, the instant disclosure made before must be corrected by the now opposite instant disclosure of the company finally not going forward with its plan. This is bound to create uncertainties and misunderstandings with the investing public, and in the worst case may even undermine investor confidence in the company and its future plans.

It is, therefore, a good move that the Takeover Act contains a provision in its section 10 which states that section 15 WpHG on instant disclosure shall not be applicable for a decision made concerning the making of an offer. In the context of this provision, an offer means not only a mandatory offer or even a takeover offer, but any public offer for a financial instrument. Technically, the provision of the Takeover Act takes precedence over the general instant disclosure provision of general securities regulation. The motives of the Takeover Act make sure to explain that the exemption from instant disclosure is applicable only if the requirements of the rule of the Takeover Act on mandatory publication of the decision to make an offer are fully met. If this is not the case—for instance, if not all information required under section 10 of the Takeover Act is given in the publication of the decision to make an offer—section 15 remains applicable if the decision qualifies for instant disclosure under this section. The wording of section 10 subsection 6 exempts only the decision to make an offer and does not cover the offeree. It is arguable that the aim of this provision can only be reached if the latter is also included by way of teleological interpretation.

A final point should be made as to European law. As explained, section 10 of the Takeover Act constrains section 15 of the German insider law. While this is, of course, no problem under German law since the later and the more special provision takes precedence over the former or more general provision, there might be a problem of European law. German takeover law, which has no basis in European law due to the failure of the 13th directive, is not permitted to infringe upon the reach of the European insider trading and stock exchange admission directives. The problem of instant disclosure in cases of decisions made by the management board when the consent of the supervisory board is still outstanding is therefore a European problem. If the management board were to be fined for not instantly disclosing its decision, the case could be referred to the European Court of Justice under article 234 (ex-117) of the treaty.

c) Instant Disclosure by the Offeror and the Offeree

Contrary to rules 2.2. and 2.3 of the City Code, the German Takeover Act does not contain a rule on instant disclosure by the offeror and the offeree. Rule 2.2 outlines when an announcement is required and specifies inter alia how to deal with rumors and speculation as to a possible takeover offer. Rule 2.3 states that before the board of the offeree company is approached, the responsibility for making an announcement can lie only with the offeror, while the primary responsibility passes over to the offeree company following an approach. This is a clear division of competences and duties between the offeror and the offeree. It is convincing since the prospective offer is relevant in particular for the share price of the offeree, and since a suspension will only be granted by the stock exchange at the request of the company whose shares are to be suspended.

The lack of a similar provision in the German Takeover Act makes it necessary to deal with this problem as a question of general instant disclosure under section 15 WpHG. It is generally agreed that as a matter of principle, it is up to the offeror rather than the offeree to take care of instant disclosure in the context of a prospective takeover offer. The new facts to be published are only those that belong to the sphere of the issuer; general market data, such as the threat of a takeover bid or even mere rumors of the imminence of such a bid, are not included.

However, in some extreme cases, the offeree company may also have a duty of instant disclosure.[11] This may be the case if a friendly takeover is arranged with the cooperation of the board of the offeree company, and if the offeree company issues its own statements that turn out to be wrong in the light of later developments. The guiding principle is that the offeree company must avoid causing the shareholders and the public to be misled by its own interference. Of course, the offeree company must also disclose instantly after the announcement or even after the offer by the offeror if there are new relevant facts within the realm of the offeree company itself which may have a substantial impact on stock prices.

Concerning rumors, the position of German law is that as a matter of principle there is no duty of the company and its board to comment, i.e., no duty of instant disclosure, either for the offeror or for the offeree. Otherwise it would be easy to force a company to disclose information it still wants to keep secret by spreading false rumors. It is true that sometimes a comment as to a false rumor may lie in the interest of the offeree company itself because the price of its securities is affected. But it is felt that the law should not interfere except in exceptional circumstances. Such circumstances can arise when an action of the offeror or the offeree has led to the particular rumor as laid down in rule 2.2 (d) of the City Code, or when the offeror has asked for exceptional permission of the supervisory authority not to be held to instant disclosure because the publication of the fact is likely to damage the legitimate interests of the offeror.[12]

d) Instant Disclosure in Group Situations

As is well known, Germany is keen on groups of companies and Konzernrecht. Group law problems also arise in the context of instant disclosure. They have been discussed in Germany only very recently. As a general rule, the duty of instant disclosure is up to the issuer—or in a takeover situation, to the offeror—and not to other members of the group to which the issuer or offeror belongs.[13] There might very well be exceptions to this rule, though they are by no means settled. Two fact patterns should be distinguished. In the first, the relevant information has an impact on the price of the securities of the group member. In the second, the parent had or could have had an influence on the nondisclosure by the subsidiary.

The takeover offer and possibly already the prospective offer may by themselves have financial consequences for the share price of another group member, be it the parent or a subsidiary. Under section 15 WpHG, instant disclosure is to be made by the company in whose field of activity the new fact occurs. A narrow view would hold that the takeover offer occurs only in the field of activity of the offeror, not of other members of the group as long as the parent is not bound to publish consolidated balance sheets including the subsidiary in question. Yet it could very well be said that the fact that this offer may have a substantial impact on the stock price of the securities of the group member is in itself a fact that occurs in the field of the latter.[14] On the other side, such a rule must avoid forcing a group member to make instant disclosure on a prospective bid by the offeror before the latter has had the opportunity to make an announcement.

The case is quite different if a 100 per cent subsidiary violates the duty of instant disclosure. It is questionable whether the parent has its own direct or indirect responsibility if it is aware of, or even responsible for, this violation. Is it enough to require the parent in such a case to urge the subsidiary to disclose, or might it even be obliged to fulfill the instant disclosure obligation itself? Some go as far as requiring the latter; a few go further and hold even the subsidiary liable for making instant disclosure of facts which have arisen with the parent provided they have an impact on the subsidiary. If one denies these extensive interpretations, the parent may at least become liable as an aider and abettor if it has caused the subsidiary not to comply with its instant disclosure obligation.

3. Mandatory Disclosure of Shareholdings

In the present context of secrecy in takeovers, mandatory disclosure of shareholders shall be mentioned only briefly. Mandatory disclosure of shareholdings was imposed on the member states by the EC in the transparency directive of 1988 from a threshold of 10 per cent on. In the U.K. and some other states, such mandatory disclosure rules already existed long before and at much lower levels. Usually the level is 5 per cent, such as, for example, in Germany, France, and outside the EU in Switzerland. In France the company may lower this threshold by a provision in its statutes down to 0.5 per cent. In 1989 the UK lowered the threshold to 3 per cent. In addition, there is a provision that the company can require any shareholder or suspected shareholder to disclose the extent, if any, of its beneficial ownership of the company's shares.

It is not clear whether this rule is just a transparency rule or is instead intended to give the management of a company an early warning about a possible future offeror. It may very well be assumed that it is the latter, i.e., a rule against creeping up, though of course this is seldom conceded in the legislative motives. In any case, the rule has an effect on future takeover offers because the management cannot easily be taken by surprise as was the case, for example, under the traditional German company law rule that required disclosure only for stakes of 25 per cent and higher. The rule should, therefore, be discussed in the context of structural impediments to—and, if the company may take action, of pre-bid defenses against—takeovers.[15] If one is convinced that post-bid defensive action is incompatible with the free functioning of the internal market, it is near at hand to extend this reasoning also to pre-bid defenses.

Successive stock purchases by the prospective offeror or the granting of a participation by the potential offeree company are not in violation of insider law *per se*. But the fact that the offeror has reached the threshold of 5 or more percent without the registration required under sections 21 et seq. WpHG may in itself constitute inside information. If the future offeror continues to purchase, this may be in violation of insider law.

4. Selected Problems of Information and Liability of the Offeror and the Offeree

The centerpiece of all takeover regulations is duties of information, both for the offeror and the offeree, though the exact reach of what has to be disclosed or on what the shareholders, the general public, and maybe specifically the workforce of the offeree have to be informed, varies substantially. The information given might be incorrect or incomplete. The takeover regulations do not trust the market, competition, and reputation to take care of this, but provide for legal liability, which again is quite different in various countries. Out of the many problems in this context, I want to pick up two: the information to be given by the offeror as to the workforce and possible liability of the offeror, and the views and possible liability of the board of the offeree company.

Under section 11 of the German Takeover Act, the information to be given in the offer document contains statements about the intentions of the offeror as to the future activities of the offeree, in particular the seat and location of relevant parts of the enterprise, the use of its assets, its future liabilities, the workforce and its representatives, the management, and relevant changes in the conditions of employment, including the measures which are provided for insofar. More detailed rules on the information to be given and on its presentation are contained in a regulation of the Ministry of Finance or the supervisory authority. Rule 24 of the City Code contains more or less similar provisions. As to the workforce, it reaches further and includes the intentions of the offeror with regard to the continued employment of the employees of the offeree company and of its subsidiaries. I think this is a serious gap in the German Takeover Act. Very often, the new owner will take measures of restructuring and laying off not—or not only—in the parent, but in the subsidiaries.

Section 12 of the German Takeover Act contains a liability provision that is closely knit after the stock exchange prospectus liability. Yet the German provisions on liability for untrue or incomplete stock exchange prospectuses have long been criticized for being far more restrictive than general tort law liability and even general civil law prospectus liability. In particular, this liability is only for gross negligence. It does not cover the full money damage, and it is statute-barred after six months or—if the purchaser did not know about the incorrectness of the prospectus—after three years.[16] Section 12 keeps the requirement of gross negligence, but allows recovery of full money damage and contains a time bar of only 12 months or three years. The latter change is in reaction to the harsh critique of the German shareholders' associations, which pointed out that the six-month period is totally unrealistic, and that even the three-year period may not be enough to find out the facts for preparing a lawsuit.[17] All these discrepancies between the statutory and the general civil law liability provisions are highly unsatisfactory. It remains to be seen whether German legislators cannot be convinced to harmonize them more thoroughly in the upcoming 5th financial market promotion acts of 2003. The pleas for harmonization not only concern Germany, but in my view should go further. It does not make much sense to have common prospectus requirements in the European Union, but when it comes to liability for false prospectus information, to have liability that differs strongly in the various member states. If it is true—and I am convinced it is—that correct prospectus information is necessary in the internal market, then this is not only a question of common requirements as to information, but also as to liability and possibly even enforcement. So in my view and according to an expert opinion of the Hamburg Max Planck Institute for the German Ministry of Finance of November 2002 the European Union should consider common framework rules for prospectus liability. In the meantime the latest draft of the prospectus directive does include an article on prospectus liability.

Section 27 of the Takeover Act requires the management board of the offeree company to issue its view as to the offer, including a statement as to whether the board members intend, in respect to their own shareholdings, to accept or to reject the offer. This corresponds to rule 25.1 and 25.3 of the City Code. But a closer look shows that these duties under the German

Takeover Act are only imposed on the members of the management board, not on the whole board as in the U.K. This is unsatisfactory since the views and intentions of the outside directors, which the supervisory board members usually claim to be, are important for the shareholders and their decision. There is also no provision for split boards, as in note 2 on rule 25.1. According to this, in the case of a split board, the directors who are in a minority should also publish their views and the Panel will normally require that they be circulated by the offeree company. A further substantial lacuna consists in the omission of the act to require the offeree company to obtain competent independent advice and to make it known to the shareholders as provided for in rule 3.1 and rule 25.1 (a) of the City Code. The discussion draft still contained the requirement of advice, though there was no independence requirement. Unfortunately this provision has been dropped with the argument that the offeree company knows quite well itself how to evaluate the offer. It was not understood that the gist of the advice was that it would be made by an independent adviser and it would be made known to the shareholders.

In the hearings on the German discussion act, the question was raised as to whether the views of the board should be backed by a liability provision modeled after the liability provision for the public offer. The drafters of the act shied away from this because they thought that a liability provision might deter the management board from giving a frank view to the shareholders. Yet this could turn out to be shortsighted, since it may very well be that German courts will hold the board members liable for giving wrong or biased views. A liability provision along the lines of section 12 concerning the public offer document would, strangely enough, better protect the management from liability since, as mentioned above, it is drafted after the model of the rather restrictive stock exchange prospectus liability. Obviously the problem of adviser liability, which in general is rather controversial in German law as well, is not a specific problem of takeover law, though it arises frequently in this context.

5. White Knights, Inside Information, and Due Diligence

Insider trading activities or violations of secrecy in connection with hostile takeovers usually occur before the bid. Violations after publication of the offer, e.g., at or during the search for a white knight, are the exception, but they do occur. As mentioned above, a person planning to purchase a block of shares or to make a takeover offer that will considerably influence the price of the shares cannot be prevented by insider law from doing so, since treating one's own plans as inside information would not make sense in such cases. This is true for the offeror company and its board, which is allowed to prepare the offer without interference of insider law. Yet for the offeree company and its board, a similar problem arises when they possess inside information about an offer they are going to receive. It is submitted that insider law should not prevent defensive measures by the offeree which are allowed under takeover law, i.e., working together with shareholders and banks in anticipation of a hostile bid as well as searching for a white knight.[18] Yet until the coordination of European insider and takeover law, it is not clear from the insider trading directive and its preamble whether this is actually the content and meaning of European law. If the board of the offeree wants to be sure, it might very well have only one way out—publication.

Another question that is very controversial in German company and takeover law is the legitimate reach of due diligence and, in the specific context of this article, whether the provisions against insider trading limit the normal due diligence examination. Allowing a due diligence examination can be very helpful for the board of the offeree company when searching for a white knight. The motives to the WpHG point out that the giving and receiving of insider information is permissible in the context of selling a block participation. This is the case when an interested party (the white knight) inspects the books of the target company in the course of the due diligence examination and gains inside information in this way.[19] Interestingly enough, rule 21.1 of the City Code states that the principle of equality of information to shareholders does not prevent the furnishing in confidence by an offeree company to a bona fide potential offeror or vice versa.

Obviously, the board of the offeree company in a hostile takeover will not and must not permit the hostile offeror a due diligence examination. However, if a prospective white knight has been allowed to inspect the books of the offeree company in a due diligence exercise, the question is whether the same information must be given to the offeror. The German _Act is silent on this point and the problem is hardly ever mentioned. It seems that German law would not require the passing on of information given or allowed to be taken by the white knight to the offeror. Rule 20.2 of the City Code, which deals with equality of information to competing offerors, is more specific. It requires that any information given to one offeror or potential offeror must, on request, be given equally and promptly to another offeror or bona fide potential offeror even if that other offeror is less welcome. This requirement, however, will usually only apply when there has been a public announcement of the existence of the offeror or potential offeror to which information has been given. This seems to be balanced well, though it must be seen that the requirement that the less welcome offeror should specify the questions to be answered ("on request") may prevent full equality. In practice, of course, the catalog of questions can be expected to be lengthy. Even more difficult questions arise in the case of management buy-outs.

Purchases beyond the earlier company commitment (alongside purchases) attributable to the exploitation of inside information are not permitted, either to the offeror or to the offeree.[20] This is true also for the purchaser of a participation who, after obtaining inside information from a due diligence examination, acquires even more shares than planned earlier, either on or off the exchange.

III. Conflicts of Interest of Boards and Banks

1. Board Responsibility Beyond Shareholders' Interests Under General Company Law

When dealing with conflicts of interest of the board in takeover situations, it is not my intention to deal generally with the question of how the opposite interests of the offeror and the shareholders of the offeree company and of the latter and their board should be balanced. After all, this is what takeover regulation is all about. Furthermore, one of the most controversial conflict of interest situations in takeovers, i.e., the conflict of interest of the board of the offeree when faced with a hostile takeover and the respective problem of post-bid defenses, has been omitted here.[21] Instead, only specific conflicts of interest of boards and banks shall be discussed. Still, one word on allowing post-bid defenses—as in the U.S.—or restricting them by a non-frustration rule—as in the U.K.—may be allowed: The U.K. rule more or less eliminates the conflict by leaving the decision on the offer and possible defenses to the shareholders. The U.S. rule is said by its proponents to protect the shareholders of the offeree company. Yet it does this without really making sure that the incumbent management acts in their interest only and not in its own of staying in office. As long as this problem cannot be solved, in my view the U.K. rule seems preferable. Details are presented elsewhere.[22]

In German law, as well as in some other jurisdictions including the U.K., the prototype of a conflict of interest of the board of the offeree company in a takeover situation is the constituency rule under German company law. The traditional interpretation of the business judgment rule for the management board under section 76 of the German stock corporation act (Aktiengesetz, AktG) is that the management board has direct responsibility for the management of the company, and that this responsibility reaches beyond the shareholders and includes the interest of the employees and even the common good. Under this opinion, the management board is neither obliged nor entitled to act solely in the interest of the shareholders. It is therefore the responsibility of the management board to balance these interests and to bring them to practical concordance. Within this framework rule there is ample room for following the shareholder value principle. This sort of constituency rule under German company law is similar to what had been proposed in article 3 section 1 (c) of the draft 13th directive as of October 2, 2002 ("the board of an offeree company is to act in the interest of the company as a whole"). In its legislative resolution on the Common Standpoint the European Parliament had been even more specific. In the version proposed by the European Parliament article 3 section (c) continued: "in particular in the interest of the business policy and its continuation, the shareholders and the employees, as well as in regard to securing jobs."

The problem with all these constituency rules is similar to the general business judgment rule concerning post-bid defenses. The rule sounds very good, but it is not possible for the shareholders to check whether the judgment of the management board is valid, since there are nearly always arguments for justifying any action either by the interest of the workforce or the common good. Nor do the workers have a right to check the decision, since they do not have individual enforceable claims. It is therefore not surprising that the similar constituency statutes in many American states have been criticized as being utterly misguided, because in the end they result in decisions maximizing managers' utility, raising the cost of equity capital, and impairing the market's allocative efficiency.

As to frustrating a takeover offer, it has been argued under German company and takeover law that quite apart from the general business judgment rule for the management board under section 76, it is not up to the management board to make decisions on the composition of the company's shareholders.[23] If this general principle is accepted as the majority view in Germany, fundamental decisions on the composition of the company's shareholders, including post-bid frustrating action, are up to all shareholders in general assembly. The German Takeover states in section 33 that post-bid defensive actions need to be authorized either by the supervisory board or by the general assembly. As to the second possibility the principal development in this section, which was proposed in vain by Germany for the 13th directive and has now been laid down in subsection 2, is that the general assembly may issue such an authorization up to 18 months before the actual offer. It is quite obvious that before having had the opportunity of seeing the actual offer, the shareholders cannot really evaluate whether it is worthwhile or not, and practitioners doubt that such authorization will be sought by many boards and accepted by many general assemblies. Indeed, such a shareholder resolution could signal that the enterprise considers itself a candidate for takeover, which may have unwelcome consequences at the stock market.

It remains to mention that these objections toward creating and maintaining such a conflict of interest for the board do not extend to the information to be given to the workers. Indeed, such duties of information not only to shareholders but also to workers are to be found in many takeover regulations, including the German one and the draft 13th directive.

2. Inducement Fees, Views of the Board, and Conflicts of Interest

If one talks about conflicts of interest of directors, one thinks of the classic cases of self-dealing, corporate opportunity, excessive remuneration, and competing with the company. This is discussed elsewhere[24] and shall not be treated here. Instead, we shall take up the phenomenon of inducement fees, which seems to be relatively recent in Europe.

According to the new rule 21.2 of the City Code, which was preceded by a Panel statement of July 16, 1999, and enacted last year, an inducement fee is "an arrangement which may be entered into between an offeror or a potential offeror and the offeree company pursuant to which a cash sum will be payable by the offeree company if certain specified events occur which have the effect of preventing the offer from proceeding or causing it to fail (e.g., the recommendation by the offeree company board of a higher competing offer)." Inducement fees—or deal protection fees or break fees—have long been common in U.S. American takeover practice and have also been discussed for some time in the U.K. In the Vodafone/Air Touch takeover matter, AirTouch had promised a break fee of $225 million to Vodafone inter alia if the shareholders of AirTouch would not accept the Vodafone takeover offer, and a break fee of $775 million if they would accept the offer of a third offeror within a period of one year after the offer of Vodafone. I do not dare to go into the English company law discussion as to whether inducement fees serve proper purposes of the company or fetter the discretion of the directors, and whether such fees might be penalty clauses and financial assistance under section 151 of the Companies Act of 1985. Interestingly enough, neither did the Panel on Takeover and Mergers when it made rule 21.2. It suffices to say that the Panel in rule 21.2 requires that any inducement fee be de minimis (normally no more than 1% of the offer value) with confirmation by the board of the offeree company and its financial adviser in writing that, inter alia, they believe the fee to be in the best interest of shareholders. Of course, all such arrangements must be fully disclosed in the announcement made under rule 2.5 and in the offer document.

In Germany, these kinds of arrangements are not yet commonly known or discussed. But it is, of course, just a question of time until the same clauses will also be used here more broadly in takeover practices. The legal treatment of such promises is ambiguous. In a certain light, they are the opposite of frustrating actions in the sense of section 33 because they facilitate the offer by giving a certain assurance to the offeror. Yet, of course, by the same token they reduce the success chances of a possible competing offer. Insofar they must be considered to be potentially frustrating, at least if they amount to more than a small fraction of the offer value in question. In this respect, the exception under section 33 par. 1 sentence 2 of the Takeover Act might come in. It allows action that an orderly and conscientious director of a company not subject to a takeover offer would undertake. If the inducement fee is just enough to assure that the prospective offeror does not make a distinct loss when his offer is not accepted, this would probably be all right. Beyond this it is questionable, however, whether the board does not fetter its discretion by making such a promise either in the name of the company or for itself. Yet under the general business judgment clause of section 76 of the Aktiengesetz, this is difficult to detect. There is no doubt that at least full disclosure of such fees should be made. But again it is difficult to find a basis for requiring such a disclosure. Neither the information required to be contained in the offer statement according to section 11 of the Takeover Act and the pertinent provisions of the regulation, nor the mandatory content of the views of the board according to section 27 of the Takeover Act, contains such a disclosure statement. It could possibly be argued that since the management board of the offeree has to give its views on the offer and reasons for them, it must also disclose such facts that might be relevant for evaluating these views in the eyes of an ordinary shareholder. If one considers the duty of the board to give its views as a professional duty of information toward investors, this might bring this duty under the general theory and case law of duty of information and advice by professionals. In this body of law, it is commonly agreed that the information must be true, complete, and clearly understandable for the recipient.[25] It follows that inducement fees are to be disclosed in the views of the board of the offeree, if a reasonable shareholder would consider this information as possibly relevant for his decision of whether or not to trust the views of the board in making his own decision on accepting or not accepting the takeover offer. What is lacking in German takeover law is the confirmation by an independent adviser of the offeree that the inducement fee is in the interest of the offeree. Such a confirmation of an independent adviser who might make himself liable may very well be more valuable than the duty of the management board to act in the interest of the company and its disclosure of having entered into such a fee arrangement. Once more the lacuna in the Takeover Act of not requiring independent advice to the offeree proves to be harmful for the shareholders.

3. Conflicts of Interest of Banks in Takeovers: A Special Problem for Continental European All-Purpose Banks

Conflicts of interest in takeovers may become particularly relevant for German banks. This is so because in Germany and some other Continental European states, such as Switzerland and Austria, the so-called all-purpose or universal banking system prevails. Under this system there is no mandatory separation of credit banks and investment banks as there formerly was under the Glass-Steagall Act in the U.S., nor is there a common practice of not combining these functions. It is well known that these combinations may lead to considerable conflicts of interest. This has been described elsewhere. Here some specific conflicts of interest situations for banks in takeovers shall be mentioned and possible solutions shall be discussed. I have omitted the conflicts that arise from inside information in respect to a bank's own security dealings or those carried out by bank-owned fund managers, including the interesting note 5 on rule 4.1 and 4.2 of the City Code which prohibits dealing contrary to published advice, and I shall leave aside the question raised in the English Mannesmann v. Goldmann Sachs International case on how to restrain an adviser from acting on a takeover.

The most prominent German case was the intended takeover offer of Krupp to the shareholders of Mannesmann in March 1997. This was not only memorable because of its status as the first public threat of a serious hostile takeover as mentioned above, but also because of the conflict of interest in which one of the then Big Three (private German banks) ended up and for which it was severely criticized in the German press and in German business. The bank had deputized one member of its management board into the supervisory board of Thyssen. Later on, the bank was approached by Krupp to render advisory and financial services in the planned takeover offer transaction. The bank agreed to do so, becoming—at least according to the information known to the public—the first large German private bank ready to support a hostile bid. This was a spectacular turnaround in German banking policy. One remembers the words of the late spokesman of the Deutsche Bank, Herrhausen, who had characterized takeovers as the "wrong track of capitalism." Yet it was a turnaround that had previously been predicted since major business opportunities and competition of foreign investment banks had been prevailing on traditional restraint in favor of industrial clients of the banks.

The new policy of banks toward takeovers highlighted once more the old problem of conflicts of interest of German all-purpose banks. At the same time, public critique of these interests in the press, in politics, and in academia was mounting. In the heated and occasionally venomous political debate on the reform of stock corporation and banking law in 1997 and 1998, proposals were made to severely curtail the possibilities of banks to hold participations in other companies, deputize representatives in their supervisory boards, and exercise the so-called depository voting for their clients who had deposited with them their shares in other companies. In the reform act of 1998, these far-reaching reforms were rightly not taken up. Instead, less spectacular and more prudent steps were taken. Yet the discussion has not come to an end. The new Social-Democratic government charged a commission with investigating corporate governance and needs for reform in German company law. In June 2001 this so-called Governmental Corporate Governance Commssion came out with a long list of reform proposals, some of which concern conflicts of interests. Conflicts of interest issues have also been taken up by the German Corporate Governance Code as of February 26, 2002.

Independently of this, the banking community itself considered whether self-regulatory measures would be advisable, in particular because of the expectations and pressures of large institutional investors from the U.S. and the U.K. who are accustomed to stricter standards concerning conflicts of interest and are not well acquainted with the combination of functions as exercised by German all-purpose banks. At the symposium held in 1997 at the Max Planck

Institute for Foreign Private and Private International Law in Hamburg on Comparative Corporate Governance, the spokesman of the Deutsche Bank, Rolf-E. Breuer,[26] announced that the policy of the Deutsche Bank as to accepting supervisory board seats in other companies would change. In this respect, the Deutsche Bank's Corporate Governance Principles of March 2001 state that, in general, members of the management board of the Deutsche Bank do not accept the chair in the supervisory boards of companies that do not belong to the Deutsche Bank group. Furthermore, it is stated that supervisory board members must disclose conflicts of interests to the president of the supervisory board (the president himself to the presidial committee). If the conflicts of interest are unavoidable, the board member has to abstain from voting or step down, but in a way which safeguards the interest of the enterprise in whose supervisory board he serves. These two principles are but two in a list of ten principles concerning rules for avoiding conflicts of interest, four principles concerning members of the management board holding seats in supervisory boards and similar committees, and six principles concerning the supervisory board of the bank itself and its members. These corporate governance principles of the Deutsche Bank are the most open, advanced, and sensible principles of a bank as to conflicts of interest of board and banks that I know of.

The non-legal nature of the Deutsche Bank principles allows dealing with such conflicts of interest in a much more detailed, nuanced, and flexible way than any legislators could. This resembles the way the Panel on Takeover and Mergers deals with conflicts of interest of the board of an offeror company, though of course this is a code for the whole city and not just a unilateral declaration of one institution such as the Deutsche Bank. Because conflicts of interest in takeovers of the kind described here are not dealt with by organized Panel-style self-regulation in Germany, I shall discuss some possible solutions under German company law which may either prevent future conflict or help solve them when they have actually come up. Of course, these solutions are not new and, at least in principle, are well known to U.S. and U.K. lawyers as well.

4. Possible Solutions: Preventing Future Conflicts or Solving Present Conflicts

a) Preventing: Chinese Walls, General Incompatibility, Special Incompatibility

The best way of dealing with conflicts of interest is to prevent them from coming into existence. Here U.S. American, British, and international banking practice points first at the practice and beneficial effects of Chinese walls. This practice and the benefits and shortcomings of Chinese walls have been often described, both in the U.K. and in Germany.[27] In the U.K., McVea's *Financial Conglomerates and the Chinese Wall* analyzed this way of regulating conflicts of interest as early as 1993. In the meantime, there has been much discussion following the famous Bolkiah case of 1998, HRH Prince Jefri Bolkiah v. KPMG, in which the House of Lords for the first time considered the law relating to conflicts of interest and Chinese walls. The more recent decision of Young v. Robson Rhodes dealt with Chinese walls in a case of merger of accountants. In Germany, the supervisory authority considers the installation of Chinese walls to be appropriate measures for providers of investment services, but to my knowledge there has not yet been the chance to test Chinese walls in a court case. While Chinese walls are certainly necessary and helpful, under German law and possibly also under U.K. law, at least after Bolkiah, establishing Chinese walls is not considered in itself a safe haven for the bank or another party subject to conflicts of interest. As the late Professor Gower once observed: "I have never met a Chinese wall that did not have a grapevine trailing over it." In practice Chinese walls can lead to embarrassing results for the bank as Deutsche Bank just experienced. Its research department recommended to buy shares of Deutsche Telecom. The next day the bank sold a large block of Deutsche Telecom shares for a client. This caused the stock price to go down by 20 %. The bank insisted that this was the result of having installed and respected Chineses walls. The public nevertheless was furious and the financial press criticised the bank for having been awkward.

A more rigorous way of preventing conflicts of interest would be to prescribe general incompatibility rules for board members, e.g., rules that would not allow management members of competing companies to sit in the board of the other, or rules severely restricting the possibility of deputizing bank representatives in boards of other enterprises. On the one side, such provisions are very abstract and general and unduly restrict banks and businesses which choose to have such representations. On the other side, they do not prevent all conflicts of interest because takeovers happen not just between competing companies, and conflicts of interest in takeovers arise for bank board members as well as non-bank board members. In any case, the present incompatibility rules of German company law do not cover this case.

Such a special incompatibility rule is, for example, a rule requiring the board member to step down if a takeover might be upcoming that would bring him in a situation of conflict of interest. Yet it is very doubtful whether such special incompatibility rules work in practice. Takeover plans are kept secret, and once a takeover offer can be foreseen, it might already be too late. More important, if the bank deputy steps down, this might give rise to speculation and rumors about possible takeovers or differences of opinion between the enterprise and the bank. In any case, the fact that the bank has deputized one of its management board members to the board of the prospective offeree company does not hinder the bank from accepting the invitation of the offeror to render it services in the coming takeover by advice and financing. Deputizing somebody is neither equivalent to a promise not to help a possible offeror even in a hostile bid, nor does it bring with it a fiduciary duty of this kind. It is self-evident that the bank deputy may not pass inside information from the board of the company to the bank, nor from the bank board to the company. As laid down in the Schaffgotsch case and as generally agreed, board secrecy has precedence over the duties of the bank deputy to his own bank.[28]

b) Solving: Abstaining from Voting, Exclusion from Deliberation, Stepping Down, Revocation of Office

It remains to try to solve the conflict of interests in a takeover when the offer is prepared or has already been made and the questions arise as to how the bank and the bank deputy in the offeree company should behave. There seem to be at least four possibilities. The least severe is to require the bank deputy in the offeree company to abstain from voting in resolutions of the board of the offeree company concerning the offer. The logic of this solution as extended to the expression of the views of the board implies that the director who has a conflict of interest should not normally be joined with the remainder of the board in the expression of its views on the offer, and the nature of the conflict should be clearly explained to the shareholders; the director might have to sign the document but make clear that he does not share the views of the board and does not accept responsibility for it. This is the position held by the Panel of Takeovers and Mergers.

A slightly more severe solution would be to already forbid the bank deputy from participating in the relevant session of the board, since the mere participation in the discussion is already tainted by the conflict of interest and might influence the outcome. Reputedly, the Deutsche Bank's deputy Cartellieri serving on the board of Thyssen in 1997 chose this way, though not openly: he pretended he was ill. It is not clear whether under German takeover law this would imply also that the bank deputy might not take part in formulating and issuing the views of the board of the offeree company under section 27 of the Takeover Act. An alternative interpretation might be that he can join in with a dissenting opinion, provided that he has disclosed his conflict in it. This solution is oriented to the position of the Panel that encourages the publication of dissenting votes in case of a split board.

If the conflict of interest is such that it cannot be resolved by the measures mentioned before, or if it is clear that the conflict is serious and continuing, the director has to solve the conflict by stepping down. The conflict of interest is good cause for him to quit the office. If he does not do this by himself, there may ultimately be cause for revocation of office.

5. Rule of Law and Self-Regulation: Differences in History, Corporate Governance, and Financial Culture Between the U.K. and Germany

The different attitudes in the U.K. and Germany concerning self-regulation have been commented upon before. It suffices to say that Germany's experience with the voluntary insider trading guidelines has been quite unsatisfactory in many respects, inter alia, as to the reach of the prohibition of insider trading, the sanctions, the lack of transparency, and the procedure. This has been described in detail elsewhere. The experience with the voluntary takeover code has been better, but not fully convincing either. Its main problem was that many German companies were just not ready to accept the code voluntarily. It is true that the takeover code had the congenital defect of requiring prior acceptance of the code by all enterprises concerned. I warned Mr. Baumann from Siemens[29] against this on the basis of experience with the former insider trading guidelines and the fact that not even the London Takeover Code contained such a requirement. If the German Takeover Commission had been able to do without such acceptances and simply apply the code in the concrete case, the result would have been much more impressive: Since the Takeover Code became effective on October 1, 1995, through June 13, 2000, the Takeover Commission registered 95 proceedings with 113 total offers. Out of these offers, 87 were voluntary, 13 were mandatory, in three cases the commission granted an exception, and only ten offers were publicly criticized by the commission as not or not fully respecting the Takeover Code. Yet the unsatisfactory acceptance rate was decisive. As of April 12, 2001, only 74.3% of all domestic enterprises with securities quoted at the stock exchange had accepted the Takeover Code. Among the

DAX 30 companies, the most prominent companies that still refused acceptance were BMW and Volkswagen. The takeover offers that were administered in full conformity with the Takeover Code included, for example, the Vodafone Mannesmann takeover and the Allianz Dresdner Bank deal. In the end, the Stock Exchange Expert Commission at the Ministry of Finance, which authored the Takeover Code, and the Takeover Commission itself pleaded publicly for a takeover act. The Takeover Act did away with self-regulation. Only very rudimentary elements of self-regulation can still be found.[30]

These German experiences with self-regulation[31] differ considerably from the ones made in the U.K., even taking into consideration the fundamental changes brought about by the Financial Services Act of 2000, and regardless of the ongoing discussion on the Takeover Panel and the Takeover Code. It is not easy to explain these differences. They are related to history or, as one says today, they are path-dependent. First of all, in financial matters and elsewhere, Germany has always had state regulation and the concept of prohibition and order instead of self-regulation. The few exceptions to be found in the regulation of stock exchanges, and of banking supervision and regulation by the Federal Banking Authority and the German Bundesbank, are but proof of the general rule. In addition, the rise of the German constitution, the Rechtsstaat, and the administrative judiciary after the Third Reich must be mentioned. In Germany, businesses are accustomed to being able to go to court against any public action of supervision or enforcement. There is no room for a threat of being blacklisted or put in the pillory or expelled from professional activities as in the U.K. The consequence is that the authority of the Panel is probably de facto higher than the legal authority of some state administration in Germany.

This also shows in different practices. While German enterprises and financial actors are also, of course, in close contact with the supervisory office (BAFin), it is hardly conceivable for the BAFin to issue a statement like that of the Panel in the City Code: "To take legal, or other professional, advice on the interpretation or application of the Code is not an appropriate alternative to obtaining a ruling (...) from the Executive."[32] With inducement fees in the U.K., for example, the details of such a fee are discussed and settled with the Panel before the takeover offer in an informal way, causing the problem of what is permissible or not to perhaps remain unsettled and not even become public. In contrast, in Germany there are textbooks, so-called commentaries, and a host of legal academic articles, doctoral theses, and books which treat these questions in a dogmatic or practical lawyer's way. When the matter is brought before the court, the attorney and the court look to these publications and may very well cite them as persuasive authority. It is not my task to judge what is better. Each system has its advantages and disadvantages. Among the pros of the German state supervisory system may be more foreseeability and transparency, together with the possibility of having each state interference scrutinized thoroughly in an administrative court proceeding (which may take very long and be economically costly). A clear pro of U.K. self-regulation by the Panel is longstanding experience and an enormous flexibility, which under a legalistic system such as the German one can never be reached and is probably much better suited to the quickly changing financial markets and practices. It is hardly surprising that one of the major British fears regarding the 13th directive was getting the courts involved in takeovers. 0

Summary:

The German Takeover Act on public securities offers and takeovers of December 20, 2001 is in force since January 1st, 2002. This date is fine-tuned with the German tax law reform, which has the result that proceeds from sales of participations in enterprises are tax-free. It is expected that this will lead to a wave of sales and restructurings of the interwoven German banks and industry. The Takeover Act differs from the former drafts in three major points: post-bid defenses, the regulation of public securities, and the offer price. Further problems concern the uneasy relationship between takeover law and the law of groups of companies (Konzernrecht). These have not yet been solved, nor have the special problems of how to deal with secrecy and conflicts of interest in takeovers.

Secrecy before the offer does not follow from the Takeover Act, but from insider law and the general company law secrecy. The conflict between insider and takeover law is well known. It might involve European law. Instant disclosure of takeover plans is mandated under takeover law as well as securities law and presents a number of legal problems. The involvement of advisers and banks by the offeror is safe except for warehousing. It is less clear whether the offeror can freely approach various banks for financing or potential purchasers or offerors for forming a takeover offer consortium. Takeover plans made before final approval by the supervisory board present a special problem of the German two-tier board. It is highly controversial at what moment instant disclosure must be made of a decision that has been reached. A sensible solution consists of requiring instant disclosure only when a decision is final within the management board as well as the supervisory board. Yet there are exceptions to this rule. It is therefore helpful that the Takeover Act provides for the precedence of takeover law disclosure over the instant disclosure rules of general securities law. Instant disclosure is usually a question for the offeror and not for the offeree. However, in rare cases, the offeree company may have its own duty of instant disclosure. This may be the case if a friendly takeover is arranged with the cooperation of the board of the offeree company, and if the offeree company issues statements that turn out to be wrong in the light of later developments. Concerning rumors, the position of German law is that as a matter of principle there is no duty of the company and its board to comment, i.e., no duty of instant disclosure, either of the offeror or of the offeree. Instant disclosure in group situations is highly controversial. Two fact patterns should be distinguished. In the first, the relevant information has an impact on the price of the securities of the group member. In the second, the parent had or could have had an influence on the nondisclosure by the subsidiary. Mandatory disclosure of shareholding begins in Germany at five per cent. This goes beyond what is required under European law. It is not clear whether this rule is just a transparency rule or is rather intended to give the management of a company an early warning about a possible future offeror. There are many problems of information and liability of the offeror and the offeree. One serious lacuna of the Takeover Act as compared to the City Code is that the information required about the workforce and the relevant changes in the conditions of employment does not cover the employees of the offeree's subsidiaries. Section 12 of the German Takeover Act contains a liability provision that is closely patterned after the stock exchange prospectus liability. Yet the German provisions on liability for untrue or incomplete stock exchange prospectuses have long been criticized for being far more restrictive than general tort law liability and even general civil law prospectus liability. Insider law should not prevent defensive measures by the offeree that are allowed under takeover law, i.e., working together with shareholders and banks in anticipation of a hostile bid as well as searching for a white knight. The European insider trading directive is not clear on this. Other problems relate to the legitimate reach of due diligence and whether the provisions against insider trading limit the normal due diligence examination. If a prospective white knight has been allowed to inspect the books of the offeree company in a due diligence exercise, it is unclear under German law whether the same information must be given to the offeror.

As to conflicts of interest of boards and banks it must be remembered that under section 76 of the German stock corporation act (AktG), the management board has direct responsibility for the management of the company. This responsibility reaches beyond the shareholders and includes the interest of the employees and even the common good. The problem with this constituency rule is similar to a general business judgment rule concerning post-bid defenses. The rule sounds very good, but it is not possible for the shareholders or the workers to check whether the judgment of the management board is valid. In the end, the rule results in decisions maximizing managers' utility. According to the majority view, under section 76 AktG it is not up to the management board to make decisions on the composition of the company's shareholders. Section 33 of the Takeover Act is less strict by allowing frustrating actions of the target's management board with the consent of the supervisory board. This is incompatible with the draft thirteenth directive as of October 2, 2002. In Germany, inducement fees are not yet commonly known or discussed. The legal treatment is ambiguous. If the inducement fee is just to assure that the prospective offeror does not make a distinct loss if his offer is not accepted, this would probably be all right. It is questionable, however, whether the board does not fetter his discretion by making such a promise. Yet under the general business judgment clause of section 76 AktG, this can hardly be ascertained. At the least, there should be a full disclosure of such fees. Conflicts of interest in takeovers may become particularly relevant for German banks. This is so because in Germany—and some other Continental European states such as Switzerland and Austria—the so-called all-purpose or universal banking system prevails. The Corporate Governance Principles of the Deutsche Bank of March 2001 state in this respect that, in general, members of the management board of the Deutsche Bank do not accept the chair in the supervisory boards of companies which do not belong to the Deutsche Bank group, and that supervisory board members must disclose conflicts of interests to the president of the supervisory board (and the president himself to the presidial committee). The best way of dealing with conflicts of interest is to prevent them from coming into existence. This can be done by Chinese walls, the principle of general incompatibility, or rules of special incompatibility. Under German law and possibly also under UK law, at least after Bolkiah, establishing Chinese walls is not considered a safe haven in itself for the bank or another party subject to conflicts of interest. General and special incompatibility rules are problematic. It remains to try to solve the conflict of interests in a takeover when the offer is prepared or has already been made and questions arises as to how the bank and the bank deputy in the offeree company should behave. There seem to be at least four possibilities: abstaining from voting, exclusion from deliberation, stepping down, and revocation of office. As to the choice between rule of law and self-regulation, there are major differences in history, corporate governance, and financial culture between the UK and Germany. They are related to history or, as one says today, they are path-dependent.

[1] German Act on Public Securities Offers and Takeovers of 20 Dec. 2001, Federal Gazette I 3822, for details see K J Hopt,
Grundsatz- und Praxisprobleme nach dem Wertpapiererwerbs- und Übernahmegesetz 166 (2002) *Zeitschrift für das gesamte Handelsrecht und Wirtschafsrecht (ZHR),*383. See the semi-official comments on the draft by A. Möller and T. Pötzsch from the Federal Ministry of Finance, who drafted the act, Das neue Übernahmerecht – Der Regierungsentwurf vom 11. Juli 2001, Zeitschrift für Wirtschaftsrecht (ZIP) 2001, 1256; see also P. O. Mülbert, Übernahmerecht zwischen Kapitalmarktrecht und Aktien(konzern)recht – die konzeptionelle Schwachstelle des RegE WpÜG, Zeitschrift für Wirtschaftsrecht (ZIP) 2001, 1221 (relationship between takeover law and law of groups of companies, Konzernrecht) and M. Habersack, Der Finanzplatz Deutschland und die Rechte der Aktionäre, Zeitschrift für Wirtschaftsrecht (ZIP) 2001, 1230 (new squeeze-out rules). The former draft was commented upon widely, for example, by K. J. Hopt, Auf dem Weg zum deutschen Übernahmegesetz, Gemeinsamer Standpunkt des Rates zur 13. Richtlinie und Diskussionsentwurf des Übernahmegesetzes, in: E. A. Kramer and W. Schumacher, eds., Beiträge zum Unternehmensrecht, Festschrift für H.-G. Koppensteiner, Vienna 2001, p. 61-89.
[2] The problem of defensive actions has been the most widely discussed reform problem in German takeover law. Cf., for example, pro an antifrustration rule along the British model, K. J. Hopt, Verhaltenspflichten des Vorstands der Zielgesellschaft bei feindlichen Übernahmen – Zur aktien- und übernahmerechtlichen Rechtslage in Deutschland und Europa –, in: Festschrift für Lutter, Cologne 2000, p. 1361; P. O. Mülbert, M. Birke, In Defense of Passivity – on the Proper Role of a Target's Management in Response to a Hostile Tender Offer, European Business Organization Law Review 1 (2000) 445; contra, for example, C. Kirchner, R. W. Painter, European Takeover Law – Towards a European Modified Business Judgment Rule for Takeover Law, European Business Organization Law Review 1 (2000) 353.
[3] Cf. Forum Europaeum Corporate Group Law, Corporate Group Law for Europe, European Business Organization Law Review 1 (2000) 165 at 217 et seq.; cf. K. J. Hopt, Konzernrecht und Kapitalmarktrecht in Deutschland, in: P. Hommelhoff, K. J. Hopt, M. Lutter, eds., Konzernrecht und Kapitalmarktrecht, Munich 2001, p. 31 at 66 et seq. and idem at 287 et seq.
[4] Cf. Forum Europaeum Corporate Group Law, loc.cit., European Business Organization Law Review 1 (2000) 165 at 228 et seq.; High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels, 10 January 2002, p. 66 et seq. The European Commission has followed this recommendation in Art. 15 of the draft thirteenth directive as of October 2, 2002.
[5] On insider trading issues in public takeover bids, cf. K. J. Hopt, Europäisches und deutsches Übernahmerecht, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1991, 17 at 32 et seq., 37 et seq.; idem, Insiderwissen und Interessenkonflikte im deutschen und europäischen Bankrecht, in: Festschrift für Heinsius, Berlin/New York, 1991, p. 296-298, 310-314 with further references; idem in: Bankrechts-Handbuch, 2d ed., Munich 2001, vol. III, § 107 comment 60; H.-D. Assmann in: H.-D. Assmann, U. H Schneider, Wertpapierhandelsgesetz, 2d ed., Cologne 1999, § 14 comments 79 et seq.
[6] P. Davies, The Take-over Bidder Exemption and the Policy of Disclosure, in: K. J. Hopt, E. Wymeersch, eds., European Insider Dealing – Law and Practice, London et al. 1991, p. 243: "locus classicus."
[7] K. J. Hopt, European Takeover Regulation: Barriers to and Problems of Harmonizing Takeover Law in the European Community, in: K. J. Hopt, E. Wymeersch, eds., European Takeovers – Law and Practice, London et al. 1992, p. 165 at 187 et seq.

[8] P. Davies, The Take-over Bidder Exemption and the Policy of Disclosure, loc. cit., p. 243 at 254 et seq.
[9] K. J. Hopt, Festschrift für Heinsius, loc. cit, p. 297 et seq..
[10] Idem in: Bankrechts-Handbuch, loc. cit., § 107 comment 49 with further references.
[11] Idem, § 107 comment 55 with further references.
[12] Idem, § 107 comment 52.
[13] Idem, § 107 comment 48.
[14] Idem, Konzernrecht und Kapitalmarktrecht in Deutschland, loc. cit., p. 31 at 59 et seq..
[15] Cf. P. Davies, K. J. Hopt, Control Transactions, in: R. Kraakman, P. Davies, H. Hansmann, G. Hertig, K. J. Hopt, H. Kanda & E. B. Rock, eds., The Anatomy of Corporate Law, A Comparative and Functional Approach, unpublished manuscript, August 2002.
[16] K. J. Hopt, Das Dritte Finanzmarktförderungsgesetz – Börsen- und kapitalmarktrechtliche Überlegungen –, in: Festschrift für U. Drobnig, Tuebingen 1998, p. 525 at 528 et seq.
[17] Idem at p. 532.
[18] Idem in: Bankrechts-Handbuch, loc. cit., section 107, comment 60; similarly R. Süßmann, Die befugte Weitergabe von Insidertatsachen, Die Aktiengesellschaft 1999, 162 at 170 et seq.. Contra H.-D. Assmann in: Assmann/Schneider, Wertpapierhandelsgesetz, loc.cit., § 14 comment 88.
[19] H.-D. Assmann in: Assmann/Schneider, Wertpapierhandelsgesetz, loc.cit., § 14 comment 88b; K. J. Hopt in: Großkommentar zum Aktiengesetz, Berlin, New York, 4th ed., 1999, section 93 comment 213; idem in: Bankrechts-Handbuch, loc. cit., § 107 comment 61; R. Süßmann, Die befugte Weitergabe von Insidertatsachen, Die Aktiengesellschaft 1999, 162 at 169.
[20] K. J. Hopt in: Bankrechts-Handbuch, loc. cit., § 107 comment 61 with further references; H.-D. Assmann in: Assmann/Schneider, Wertpapierhandelsgesetz, loc.cit., § 14 comment 88 c.
[21] See supra note 3.
[22] This is also the view of the High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels, 10 January 2002, p. 18 et seq., 39 et seq. See also various contributions by L Bebchuk, most recently: L Bebchuk, The Case Against Board Veto in Corporate Takeovers, Harvard Discussion Paper 4/2002. As to the different agency conflicts to be addressed in takeover regulation, see P. Davies, K. J. Hopt, Control Transactions, in: R. Kraakman, P. Davies, H. Hansmann, G. Hertig, K. J. Hopt, H. Kanda & E. B. Rock, eds., The Anatomy of Corporate Law, A Comparative and Functional Approach, unpublished manuscript, August 2001.
[23] K. J. Hopt, Aktionärskreis und Vorstandsneutralität, ZGR 1993, 534 at 545 et seq. This is also the view of the High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels, 10 January 2002, p. 18 et seq.
[24] Cf. idem, Self-Dealing and Use of Corporate Opportunity and Information: Regulating Directors' Conflicts of Interest, in: K. J. Hopt and G. Teubner, eds., Corporate Governance and Directors' Liabilities, Legal, Economic and Sociological Analyses on Corporate Social Responsibility, Berlin, New York 1985, p. 285; idem in: K. J. Hopt/H. Wiedemann, eds., Grosskommentar zum Aktiengesetz, Berlin, New York 1999, section 93 comments 156-186 with further references.
For the U.K., P. L. Davies, Gower's Principles of Modern Company Law, 6th ed., London 1997, p. 610 et seq.; The Law Commission, Company Directors: Regulating Conflicts of Interests and Formulating A Statement of Duties, London, September 1999, Cm 4436, SE/1999/25.
[25] For detailed case law, see A. Baumbach, K. J. Hopt, Handelsgesetzbuch, 30th ed., Munich 2000, section 347 comment 24 et seq.

[26] Cf. R.-E. Breuer, The Role of the Financial Intermediaries and Capital Markets, in: K. J. Hopt/H. Kanda/M. J. Roe/E. Wymeersch/S. Prigge, eds., Comparative Corporate Governance, Oxford 1998, p. 537.
[27] Cf. Section 3.3.1 (areas of discretion, so-called Chinese walls) and 3.3.2 (information flow across areas, wall crossing) of the Regulation of the BAWe as to concretization of the organizational duties of providers of investment services under section 33 subsection 1 of the WpHG as of 25 October 1999; K. J. Hopt in: Festschrift für Heinsius, loc. cit., p. 319 et seq.; most recently P. Buck, Wissen und juristische Person, Tübingen 2001, p. 500 et seq.
[28] Bundesgerichtshof, Neue Juristische Wochenschrift 1980, 1629 (Schaffgotsch case); P. Ulmer, Aufsichtsratsmandat und Interessenkollision, Neue Juristische Wochenschrift 1980, 1603; M. Dreher, Interessenkonflikte im Aufsichtsrat, Juristenzeitung 1990, 896 at 900; K. J. Hopt, Die Verantwortlichkeit der Banken bei Emissionen, Munich 1991, p. 49 et seq.; M. R. Deckert, Inkompatibilitäten und Interessenkonflikte – Zur Pflichtenstellung des Aufsichtsratsmitglieds –, Deutsche Zeitschrift für Wirtschaftsrecht 1996, 406 at 408 et seq.; P. W. Heermann, Interessenkonflikte von Bankvertretern in Aufsichtsräten bei (geplanten) Unternehmensübernahmen, Wertpapier-Mitteilungen/Zeitschrift für Wirtschafts- und Bankrecht, 1997, 1689 at 1693; K. E. Herkenroth, Bankenvertreter als Aufsichtsratsmitglieder von Zielgesellschaften: Zur beschränkten Leistungsfähigkeit des Rechts bei der Lösung von Interessenkonflikten anläßlich der Finanzierung von Übernahmen, Die Aktiengesellschaft 2001, 33 at 35.
[29] Mr. Baumann, then chief financial officer of Siemens, was the head of the Commission of Stock Exchange Experts at the Ministry of Finance. This Commission had already favored a takeover statute solution, but under the presidency of Mr. Baumann decided for a takeover code solution.
[30] Section 5 of the German Draft Act (see supra note 1) provides for an advisory council. Yet its competence is very small indeed. It is to advise the supervisory office before the latter enacts regulations, but it is not involved in the actual day to day supervision and decision of cases.
[31] Cf. K. J. Hopt, Self-Regulation in Banking and Finance – Practice and Theory in Germany –, in: La Déontologie bancaire et financière/The Ethical Standards in Banking & Finance, Brussels 1998, p. 53; idem, Das System der Unternehmensüberwachung in Deutschland, in: Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW), ed., Kapitalmarktorientierte Unternehmensüberwachung, Düsseldorf 2001, p. 27 at 55 et seq.
[32] City Code, section A, para. 3(b).

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