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Merkels & Acquisitions *or* Locusts and Labor Law: What's Really "Plaguing" Cross-Border M&A in Germany?

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MERKELS & ACQUISITIONS
OR
LOCUSTS AND LABOR LAW:
WHAT'S REALLY "PLAGUING" CROSS-
BORDER M&A IN GERMANY?

[A]nd out of the smoke dropped locusts which were given the powers that scorpions have on earth: they were forbidden to harm any fields or crops or trees and told only to attack any men who were without God's seal on their foreheads. They were not to kill them, but to give them pain. . . . When this happens, men will long for death and not find it anywhere; they will want to die and death will evade them.

To look at, these locusts were like horses armored for battle. . . . That was the first of the troubles. . . .¹

I. INTRODUCTION

In May and June of 2006, Germany's Chancellor, Angela Merkel, came to America for meetings with various leaders of American business.² Merkel intended to make a "big push to ramp up U.S. investment in Germany."³ *Forbes.com* proclaimed her the World's Most Powerful Woman and said, "Angela Merkel has a message for American companies: 'Germany is open for business.'"⁴

These efforts by Merkel to encourage business growth so early in her tenure as Chancellor⁵ are not surprising. Described regularly by the media as "business friendly,"⁶ Merkel ran largely on a platform of promises to stimulate the "sluggish"⁷ German economy.⁸ During her campaign, Merkel

1. 9 *Revelation* 9:3-7.

2. Tatiana Serafin, *The Most Powerful Woman in the World*, FORBES.COM, Sept. 1, 2006, http://www.forbes.com/2006/08/31/angela-merkel-power_cz_ts_06women_0831merkel.html.

3. *Id.*

4. *The World's Most Powerful Women*, FORBES.COM, Aug. 31, 2006, http://www.forbes.com/lists/2006/11/06women_The-100-Most-Powerful-Women_land.html.

5. Merkel was elected November 22, 2005. See Richard Bernstein, *Merkel Takes Office in Germany and Announces Coalition Cabinet*, N.Y. TIMES, Nov. 23, 2005, at A11.

6. See, e.g., *The Beginning of the End?*, EUR. REP., Sept. 21, 2005; Mitra Thompson, *Healthcare Reforms on Hold as New German Chancellor Appointed*, WORLD MARKETS RES. CENTER, Oct. 13, 2005 (describing Merkel as "big business-friendly").

7. Int'l Monetary Fund Country Report No. 06/17, *Germany: Selected Issues*, Jan. 2006, at 70, available at <http://www.imf.org/external/pubs/ft/scr/2006/cr0617.pdf>. See also Ben Aris, *Western Europe: Germany—The Slow Road to Recovery—Although Business and Confidence Is Up Regarding Germany's Prospects For Recovery This Year. Members of the Public and the Mittelstand Remain Unconvinced*, THE BANKER, Apr. 1, 2006, at 56 (suggesting that, although some signs point to an economic "upswing" in Germany, "[n]one of the macroeconomic ailments that the 'sick man of Europe' has been suffering from have disappeared").

8. See, e.g., Vanessa Drucker, *Turning Point*, GLOBAL FIN. MAG., June 2006, at 27.

made it clear that she intended to accomplish this “heal[ing of] the sick man of Europe”⁹ by ushering in a host of reforms intended to encourage business growth.¹⁰ Doing this would, according to her free-market way of thinking,¹¹ stimulate the economy.¹²

Assuming that Merkel’s “opening” of Germany to American business¹³ is related to her overall goal of spurring economic recovery by encouraging German business growth,¹⁴ the question is how intimately she will connect the two. One way that she might consider using the one to accomplish the other would be to open German companies to takeovers from American companies or other investors. As numerous commentators have pointed out, an open, strong takeover market that facilitates cross-border mergers and acquisitions (M&A)¹⁵ is one way to accomplish such a goal.¹⁶ Given that

9. Heather Stewart, *Business & Media: Iron Frau With a Tinpot Plan for Germany: Angela Merkel’s Ideas Aren’t New and Her Proposals Don’t Go Far Enough*, THE OBSERVER, Sept. 11, 2005, at 4. “The sick man of Europe” is a phrase coined by Russian Tsar Nicholas I to refer to the ailing Ottoman Empire. Since then, it has come to be applied to a European economy that is economically stagnant and seemingly failing. See *The Real Sick Man of Europe*, ECONOMIST.COM, May 19, 2005, available at http://www.economist.com/displaystory.cfm?story_id=3987219. Since the 1990’s, it has been a favorite descriptor of post-unification Germany. *Id.*

10. See Stewart, *supra* note 9, at 4.

11. Free-marketeers generally have the view that economic growth will reach its ideal level with minimal interference by government in businesses’ affairs and dealings with each other. See, e.g., Murray N. Rothbard, *Free Market*, THE CONCISE ENCYCLOPEDIA OF ECONOMICS, available at <http://www.econlib.org/library/enc/FreeMarket.html>.

12. *Id.* Rothbard states:

A common charge against the free-market society is that it institutes “the law of the jungle,” of “dog eat dog[.]” . . . On the contrary, . . . [t]he peaceful market competition of producers and suppliers is a profoundly cooperative process in which everyone benefits, and where everyone’s living standard flourishes (compared to what it would be in an unfree society).

Id.

13. See *The World’s Most Powerful Women*, *supra* note 4, and accompanying text.

14. This is only an assumption, as Merkel refused all interviews during the trip. According to her “right-hand man, [however,] . . . Merkel used the meetings to promote the research and high-tech skills in Bavaria as on par with Silicon Valley, in addition to showcasing other potential markets in Germany.” See Serafin, *supra* note 2.

15. “[A] cross-border M&A transaction is a transaction in which the target company [the one being acquired] and the acquiring company [the buyer] are from different countries.” Kathy Lien, *Mergers and Acquisitions: Another Tool for Traders*, INVESTOPEDIA.COM, Oct. 12, 2005, <http://www.investopedia.com/articles/forex/05/MA.asp>.

16. See, e.g., Peer Zumbansen, *Book Review: European Corporate Law and National Divergences: The Case of Takeover Regulation*, 3 WASH. U. GLOBAL STUD. L. REV. 867, 882 (2004) (suggesting that, in any debate about takeover regulation, scholars should address the “economic pressure experienced by mature industrial and post-industrial states [at least the “industrial” category would include Germany] to develop innovative means for economic . . . growth,” the inference being that takeover regulation is very intertwined with economic growth). See also Jeffrey M. Peterson, *Unrest in the European Commission: The Changing Landscape and Politics of International Mergers for United States Companies*, 24 HOUS. J. INT’L L. 377, 405 (2002) (“There are no winners with protectionism. Protectionist measures are not beneficial to Europe, as European industry cannot compete in world markets if it is fenced in by protectionist

there is no shortage of interest in German companies from foreign, including American, buyers,¹⁷ at first glance Merkel appears to be well-positioned to allow cross-border acquisitions by American purchasers assist her in accomplishing both her economy-stimulation and increasing-American-business goals. And indeed, Merkel has indicated that she would like to relax certain German laws that are significant barriers to the development of a freer German market.¹⁸

Unfortunately, certain moves in 2006 by the German legislature, as well as public comments by high-ranking political officials,¹⁹ indicate that not all of Germany is as open to encouraging foreign investment, particularly via cross-border acquisition, as Merkel may be.²⁰ First, and perhaps most significantly, in July 2006 Germany enacted national legislation to implement the Thirteenth Directive of the European Union on Takeover Regulation, the European Commission legislation aimed at harmonizing “rules on takeovers in the European Union.”²¹ The goal of such harmonization was to make cross-border takeovers, in particular “hostile” ones, easier within the European Union.²² However, because of sustained opposition to original provisions of the Directive that would effect this goal,

measures.”). As Charlie McCreevy, the European Commissioner for the Internal Market noted, there is “a direct correlation between openness and prosperity.” See *Bad for Europe: Flag-wrapped Protectionism is Thwarting the EU's Economic Potential*, THE TIMES (LONDON), Feb. 28, 2006, at 17. While McCreevy was referring to openness within the EU, proponents of a strong takeover market would assert that openness *in general* to cross-border takeovers should be encouraged, particularly when a country is trying to boost economic growth.

17. See, e.g., Michael Wang, *Germany Enjoys an M&A Fest—Year's Deal Value to Top \$96 Billion, as Financial Sector Shines*, WALL ST. J., Dec. 19, 2005, at C8 (noting some very large deals involving non-German purchasers of German companies in 2005). Cross-border deals (those involving purchasers from one country buying a company in another) have generally been on the rise in recent years. See Dennis K. Berman & Jason Singer, *Blizzard of Deals Heralds an Era of Megamergers—Ample Credit, Foreign Rivals and High Commodity Prices Propel Push for Global Reach*, WALL ST. J., June 27, 2006, at A1.

18. See, e.g., Jonathan Braude, *Days of the Locust*, THEDEAL.COM, July 22, 2005, http://www.thedeal.com/servlet/ContentServer?pagename=TheDeal/TDDArticle/TDPrinterFriendly&c=TDDArticle&ArtID=1121176502234&cid=1121176502234&bn=/images/weekly/NewsReview_FIN.gif (contrasting Merkel and her party's stated goals of, for example, making layoffs easier, with the current landscape that legally requires a prospective buyer to elicit significant—and often, ultimately fatal to an attempted acquisition—cooperation from labor factions). Braude describes Merkel's party's approach as “a nudge in the direction of freer markets.” *Id.*

19. Specifically, or at least most famously, this refers to a comment by now Vice-Chancellor Franz Müntefering describing American private equity firms and hedge funds as “locusts who were ravaging German companies and destroying jobs.” Braude, *supra* note 18.

20. *Id.*

21. Council Directive 2004/25, 2004 O.J. (L 142/12) 12-23 (EC), Preamble ¶ 29, available at <http://europa.eu.int/eur-lex> [hereinafter the Directive]. The European Union will hereinafter be referred to as the EU. In European Union lawmaking, “[a] directive establishes Union policy. It is then left to the member states to implement the directive in whatever way is appropriate to their [respective] national legal system[s].” RALPH H. FOLSOM, PRINCIPLES OF EUROPEAN UNION LAW 31 (2005). This is why Germany had to enact its own legislation to implement the Directive.

22. See Peggy Hollinger & John Thornhill, *Paris Prepares Sweetener for Italy*, FIN. TIMES, Mar. 13, 2006, at 21.

particularly from Germany,²³ the Directive is highly unlikely to achieve its desired ends in any significant measure.²⁴ The German implementation of the Directive²⁵ enshrined the country's expected position²⁶ on the Directive in German law, and suggests a Germany distinctly *disinterested* in opening its national companies to foreign purchasers.²⁷ It leaves national companies free to opt out of the two provisions of the Directive perhaps most "aimed at . . . removing barriers to takeovers,"²⁸ by "provid[ing] management with considerable flexibility . . . to take frustrating action[] against unsolicited takeovers."²⁹ This means that management averse to takeover by a U.S. bidder, for example, would have fairly free reign to reject a bid.³⁰

As a secondary matter, Merkel does not appear to have anything like unified support for her agenda of encouraging foreign—American or otherwise—investment in German companies, even within her governing

23. John Plender, *Europe Feels the Toxic Effect of Corporate Nationalism*, FIN. TIMES, Apr. 6, 2006, at 19 ("[T]he Germans and Swedes . . . were able to knock the stuffing out of Europe's takeover directive."); Tobias Buck, *Setback for EU as Members Opt out of Takeover Rules*, FIN. TIMES, Mar. 2, 2006, at 6 ("[S]trong opposition from member states such as Germany and Sweden . . . ensured the draft law was severely watered down.").

24. See discussion *infra* Part II.B.

25. Gesetz zur Umsetzung der Richtlinie 2004/25/EG des Europäischen Parlaments und des Rates vom 21. Apr. 2004 betreffend Übernahmeangebote (Übernehmerichtlinie-Umsetzungsgesetz), July 8, 2006, BGBl. I at 1433 [hereinafter the German Implementation]. The German Implementation, art. 8.

26. See, e.g., *A Map of Europe After the Takeover Directive: Firms Across the EU Detail the Local Variation in Implementation of the Takeover Directive*, INT'L FIN. L. REV., July 1, 2006, at 26 [hereinafter *A Map of Europe After the Takeover Directive*] (predicting how various Member States would implement the Directive); Freshfields Bruckhaus Deringer, *The Takeover Directive: Implementation in Germany*, Summary, July 2006, at 1, available at www.freshfields.com/publications/pdfs/2006/15837.pdf ("The new legislation confirms the position Germany was expected to take on the Directive's optional articles.").

27. See, e.g., *Bad for Europe: Flag-wrapped Protectionism is Thwarting the EU's Economic Potential*, *supra* note 16 (discussing European countries' use of "loopholes" in the Directive to protect national industry).

28. Scott V. Simpson & Lorenzo Corte, *EU Directive Fails to Harmonize Takeovers*, THE GUIDE TO MERGERS & ACQUISITIONS 2005, INT'L FIN. L. REV., Apr. 1, 2005, at 15. Furthermore,

[a]dditional legislative activity is still needed in order to provide a framework for companies whose shareholders decide to opt in. The legislature will also need to clarify the requirements for a shareholder 'opt in' resolution, as well as provide a set of rules governing frustrating actions taken by those companies.

Klaus Riehmer, *Germany*, in EUROPEAN TAKEOVERS: THE ART OF ACQUISITION 207, 212 (Jeremy Grant ed. 2005).

29. Simpson & Corte, *supra* note 28, at 18.

30. There is reason to believe that Germany lobbied for making these provisions optional at least in part *because* of concern that, if mandatory, they might open German companies to takeover by unsolicited U.S. bidders, and German politicians, at least, felt that national industry needed protection. See Peterson, *supra* note 16, at 402 ("Klaus-Heiner Lehne, a German Christian Democratic MEP who was concerned that EU companies should have the chance to defend themselves against hostile bids from the United States, put many of the changes [that finally resulted in Articles 9 and 11 being optional] forward.").

coalition.³¹ The most striking example of this is perhaps Franz Müntefering, former Chairman of the SPD³² and now Vice Chancellor and Federal Minister for Labor and Social Affairs.³³ In 2005, Müntefering famously³⁴ referred to (depending on the account one reads) foreign investors,³⁵ private equity³⁶ and/or hedge funds,³⁷ as “locusts.”³⁸ Müntefering’s comments seemed to echo the sentiments of many of his leftist (especially trade-union-friendly) brethren in Europe.³⁹ German unions’ historical power in deciding

31. This coalition is made up of the CDU, Merkel’s conservative party; the CSU, another conservative party; and the SPD, the left-leaning social democratic party. See BBCNEWS.CO.UK, *German Coalition Agreement Signed*, Nov. 18, 2005, available at <http://news.bbc.co.uk/2/hi/europe/4449662.stm>. Given the mix of political leanings within this “left-right coalition,” see *Merkel Vows to Make Germany Economic Motor of Europe Again*, AFX INTERNATIONAL FOCUS, Nov. 30, 2005, <http://www.lexisnexis.com>, it is perhaps unsurprising that she and her governing compatriots agree on fairly few issues. See, e.g., Tony Paterson, *Main Parties Agree Merkel As Head of Grand Coalition*, INDEP., Nov. 15, 2005, at 23.

32. Sozialdemokratische Partei Deutschlands (Social Democratic Party of Germany). For a brief English-language history, see HIGHBEAM ENCYCLOPEDIA, available at <http://www.encyclopedia.com/doc/1B1-378985.html>.

33. Müntefering’s official (German-language) title is Bundesminister für Arbeit und Soziales. A brief biography of the Minister is available on the SPD website. See SPD.DE, <http://www.spd.de/menu/1684138/>.

34. Two years later these comments are *still* being repeated by both the media and Mr. Müntefering. See, e.g., Bertrand Benoit, *German Deputy Stands by Call to Tackle Locusts*, FT.COM, Feb. 14, 2007, <http://www.ft.com/cms/s/55437712-bc4e-11db-9cbc-0000779e2340.html>. Benoit writes,

Asked how he feels about the [private equity firms as locust] metaphor, [Müntefering] grabs a metal grasshopper from a shelf and borrows from singer Edith Piaf. “I have no regret whatsoever. . . . It is a nice image, locusts that move into a field, eat it to the ground, and move on to the next without looking back. I think it was quite apt.

Id.

35. Norma Cohen & Patrick Jenkins, *Book By Ex-Bourse Chief May Upset Exchange*, FIN. TIMES, Dec. 5, 2005, at 25.

36. Sharon Reier, *Is Success Spoiling Private Equity?; Despite Fat Returns, Bigger Risks and Louder Critics Are Crashing the Party*, INT’L HERALD TRIB., Mar. 27, 2007, at 16.

37. Ralph Atkins & Jeremy Grant, *US Opposes ‘Fuzzy’ Voluntary Hedge Fund Code of Conduct*, FIN. TIMES, June 18, 2007, at 17.

38. See, e.g., Michael Jivkov, *‘Mothers Use My Name to Frighten Their Children’; Quote Unquote The Most Interesting Quotes of the Year Tell Their Own Story; Business Operators Displayed the Usual Flamboyance This Year, and, For a Few, Plain Old-Fashioned Crookery*, INDEP., Dec. 27, 2005, at 50; Reier, *supra* note 36, at 16. This note will focus primarily on opposition to private equity funds in Germany.

39. See Jean Eaglesham, *UK Union Adds to Pressure for Curbs on Private Equity Firms*, FT.COM, Feb. 18, 2007, <http://www.ft.com/cms/s/1b76af40-bf87-11db-9ac2-000b5df10621.html>. The sentiment suggested here is that private equity firms are not concerned enough with the welfare of constituencies other than shareholders, in particular labor and the workers that it represents. See, e.g., Jean Eaglesham, *Labour Deputy Leader Hopefuls Quizzed: Private Equity*, FIN. TIMES, Feb. 19, 2007, at 2 [hereinafter Eaglesham, *Labour Deputy Leader Hopefuls Quizzed*] (“Labour’s deputy leadership candidates will this week be asked by one of the biggest unions to explain their stance on private equity, amid growing national and international pressure on politicians to take regulatory action against the sector.”).

the course of German business⁴⁰ could pose a significant problem for Merkel's plans of economic revitalization via encouragement of foreign investment.⁴¹ With a Vice Chancellor in power inclined to support their positions on such matters, the potential for labor to stymie Merkel's efforts in this area is significant.

Despite potential continued problems for foreign investors in the country, investors like private equity funds continue to insist they are interested in attempting to build a greater presence in the German market.⁴² In one way this is surprising, given that much has been made of the need for changes to the country's highly restrictive labor laws, which make hiring and firing of workers complicated and costly, and therefore, "investors' lives most uncomfortable."⁴³ Nevertheless, Germany is of great interest to private equity firms.⁴⁴ Ongoing restructuring by major German corporations, has in part entailed divestment of "underperforming or non-core parts of their businesses,"⁴⁵ allowing private equity purchasers to approach companies at the latter's behest.⁴⁶ Noting the divide between private equity firms' interest in the country on the one hand, and labor laws that place restrictions on investors' maneuverings on the other, Merkel indicated that she plans to institute changes to German law that would ideally encourage foreign, especially private equity, investment in German firms.⁴⁷ Thus, while Müntefering and the unions may not be keen on this push, private equity and foreign investors generally have a friend in Merkel.

40. See, e.g., Heather Stewart, *Business: No Quick Fix for the German Malaise: Wrangles Over Employment Laws and Tax Rates Could Prevent the Radical Reforms Needed to Revitalise Europe's Largest Economy*, THE OBSERVER, Oct. 16, 2005, at 10.

41. See discussion *supra* pp. 199–201.

42. See, e.g., Angela Maier, *German Private Equity to Lobby*, FIN. TIMES, Jan. 25, 2007, at 8 ("Private equity managers have . . . stepped up their efforts to win political acceptance." Presumably this reflects their continued interest in investing in the country).

43. See, e.g., Braude, *supra* note 18. See also Charlie Wright, *Senior Lawyers Brand EU Code Major Hurdle to German M&A*, LEGAL WEEK, Dec. 16, 2004, available at <http://www.legalweek.com/Articles/122466/Senior+lawyers+brand+EU+code+major+hurdle+to+German.html> ("Employment laws in Germany are . . . an impediment [to] . . . investors. They cannot be bothered to wade through [them] and it has been a major brake on German M&A.") (Internal quotations omitted).

44. Oliver Felsenstein, *Private Equity: Germany is Learning to Live With Locusts*, LEGAL WEEK, July 20, 2006, available at <http://www.legalweek.com/Articles/129901/Private+Equity+Germany+is+learning+to+live+with+locusts.html> ("There are a number of quantifiable factors that make Germany one of the most attractive places for private equity investments in Europe, if not the world.").

45. *Id.*

46. Examples of recent transactions include E.ON's divestment of the Viterro Group to private equity firm Terra Firma, and Linde's announcement of its intent to auction its materials-handling business. *Id.*

47. Translation of the Coalition Agreement Between the CDU, CSU and SPD, Nov. 11, 2005, at 69, available at http://www.spd.de/show/1683399/Koalitionsvertrag2005_engl.pdf.

The goal of this note is to use certain facets of German takeover law as a lens to examine the viability of Merkel's stated⁴⁸ goal of increasing American investment in Germany. In particular, the question this note seeks to address is whether Merkel can achieve her goal of increasing foreign investment in light of the resistance she is likely to meet from important forces in the German socio-political landscape (especially from certain members of her coalition and powerful union forces). Part II of this note examines the current M&A environment in Germany, with particular focus on the Directive, and Germany's implementation thereof, an indicator that Merkel is up against a legislature inclined to protect national business from foreign takeovers.⁴⁹ This Part concludes that the effect the German Implementation will have on opening Germany to foreign investors' acquisitions of German companies will be negligible at best.⁵⁰ Part III suggests, however, that while the Directive may not have the effect of opening Germany to foreign investors by encouraging hostile cross-border acquisitions, Germany's government might still be able to encourage some form of 'investment through cross-border acquisition.' Specifically, though highly unpopular with politicians like Müntefering and labor officials,⁵¹ private equity firms may be just the type of investors that Merkel should "invite" into the country.⁵² This is because such investors tend to be *friendly*⁵³ (as opposed to hostile) purchasers, so in this respect they are a different kind of buyer than the ones that the German Implementation intended to keep away from national companies. Though the restrictive labor laws pose a serious barrier to such investment,⁵⁴ there may be useful European models of labor laws elsewhere on the Continent that protect workers while still allowing buyers of companies the freedom they need to downsize and restructure staffing to create more successful firms. Especially promising is the Danish "flexicurity" system, which Part III examines, ultimately concluding that flexicurity could serve as a useful model for the German legislature in considering reformation of its own labor laws. Part IV attempts to draw some conclusions about the likelihood of changes in the near future and whether Germany's 'American-business-

48. See *supra* note 47 and accompanying text.

49. See discussion *infra* Part II.

50. Simpson & Corte, *supra* note 28, at 18 (suggesting that, because relatively little about German takeover law has changed, there will not be any noticeable difference in U.S. acquisition of German companies precipitated by the German Implementation).

51. See Eaglesham, *Labour Deputy Leader Hopefuls Quizzed*, *supra* note 39, at 2.

52. As already noted, see *supra* note 47 and accompanying text, Merkel in fact intends to try to do this anyway, despite the opposition she faces.

53. Andrew Geoghegan, *Coles Myer Refuses Takeover Offer*, ABC TRANSCRIPTS (Australia), Sept. 7, 2006 ("Private equity firms by nature are generally not willing to make hostile takeover bids. They much prefer to do things with board approval.").

54. See Wright, *supra* note 43. See also discussion *infra* Part III.

friendly' Chancellor,⁵⁵ can manage to welcome American or other foreign investors.⁵⁶

II. THE DIRECTIVE

A. HISTORY AND REALIZATION: A ROAD PAVED WITH GOOD INTENTIONS, BUT ULTIMATELY LEADING NOWHERE?

Passage of the Directive was hard-won.⁵⁷ Fourteen years in the making,⁵⁸ the final Directive represents a compromise on a number of issues.⁵⁹ By nearly all accounts, the Directive's main goals, to harmonize and clarify national regulations regarding takeovers within the EU,⁶⁰ and to create a "level playing field for takeover bids in the EU,"⁶¹ ultimately failed.⁶² Because "its two most important provisions,"⁶³ *i.e.*, those that

55. See Serafin, *supra* note 2 and accompanying text.

56. See *supra* notes 2–4 and accompanying text.

57. Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171, 174 (2006) ("Passage of the . . . Directive . . . is no minor event.").

58. As Christian Kirchner and Richard Painter point out, "Attempts to harmonize takeover law in Europe started in 1974 with a first draft—proposal for a Takeover Directive of the Commission," but it was not until 1990 that the European Commission adopted an amended version of a proposal first presented in 1989. See Christian Kirchner & Richard Painter, *Takeover Defenses Under Delaware Law, the Proposed Thirteenth EU Directive and the New German Takeover Law: Comparison and Recommendations for Reform*, 50 AM. J. COMP. L. 451, 455–56 (2002).

59. *EU Eases the Way For Merger Deals Across Borders—Compromise Legislation Protects Rights of Workers And Minority Shareholders*, WALL ST. J., Nov. 26, 2004, at A7 (noting compromise that had to be reached before passage on workers' rights issues). A favorite descriptor of the final version of the Directive is that it was "watered down" significantly from its initial form. See, e.g., Susie Mesure, *EU Directive Could Cause Takeover Chaos*, INDEP., May 30, 2006, at 34; Tobias Buck, *Setback for EU as Members Opt Out of Takeover Rules*, FIN. TIMES, Mar. 2, 2006, at 6; and Andrew Bulkeley & Paul Whitfield, *France, Germany Propose 'Poison Pill'*, THEDEAL.COM, Feb. 17, 2006, http://www.thedeal.com/servlet/ContentServer?cid=1140027926883&pagename=TheDeal%2FTDDArticle%2FTDStandardArticle&c=TDDArticle&bn=/images/headers/LAW_REGULATION.gif.

60. "It is necessary to create Community-wide clarity and transparency in respect of legal issues to be settled in the event of takeover bids and to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures." Pre-ambule of the Directive, *supra* note 21, at Paragraph (3).

61. The level playing field description is a favorite among commentators on the Directive. See, e.g., Jaap Winter, *The Good, the Bad and the Ugly of the European Takeover Directive*, in EUROPEAN TAKEOVERS: THE ART OF ACQUISITION, *supra* note 28, at xxv, xxvi; Ventoruzzo, *supra* note 57, at 210.

62. See, e.g., Aditi Bagchi, *The Political Economy of Merger Regulation*, 53 AM. J. COMP. L. 1, 16 ("[T]he Directive as passed achieves little by way of harmonization, instead setting forth certain minimum standards."); Harmut Krause, *Keine gleichen Rahmenbedingungen für Übernahmen; Harmonisierungsziel in Europa verfehlt—Deutsche Gesellschaften werden benachteiligt—Dringender Gestaltungsbedarf*, BÖRSEN-ZEITUNG, June 21, 2006, at 2; and Simon F.T. Cox, *Takeover Makeover*, UTILITY WEEK, July 14, 2006, at 20 ("It is now clear that the European Takeover Directive has failed to create uniform takeover rules across Europe.").

63. Bagchi, *supra* note 62, at 16.

would achieve the “aim . . . [of] phasing out of all defence mechanisms,”⁶⁴ are optional, the European Commission essentially gave Member States carte blanche *not* to change their takeover laws in a fashion that would make their national industrial companies more open to takeover by foreign concerns.⁶⁵

This tendency to protect national businesses is not surprising. The composition of the EU, as a confederation of independent nations, arguably invites a certain amount of protectionism.⁶⁶ This protectionism is played out in the business/takeover context in the form of “corporate nationalism.”⁶⁷ Because “[t]he corporation reflects a bundle of relationships that include owners, managers, suppliers, creditors, and customers,”⁶⁸ a takeover of a corporation will have some effect on each such group involved with a target, some of which may be adverse.⁶⁹ In the context of a cross-border transaction the target and acquiring firms are not in the same State (country), the result being that “the legislature of the state of the target corporation has an incentive to allow defensive measures . . . in order to favor its national constituencies.”⁷⁰

Interestingly, until recently the ability to defend national corporations from (especially hostile) takeovers in Europe was hardly necessary. In the 1990’s only 1.3% of all tender offers were hostile bids in the EU.⁷¹ This is in large part attributable to “the historically more permissive attitude toward the regulation of technical barriers, such as pre- and post-bid defences.”⁷² Particularly popular as a hostile bid defense were provisions in corporate charters that “ha[d] as their primary purpose to ward off interference from

64. Opinion of the European Economic and Social Committee on the ‘Proposal for a Directive of the European Parliament and of the Council on Takeover Bids, 2003/C 208/15, Sept. 3, 2003 [hereinafter European Commission Opinion].

65. As of March 2006, when a number of Member States had not yet enacted legislation implementing the Directive, only Latvia, Lithuania and Greece had suggested they would “apply both provisions and therefore make takeovers easier.” Buck, *supra* note 59, at 6.

66. See, e.g., TIMOTHY BAYCROFT, NATIONALISM IN EUROPE 1789–1945, at 84 (1998). Baycroft states,

The European world view . . . [is] heavily influenced by . . . the belief that the nation is the only legitimate source of power, . . . that one’s own nation has inherent value above and beyond that of other nations—putting it first in matters of policy—and finally that defence of its glory and honor are essential.

Id.

67. John Plender, *Europe Feels the Toxic Effect of Corporate Nationalism*, FIN. TIMES, Apr. 6, 2006, at 19. See also Peterson, *supra* note 16, at 390.

68. JAMES D. COX, THOMAS LEE HAZEN AND F. HODGE O’NEAL, CORPORATIONS, § 4.10 (2002).

69. See Ventruruzzo, *supra* note 57, at 178 (Noting that takeovers can have various (and varying) effects on directors, managers, shareholders, employees and “providers”).

70. *Id.* at 179.

71. Jeremy Grant, *Takeovers and the Market for Corporate Control*, in EUROPEAN TAKEOVERS: THE ART OF ACQUISITION (Jeremy Grant ed.), at 1, 10.

72. *Id.*

outsiders.”⁷³ Secondly, (Continental) European ownership structures are traditionally characterized by strong controlling shareholders with “either de facto or absolute control of the corporation.”⁷⁴ For example, in Germany as of 2002, 31 of the 100 largest publicly traded companies were still family-owned/controlled.⁷⁵ This highly concentrated form of ownership lends itself to resistance of hostile takeovers, even when such a takeover might realize greater shareholder value.⁷⁶ If one homogenous (familial, financial or otherwise) group stands to lose control over an enterprise, which control it has long enjoyed, it is unlikely to yield to outside pressure to sell.⁷⁷ When paired with the relatively lax regulation of bid defenses (and therefore a corresponding ease of employment of such defenses by management), European companies were probably viewed by potential investors as being worth approaching only in friendly bid situations that were likely to succeed.

It almost seems a wonder, in light of Europe’s highly varied,⁷⁸ but generally anti-hostile, takeover landscape that the European Commission undertook to pass legislation with the goal of *increasing* pan-Continental hostile takeovers.⁷⁹ Nevertheless, the lure of the benefits offered by a healthy takeover market, including a corporate governance function⁸⁰ and “allow[ing] firms to take advantage of EU-wide economies of scope and scale”⁸¹ proved too strong a lure—hence the Directive’s ultimate passage, albeit not in the form that all observers would have liked to see it.⁸²

73. *Id.* at 16. Grant lists such provisions as allowance of staggered boards, voting caps and restrictions on share transfers that, for example might keep control out of the hands of an “unfriendly” outsider.

74. Ventoruzzo, *supra* note 57, at 179. *See also* Grant, *supra* note 71, at 10–12.

75. Grant, *supra* note 71, at 12, exhibit 1.4.

76. The notion that takeovers may often increase or release the value of a firm has been widely supported and commented upon. *See, e.g.*, Ventoruzzo, *supra* note 57, at 177 (“Takeovers—and in particular hostile ones—seem to increase . . . shareholders’ wealth.”); Grant, *supra* note 71, at 4 (describing takeovers as an “[e]ffective corporate governance mechanism” that ensures capital is put to its most valuable uses by management, lest shareholders decide to sell their firms to an owner that will use said capital more effectively).

77. Ventoruzzo, *supra* note 57, at 178 (“[I]n every takeover a conflict of interest arises among who will be prejudiced by the success of the acquisition—this group includes subjects in control of the target corporation—and who will benefit from it.”).

78. *See* Scott Mitnick, *Cross-Border Mergers & Acquisitions in Europe: Reforming Barrier to Takeovers*, 2001 COLUM. BUS. L. REV. 683, 684–85 (2001) (“The legal framework for takeovers in Europe is as varied as the languages and cultural traditions.”).

79. Grant, *supra* note 71, at 5.

80. *See, e.g.*, MB, Corporate Acquisitions and Mergers, § 5E.06 (2006) (describing how “[t]he possibility of an unwanted tender offer may serve as a spur to management to improve its performance” if a company’s stock valuation is lower than it should be because its management is perceived as being inefficient).

81. Grant, *supra* note 71, at 5.

82. Jaap Winter notes, for example, that “Mr. Bolkestein, the European Commissioner in charge of securing agreement on the Directive in the Council and Parliament, has suggested that the Directive is not worth the paper on which it is printed.” Winter, *supra* note 61, at xxv. *See*

The problem in passing the Directive was partially that the European Commission proposed the more recent versions in a particularly hostile⁸³ climate vis-à-vis opening national companies to takeovers. The last *failed* iteration, defeated in 2002, came directly on the heels of some theretofore exceedingly rare—but, unfortunately for the European Commission, very high-profile—hostile bids for major companies in certain European Member States.⁸⁴ The hostile takeover of German telecommunications firm Mannesmann—at the time, Germany’s largest company by market capitalization⁸⁵—was arguably a catalyst in getting Germany to draft what became the WpÜG.⁸⁶ As one Germany-based practitioner put it, “German companies used to think of themselves as fortresses. . . . Then Vodafone-Mannesmann happened and their perspectives changed overnight: they were no longer predators but potential preys.”⁸⁷ By 2001, Germany was working to defeat a mandatory provision in the then-current draft of the Directive that would have prohibited management implementation of defensive tactics⁸⁸ while simultaneously drafting its own, and first ever mandatory,⁸⁹ takeover code that widened defensive tactics available to German businesses in the event of a hostile takeover.⁹⁰ This code, the WpÜG, took effect in January of 2002,⁹¹ it was amended to “conform” with the Directive as of July 2006,⁹² and makes neither of the Directive provisions that would have accomplished the “phasing out of all defence mechanisms”⁹³ mandatory for German firms.

also Tobias Buck, *supra* note 59 (quoting a Europe-based lawyer, saying the Directive was ultimately a “disappointment”).

83. No pun intended.

84. Specifically, the Vodafone-Mannesmann hostile takeover—the first successful one in Germany (*see, e.g.*, Grant, *supra* note 71, at 10)—happened in 2000 and “provided some momentum for the enactment of German takeover legislation [the WpÜG, *infra* note 91] in 2002.” Simpson & Corte, *supra* note 28, at 17–18. The LVMH/Gucci takeover battle (involving luxury goods maker LVMH’s ultimately thwarted battle for control of Gucci) also happened shortly before this time, beginning in 1999 and finally reaching resolution in 2004. *See* Grant, *supra* note 71, at 25–29.

85. David Fairlamb & Jack Ewing, *Auf Wiedersehen, Germany Inc.*, BUSINESS WEEK, Feb. 21, 2000, at 64.

86. *See supra* note 84.

87. Bertrand Benoit, *Effects of Hostile Takeover Still Being Felt in Germany Vodafone-Mannesmann Case Study of a Clash of Ethos*, FIN. TIMES, Nov. 6, 2002, at 13.

88. *See* Kirchner & Painter, *supra* note 58, at 460, 463.

89. *See, e.g., id.* at 463 (“German industry . . . for years operated under a voluntary Takeover Code.”).

90. Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 66–67 (2005).

91. Wertpapiererwerbs- und Übernahmegesetz, December 20, 2001, Bundesgesetzblatt Teil I [BGBI. I] at 3822 [(Securities Acquisition and Takeover Law; hereinafter WpÜG)].

92. The German Implementation, *supra* note 25, at 1426.

93. *See* European Commission Opinion, *supra* note 64 and accompanying text.

**B. THE GREAT (OR NOT-SO-GREAT) COMPROMISE:
ARTICLES 9 AND 11**

The two Articles of the Directive aimed at placing restrictions on the actions a company's board can take to frustrate takeover offers⁹⁴ are Articles 9 and 11.⁹⁵ Article 9 of the Directive, or the "Board Neutrality Rule,"⁹⁶ requires that the board of a target company refrain from taking any frustrating defensive action "at least" between the time the board of the target company receives notification of intent by another party to launch a hostile bid and the time the "result of the bid is made public or lapses."⁹⁷ In other words, the board should not do anything that might "result in the frustration of the bid . . . in particular [by] issuing any shares which may result in a lasting impediment to the offeror's acquiring control of the company."⁹⁸ However, pursuant to Article 9(3) of the Directive, decisions that "form part of the normal course of the company's business" need not be approved by shareholders.⁹⁹ The dividing line between "normal course of business"-type actions and "extraordinary measures taken to frustrate a bid"¹⁰⁰ is entirely unclear and may give target boards a way to circumvent a need to get shareholder approval before taking frustrating action in a bid.¹⁰¹ Furthermore, because most of Article 9 is optional,¹⁰² it seems that those Member States with little or no history of giving shareholders particularly strong decision-making power are unlikely to dramatically change their laws governing this power dynamic now.

The other article of the Directive that was highly contentious,¹⁰³ and ultimately made optional, was Article 11.¹⁰⁴ Article 11, or the "Breakthrough" Rule,¹⁰⁵ provides that a board must get shareholder

94. Ventoruzzo, *supra* note 57, at 194 ("[T]he European approach freezes directors' powers once a public offer has been launched and requires any action that might adversely affect the outcome of the takeover to be approved by the shareholders.").

95. *See infra* notes 99, 111 and accompanying text.

96. Ventoruzzo, *supra* note 57, at 208 ("[T]he Directive follows the British approach . . . by mandating that the board remain neutral in its actions."). *See also*, Grant, *supra* note 28, at 50 ("Board neutrality is an important principle of the European Takeover Directive.").

97. The Directive, art. 9(2).

98. *Id.*

99. *Id.* at art. 9(3).

100. Ventoruzzo, *supra* note 57, at 209.

101. *Id.* Ventoruzzo also notes that such behavior is likely to "lead to inefficient litigation," *id.*, a view echoed by Daniel Andrews, *European M&A Will Take Longer and Cost More: Protectionism and Uneven Takeover Regimes Will Make European Mergers More Litigious and Protracted, but They Will Go Ahead*, INT'L FIN. L. REV., July 1, 2006, at 25. *See also* Simpson & Corte, *supra* note 28, at 19 (predicting that European courts will have to mediate more in the European takeover landscape as countries adopt different variations of the Directive in their national legislation).

102. The Directive, *supra* note 21, at art. 12(1) ("Member States may reserve the right not to require companies . . . to apply Article 9(2) and (3).").

103. *See A Map of Europe After the Takeover Directive*, *supra* note 26, at 26.

104. The Directive, *supra* note 21, art. 12(1).

105. *Id.* at art. 11.

approval before taking potentially frustrating action that controlling shareholders have already adopted and “entrenched”¹⁰⁶ in the target’s articles of association, shareholders’ contracts and other “[extant] provisions designed to . . . make a successful hostile offer much less likely to succeed.”¹⁰⁷ The purpose of Article 11 “has two major goals.”¹⁰⁸ First, it aims to keep controlling shareholders and/or management from defeating offers that might be in the best interest of the company and its shareholders.¹⁰⁹ Second, and “[m]ore importantly . . . the purpose of [Article 11] is to create a leveled playing field across Europe.”¹¹⁰ The problem, however, as with Article 9, is that adoption of Article 11 is optional for Member States.¹¹¹ Because EU Member States can enact the Directive in a number of different ways, it “will not align takeover rules throughout Europe as originally expected.”¹¹²

C. THE GERMAN IMPLEMENTATION

Unsurprisingly,¹¹³ the German Implementation does not make following either Article 9 or Article 11 mandatory for national firms.¹¹⁴ To take the discussion perhaps seemingly out of order, this note first addresses Article 11’s implementation in Germany. The reason for this is, in practice, this provision is unlikely to affect takeovers of German companies either way: Multiple-vote shares, the primary security whose effect would be de-

106. Ventoruzzo, *supra* note 57, at 210.

107. *Id.* at 209. *See also* The Directive, *supra* note 21, at arts. 11(2) and (3) (stipulating that “restrictions on the transfer of securities” in the target’s articles of association, “contractual agreements” between the target and its shareholders or among various of its shareholders, restrictions on voting rights, etc. will not apply to the offeror “during the time allowed for acceptance of the bid”).

108. Ventoruzzo, *supra* note 57, at 210.

109. *Id.* (“The first and obvious purpose is to limit the ability of the controlling group to entrench its position and fend off efficient offers.”). The efficiency argument is one most frequently advanced in favor of a U.S.-style takeover market, where takeovers are viewed as ways to make companies more efficient. *See, e.g.,* Sinclair Stewart, *Cash, Low Interest Rates Fuel Canadian M&A Surge*, GLOBE & MAIL, Dec. 12, 2005, at B3 (describing Asian companies’ desire to “become more efficient through mergers and takeovers”).

110. Ventoruzzo, *supra* note 57, at 210. Ventoruzzo goes on to give one of the more clear explanations of why the fabled ‘level[ed] playing field’ was necessary. The primary problem is/was that, because different Member States allowed for different takeover defense devices, “some Member States would be constrained by significant ‘external limitations’ [“the actions that can legally be taken according to applicable corporate laws”] . . . to the adoption of defensive schemes.” *Id.* Therefore, those Member States with more liberal takeover-defense laws left their national companies open to takeover from other nations than their European counterparts.

111. The Directive, *supra* note 21, at art. 12(1).

112. Simpson & Corte, *supra* note 28, at 15.

113. It is unsurprising because, as noted above, *see supra* note 88 and accompanying text, Germany put up much of the fight against these provisions when they were mandatory.

114. Articles 9 and 11 are “enacted” via Article 1(5)(16) of the German Implementation. The new § 33(a) of the WpÜG enacts Article 9 and largely allows companies to choose whether or not to opt into the provision. § 33(b) of the WpÜG enacts Article 11, with similar “optionality” for German companies. *See* the German Implementation, *supra* note 25, at 1428–29.

activated by implementation of an anti-break-through provision, are not generally allowed in German public companies.¹¹⁵ Article 11 of the Directive is “enacted” by giving German companies the opportunity to implement newly added § 33(b) of the WpÜG.¹¹⁶ As is the case with Article 9, however, it is up to German companies to elect to adopt Article 11 at all, in this case by incorporating relevant provisions in their articles of association.¹¹⁷ Given the general tendency to protect themselves from takeover,¹¹⁸ it seems that few of Germany’s national companies will elect to adopt this rule.

The German Implementation of Article 9 of the Directive is slightly more noteworthy, if also unlikely to be widely adopted by German firms.¹¹⁹ The German Implementation enacts Article 9 of the Directive by amending § 33(a) of the WpÜG.¹²⁰ Importantly (but unsurprisingly), however, it first indicates that German companies are free to decide not to opt in to the new provisions.¹²¹ If they do not opt in, the provisions of the WpÜG that were already in place restricting frustrating action, albeit in somewhat more limited measure, apply.¹²² If the “old” (non-Directive-based) rules apply, executives may do four things that might ultimately frustrate a bid. They may

[take] actions that a prudent and conscientious manager of a company not subject to a public offer would have taken; . . . search for an alternative bid, [take] actions approved by the supervisory board of the target; and [take] actions subject to shareholders’ consent that the shareholders’ meeting of the target has authorized the managing board to take to frustrate a bid and that have been approved by the supervisory board of the target.¹²³

Any consent by shareholders authorizing management to take specific defensive measures expires within 18 months.¹²⁴

These four allowed actions by management subject to a takeover bid are arguably “rather extensive prohibition of frustrating action.”¹²⁵ However,

115. Freshfields Bruckhaus Deringer, *supra* note 26, at 2.

116. The German Implementation, *supra* note 25, at 1428.

117. *Id.*

118. See discussion *supra* pp. 207–08.

119. See discussion *supra* Part I.

120. The German Implementation, *supra* note 25, at 1428–29.

121. The German Implementation, *supra* note 25, at 1428. (“Die Satzung einer Zielgesellschaft kann vorsehen, dass § 33 keine Anwendung findet. In diesem Fall gelten die Bestimmungen des Absatzes 2.” [The articles of association of a target company may provide that § 33 [of the WpÜG] does not apply. In such a case, the provisions of paragraph 2 apply.]). The upshot of this is, if the extant rules regarding takeover defense measures in Germany, enshrined in § 33 of the WpÜG, don’t apply, the new European rules do.

122. *Id.*

123. WpÜG, *supra* note 91, at § 33. English translation and concise explication provided by Freshfields Bruckhaus Deringer, *supra* note 26, at 1–2.

124. WpÜG, *supra* note 91, at 3831.

what a company's management can do if a company opts into the European rules is even more limited. Under the European rules, management may,

[take] actions approved by the shareholders' meeting after the decision to launch an offer has been published; [take] actions falling within the normal business operations of the company; [take] actions not forming part of the normal business operations of the company, provided that such actions are intended to implement decisions taken before the publication of the decision to launch an offer and have partly been implemented; and . . . search for an alternative bid.¹²⁶

While there are some similarities between the European and pre-Directive German rules, the latter gives management broader room to maneuver in the event of a bid. Particularly noteworthy is the provision allowing actions that any "prudent and conscientious manager" would take. In Germany, where "stakeholder capitalism" has historically been the rule,¹²⁷ it seems entirely possible that a prudent and conscientious manager would consider it part of his job to protect stakeholders/constituencies other than shareholders. This might even include management itself, and certainly the workers under it, as both groups might lose their jobs if a takeover is successful. Thwarting a bid in light of these considerations does not seem to go against the letter of the law, if it perhaps defies its spirit.

Secondly, as one practitioner points out, even the legislation "meant to implement Article 9 of the Directive"¹²⁸ uses language that "seems to be wider"¹²⁹ than that actually used in the Directive. Specifically, the Directive allows management to take actions pursuant to decisions that "form part of the normal course of the company's business."¹³⁰ The German Implementation, however, allows actions "forming part of the normal business operations of the company," a term that "seems to go beyond what is permitted by the Directive."¹³¹ While this may seem like a minor point interesting largely to linguistics wonks, it serves to further illustrate the spirit in which Germany drafted and enacted its implementing legislation: There remains a desire to continue to allow German management a fair amount of freedom in deciding to refuse advances on their enterprises.

125. Clifford Chance, EVCA Tax & Legal Committee, Tax & Legal Update: Germany—National Developments (Sept. 2006), *available at* http://www.evca.com/images/attachments/tmpl_14_art_88_att_1036.pdf.

126. The German Implementation, *supra* note 25, at 1428; English translation from Freshfields Bruckhaus Deringer, *supra* note 26, at 2.

127. *Germany's Pay Law: Disclosure Is Right—But Anti-Business Rhetoric Is Futile*, FIN. TIMES, May 20, 2005, at 18. *See generally*, Baums & Scott, *supra* note 90, and discussion *infra*.

128. Freshfields Bruckhaus Deringer, *supra* note 26, at 2.

129. *Id.*

130. The Directive, *supra* note 21, at Art. 9(3).

131. Freshfields Bruckhaus Deringer, *supra* note 26, at 2. The difference is between the word "Geschäftsbetrieb" and "Geschäftsverlauf," in German, the former being the word used in the German Implementation but the latter more nearly translating the text of the Directive. *Id.*

Given the German response (under Merkel's rule, no less, at least as far as the national implementing legislation is concerned¹³²) to the Directive, it may seem bizarre to suggest that the country is in fact ready to open its borders to foreign purchasers of its companies. However, evaluating Germany's openness to foreign investment by takeover in its firms by only looking at its response to the Directive is too myopic an evaluation. There are other indicators that Germany will succeed in achieving greater openness to foreign purchasers of its firms if it so desires. Though it will not be via hostile takeovers from strategic buyers, as a full implementation of the Directive would have facilitated,¹³³ it might be by encouraging investment by private equity buyers.

III. A DELICATE BALANCE: REFORMING LABOR LAW, PROTECTING WORKERS AND ATTRACTING PRIVATE EQUITY

As noted, Merkel stipulated in her Coalition Agreement that she intends to encourage private equity investment in Germany.¹³⁴ Of particular importance to her success in this endeavor, however, will be finding a way to protect the social security that inheres in Germans' views of "good" corporate governance. Germany adheres to what is commonly referred to as the "stakeholder" view of capitalism.¹³⁵ This system of beliefs (held by much of Continental Europe) holds that more than shareholders' interests must be considered in making business decisions.¹³⁶ This philosophy stands in marked contrast to the classical American view of corporate law that puts the interests of shareholders above those of all others involved with a business.¹³⁷

The differences between the two systems are especially relevant in the M&A context, because when a business is taken over, the people connected

132. Merkel was elected in November 2005. *See supra* note 5. The German Implementation was passed in July 2006. *See the German Implementation, supra* note 25, at 1426.

133. *See generally* Simpson & Corte, *supra* note 28. *See also* Ventrizzo, *supra* note 57, at 210 (referring to Article 11's "Breakthrough Rule" as being "intended to neutralize some . . . anti-takeover devices in the event of a hostile offer"). The reason for the connection between these defense-minimizing provisions and hostile offers is doubtless that, if an offer is not hostile—especially if it has been solicited, for example—the board is less likely to try to defend against it because it would like the takeover to happen.

134. *See supra* note 47 and accompanying text.

135. Timothy Garton Ash, *There's a Certain Comfort in Capitalism*, ALBANY TIMES UNION, Feb. 27, 2007, at A11 ("[W]hat we have across Europe are multiple varieties of capitalism, from more liberal market economies like Britain and Ireland to more coordinated 'stakeholder' economies like Germany.").

136. *See, e.g.*, Joseph S. Spoerl, *The Social Responsibility of Business*, 42 AM. J. JURIS. 277, 290–91 (1997).

137. *See generally id.* (outlining the differences between the stakeholder and shareholder capitalism models). The American capitalist philosophies are also commonly referred to as the "Anglo-Saxon" model. *See, e.g.*, Mario Monti, *What Germany and France Must Rediscover*, FIN. TIMES, Oct. 27, 2005, at 19.

with the target of such takeover are often adversely affected.¹³⁸ Stakeholder-model proponents are fundamentally concerned that, if takeover rules are relaxed so as to allow the market and its competitive pressures to dictate which businesses survive and which are taken over, the interests of stakeholders other than shareholders will not be taken into “adequate” consideration.¹³⁹ At the same time, Merkel will need to somehow liberalize German labor law to achieve her stated¹⁴⁰ goal of encouraging private equity investment in the country: As one commentator wrote, German labor law has been long viewed as “an impediment, . . . particularly with US private equity investors . . . [who] cannot be bothered to wade through [it].”¹⁴¹ Fortunately, Merkel perhaps need only “look North” at the Danish system of flexicurity, the labor market scheme employed in Denmark in recent years with great success in stimulating the economy and investment in the country’s businesses.¹⁴² Flexicurity’s unique combination of flexible labor markets and a large social security net for workers displaced by company changes would allow investors like private equity firms flexibility in restructuring companies, while placating people such as Müntefering, and his labor-friendly, stakeholder-capitalist cohorts.

A. FLEXICURITY GENERALLY

Flexicurity has three basic “pillars”¹⁴³ known as the “Golden Triangle of flexicurity.”¹⁴⁴ These are (i) ease of hiring and firing for employers, (ii) generous unemployment benefits and (iii) “active labor market policies.”¹⁴⁵

138. Michael Skapinker, *Fair shares?*, FIN. TIMES, June 11, 2005, at 18. Skapinker lists those likely to adversely affected by being associated with a takeover target as workers, pensioners and neighborhoods, for example. *Id.*

139. See, e.g., Timothy L. Fort, *Article: Corporate Makahiki: The Governing Telos of Peace*, 38 AM. BUS. L.J. 301, 314 (2001) (“[T]here has been a strong perception that takeovers tend to favor one group of stakeholders (i.e. executives and shareholders) to the disadvantage of nonshareholders such as bondholders and employees.”).

140. See *supra* notes 47, 134 and accompanying text.

141. Wright, *supra* note 43.

142. See, e.g., *Denmark’s Labour Market: Flexicurity*, ECONOMIST, Sept. 9, 2006, at 29 (noting that unemployment in Denmark is “at its lowest in over 30 years” and that “Denmark’s exceptional performance . . . has attracted much attention”).

143. Nils Bernstein, *Lessons From the Danish Economy*, THE BANKER, Mar. 1, 2006, at 8.

144. See Lee Jae-kap, *Creating ‘Golden Triangle of Flexicurity’: Danish Model Combines Flexible Labor Market and Social Security*, KOREA HERALD, Sept. 26, 2006, available at <http://www.lexisnexis.com>.

145. *Id.* The idea of active labor markets is a broad concept, but generally it involves a focus on training (or retraining) of workers displaced by their companies’ purchases and the like, and a fairly specific commitment on the part of government to reduce unemployment by getting workers back into the workforce as soon as possible. See, e.g., W. Norton Grubb, Norena Badway & Denise Bell, *Community Colleges and the Equity Agenda: The Potentials of Non-Credit Education*, 586 ANNALS 218, 240 n.18 (Mar. 2003), who explain

While conceptions of active labor market policies vary, they usually include fiscal and monetary policy to reduce unemployment; labor matching efforts including job banks, sometimes career information and counseling, and apprenticeship policies;

More broadly, flexicurity can be described as “balancing flexibility and security,”¹⁴⁶ by making hiring and firing of workers easier, but without removing social security nets.¹⁴⁷ A number of articles suggest that flexicurity would be difficult to implement in any country other than Denmark.¹⁴⁸ The reasons given for the purported difficulty of replication are various, but generally consist of such largely Denmark-specific (or so it is argued) factors as low debt and a budget surplus,¹⁴⁹ a particularly close (and apparently, unusually friendly or cooperative) “dialogue between employers and unions that is not easily exportable to other countries,”¹⁵⁰ and a cultural history of social equality and a belief that ‘the system’ should take care of everyone, not just a privileged few.¹⁵¹ The interesting point about all of these factors offered by nay-sayers as Denmark-specific attributes that would make flexicurity un-exportable is, they are actually not cultural attributes wholly missing in other European countries, including Germany.¹⁵²

B. ADAPTING FLEXICURITY TO GERMANY

Any legislation aimed at encouraging U.S. investment in Germany should help foreign firms “establish a strong local presence and cultivate

unemployment insurance; income support for low-income individuals, including direct funding (like welfare policies) as well as tax credits; legislation covering organized labor, wages, and working conditions, including minimum wage laws and employment leaves; health and safety legislation; retirement policies; antidiscrimination policies for women and minority groups; some aspects of trade policy, including tariffs on goods assembled abroad and efforts to prevent the export of jobs; the use and potential creation of tripartite groups (including business, labor, and government) to plan policies; and manpower policy covering job training (but not education).

Id.

146. Bulletin EU 3-2006, Presidency conclusions (5/10), available at <http://europa.eu/bulletin/en/200603/i1006.htm>.

147. See, e.g., David Corderi & Gustav Ranis, *When Labor Loses Out to Trade*, YALEGLOBAL ONLINE, Aug. 10, 2006, <http://yaleglobal.yale.edu/display.article?id=7963> (describing flexicurity as “a set of liberal policies for hiring and firing . . . [with a] generous system of carefully monitored unemployment benefits and funding for retraining displaced workers”).

148. See, e.g., Lee Jae-kap, *supra* note 144; *Denmark’s Labour Market: Flexicurity*, *supra* note 142, at 29; *Social Policy: Danish Flexicurity Model Would Be Hard to Emulate Everywhere*, EUR. REP., May 30, 2006, available at <http://www.lexisnexis.com>.

149. *Social Policy: Danish Flexicurity Model Would Be Hard to Emulate Everywhere*, *supra* note 148.

150. *Denmark’s Labour Market: Flexicurity*, *supra* note 144, at 29.

151. See Richard Karlgaard, *The Scandinavian Model*, FORBES, July 24, 2006, at 39. See also Bruce Stokes, *All for One, One for All*, NAT’L J., Mar. 4, 2006, at 33.

152. For example, Germany’s “Rheinland capitalist” model, which “stands for a market economy which is, although capitalist in principle, characterized by important social protections.” Marita Körner, *German Labor Law in Transition*, 6 GERMAN L.J. 805, 805–06 (2005), is clearly concerned with ensuring a social net similar to the one that would be provided by flexicurity is available to its citizens.

relationships.”¹⁵³ Part of cultivating relationships in a country, if they are to be long-lasting and mutually satisfactory to both the foreign and the national parties, necessarily involves identifying and respecting that country’s cultural and legal peculiarities.¹⁵⁴ National legislation aimed at facilitating foreign investments should show similar respect for cultural mores.¹⁵⁵ It is therefore important to realize that in analyzing potential paths of reform, imposing U.S. (or, more broadly, “Anglo-Saxon”¹⁵⁶) economic and social norms on Germany is probably not the ideal way to encourage the country to embrace investment from other nations.¹⁵⁷ As Robert Kimmett noted, “[T]he United States is in no way trying to impose the U.S. economic model on Germany or any other country. Europe has plenty of successful economic growth stories . . . that provide useful lessons for reform.”¹⁵⁸ As noted,¹⁵⁹ one such successful economic growth story is

153. Matthew Craft & Priya Malhotra, *Germany Luring U.S. Private Equity*, CORP. FIN. WK., Apr. 4, 2005, at 1.

154. As Terence Halliday noted, “In wine, as in law, terroir makes a discernible difference.” Terence Halliday, Remarks at the Brooklyn Journal of International Law Symposium: Bankruptcy in the Global Village—The Second Decade (Oct. 21, 2006). In other words, as not all varieties of grape will grow in all soil, so not all legal mechanisms that work well in one culture will work in others. See generally Trevor Buck & Shahrin Azura, *The Translation of Corporate Governance Changes Across National Cultures: the Case of Germany*, J. INT’L BUS. STUD., Jan. 1, 2005; Zumbansen, *supra* note 16, at 881.

While the discussion on takeover regulation continues, it is important to bear in mind that an adequate assessment of the regulatory context and the political economy, from which any takeover regulation arises, must be built upon careful consideration of the different historical developments and political decisions that have shaped various regulatory regimes.

Id. (internal citations omitted).

155. See Karlgaard, *supra* note 151, at 39 (“[N]ational economies must be fitted to the culture.”).

156. Monti, *supra* note 137, at 19.

157. This would be true of any commentator of one nationality making recommendations for legislative or other reforms in another country. As a U.S. commentator, I note only my own potential biases.

158. Robert Kimmett, Reinventing the US-German Economic Partnership, Luncheon Keynote at American Council on Germany Conference, Jan. 13, 2006, available at <http://www.ustreas.gov/press/releases/js3081.htm>. Another commentator goes so far as to say that Germany does not necessarily need any model for reform:

The basic thesis . . . that France, Germany and Italy are all stuck in the mud, while the Nordic countries, plus the UK and Ireland, the Netherlands and Spain (up to a point) are much better at reforming both welfare systems and labour markets to encourage greater flexibility and lower unemployment is well worn. It is also rather smug. Germany does reform slowly, with an agonising consensual process. But the country’s impressive productivity, and recent economic acceleration, suggest that it may be getting some things right.

Quentin Peel, *A Most Unhappy Union: A Leading Social Theorist Has No Real Answers to Europe’s Problems*, FIN. TIMES, Oct. 21, 2006, at 29. Peel’s view is the minority one, however; far more sources suggest that Germany does need to make some changes to its labor markets, even if the sources fail to agree on how such changes should be implemented, and by whom.

Denmark, which has managed to encourage free trade and the flexible labor market that seems to accompany or possibly foster it, without giving up many aspects of social security so valued in Europe,¹⁶⁰ including in Germany.

The question is how Merkel might go about implementing aspects of flexicurity in Germany. On October 21, 2006, thousands of German workers and their representatives protested the government's stated plans to raise consumers' value-added taxes while cutting company taxes, with worker representatives complaining that such a move would "hurt workers' incomes."¹⁶¹ Significantly for the prospects of flexicurity implementation, however, the same group called on the government to "boost training."¹⁶² If the government could convince such protesting groups that in fact a tax hike might make for an opportunity to do just this by providing funds to implement training programs, it might find that otherwise unpopular tax moves are not quite as detrimental to its reputation as they might otherwise be. In Denmark, "workers pay high taxes,"¹⁶³ but do so in exchange for, in part, access to training and higher availability of jobs.¹⁶⁴ Additionally, the high taxes contribute to the "generous unemployment pay," which in turn (so far, at least) does not run out in part because workers are forced back into other jobs quickly.¹⁶⁵ If German unemployment remains as steadily high as it is,¹⁶⁶ German workers may find they will agree to a tax increase if they stand to benefit from it by retaining employment.

159. See *supra* note 142.

160. Monti, *supra* note 137, at 19 (Noting that there is an "impression that the 'Anglo-Saxon model' . . . is the only one available if . . . Germany [is] to become more competitive . . ." Monti goes on to note, however, that "there are some key elements of the 'Nordic model' . . . that could help . . . Germany . . . to achieve a high degree of social equity but in ways that are more consistent with economic efficiency and competitiveness"). See also Corderi & Ranis, *supra* note 150 (suggesting that the Scandinavian countries "occupy a middle ground" between, on the one hand, Continental European countries, which tend to have rigid labor laws that prevent firing of workers, and the U.S. or U.K., both of which have a more liberal labor market and little social security).

161. Brian Parkin & Christiane Markwort, *Thousands of Germans Protest Higher VAT and Healthcare Costs*, BLOOMBERG NEWS, Oct. 21, 2006, available at <http://www.bloomberg.com/apps/news?pid=20601100&sid=apx5tYZsiW1A&refer=germany>.

162. *Id.*

163. *Denmark's Labour Market: Flexicurity*, *supra* note 142, at 29.

164. Bernstein, *supra* note 143.

165. *Denmark's Labour Market: Flexicurity*, *supra* note 142, at 29.

166. The German unemployment rate was at 9% as of July 2006. See Bertrand Benoit, *German Unemployment Rate Falls, But Skills Shortage Worsens*, FIN. TIMES, Aug. 31, 2007, at 6. In fairness to Merkel and accuracy, this number has indeed fallen since Merkel came to power. See Bertrand Benoit, *Merkel Rides High on Falling Jobless Rates*, FIN. TIMES, June 27, 2007, at 10. However, it represents the entire country's unemployment rate, and does not reveal the enormous disparity between the states in the former East Germany, where unemployment is significantly higher (approaching 20%—"nearly twice the national average"). See Tom Hundley, *Few Births, Exodus Wilt East Germany*, CHI. TRIB., June 18, 2007, at C1.

One major challenge, at least superficially, to implementing flexicurity in Germany may not even be tax-related. Rather, it seems likely that it will be convincing workers and their representatives that making hiring and firing easier (the “flex” (as in “flexibility”) part of flexicurity) as part of a long-term plan to ultimately reduce unemployment and increase employability is an acceptable strategy. The problem is that, “[from] a historical perspective, labor law is not an example for a flexible system . . . [because] the aim of labor law was to restrict the opportunity for the employer to destroy the security which labor law, as one of its prominent goals, has to guarantee.”¹⁶⁷ Perhaps nowhere is this truer than in Germany, where the system of codetermination¹⁶⁸ presents a real structural barrier with potential for causing conflict between workers and shareholders like private equity investors. The reason for this is,

[C]odetermination . . . allocates control functions to agents whose positions are determined by their interests as employees, not as providers of capital or holders of cash flow rights. The interests of these agents may well be at odds with those of shareholders. For employees, the survival of the company, the protection of the workplace, as well as their wage and nonwage benefits are naturally of primary interest. Shareholders, by contrast, are likely to focus on the monetary value of their investment.¹⁶⁹

Therefore, without the support of works councils and the employee representatives on German supervisory boards, allowance for easy firing of employees is likely to be met with resistance.

This does not mean that German workers will never be amenable to aspects of flexicurity. Because flexicurity also has as one of its goals maintenance of a significant social security net,¹⁷⁰ it is less likely to completely rend apart the social safety net on which traditional Continental (including and especially German) labor law places such importance. Instead of guaranteeing a ‘job for life’ as the German system historically has,¹⁷¹ flexicurity instead provides social safety and security through generous unemployment benefits and “training and other measures to

167. Rolf Birk, *Europe: Labor Law Scholarship in France, Germany, and Italy: Some Remarks on a Difficult Question*, 23 COMP. LAB. L. & POL’Y J. 679, 690 (2002).

168. Codetermination is, generally, a system wherein employees are represented “at the enterprise level through works councils” and the supervisory board level through employee representatives. Anthony Forsyth, *The Transplantability Debate: Can European Social Partnership Be Exported to Australia?*, 27 COMP. LAB. L. & POL’Y 305, 315 (2006). See also GERHARD WIRTH, MICHAEL ARNOLD & MARK GREEN, CORPORATE LAW IN GERMANY 117 (2004).

169. Katharina Pistor, *Codetermination: A Sociopolitical Model With Governance Externalities*, in EMPLOYEES AND CORPORATE GOVERNANCE 163, 169 (Margaret M. Blair & Mark J. Roe eds., 1999) (internal citation omitted).

170. See discussion *supra* pp. 215–16.

171. See Körner, *supra* note 152, at 808 (“During the phase of Rhineland capitalism, life-long employment was the rule.”).

improve each jobless individual's employment prospects."¹⁷² Essentially, flexicurity just provides security after dismissal, not before or in order to pre-empt it. In this way, it might be viewed less as a reduction of benefits, but rather more as a 're-ordering' of them.

By establishing legislation that might encourage flexicurity's development in Germany, the government has an opportunity to help redefine what its constituents place under the "job security" rubric. This is how flexicurity's development in Germany might also relate to increased foreign (including U.S.) private equity investment in the country:

[T]he reduction of unemployment is one of the principal arguments for changes in labor law. According to well accepted logic, it is the high level of labor protection that prevents employers from employing people (*and foreign investors from investing in German corporations*). On the other side of this coin, there is the idea that less anti-dismissal law . . . or [fewer] collective bargaining rights, could incite more employers to build up their workforce[s].¹⁷³

Assuming that reducing a workforce, at least over the short term, is often part of executing a private equity investment strategy,¹⁷⁴ loosening some of the highly protective strictures of German labor law will encourage foreign investment in Germany.¹⁷⁵ Furthermore as Körner notes, employers might actually employ *more* people, if they do not have to contend with such strict anti-dismissal and collective bargaining laws.¹⁷⁶ Finally, numerous sources suggest that, over the long term, private-equity sponsored companies often see an *increase* in the number of workers they employ, and fare on the whole better than their non-private-equity-sponsored compatriots.¹⁷⁷ Therefore, while the short-term effects on easing the path to workforce reductions may make German labor nervous, the long-term effects may, on balance, be worth it.

172. Diana Farrell, *Sweden's Balancing Lessons for Europe*, BUSINESSWEEK ONLINE, Sept. 25, 2006, http://www.businessweek.com/globalbiz/content/sep2006/gb20060922_333746.htm.

173. Körner, *supra* note 152, at 808 (emphasis added).

174. This is often the case. See, e.g., Grace Wong, *LBO's: What the Little Guy Should Fear*, CNNMONEY.COM, July 25, 2006, <http://money.cnn.com/2006/07/25/news/companies/lbo/index.htm> ("[P]rivate equity investors often aim to repay their debt by improving operations, which can result in job cuts and other cost-saving plans.").

175. See Wright, *supra* note 43.

176. Körner, *supra* note 152, at 808.

177. See, e.g., *New Fuel for an Old Engine: Refinancing Corporate Germany*, ECONOMIST, Nov. 20, 2004, at 75 (citing a study, "co-sponsored, admittedly, by a German private-equity firm" that suggested, "a sample of 45 companies that had taken on private equity between 1993 and 1999 grew faster and created more jobs between 1999 and 2003 than those that had not"). See generally European Commission and Internal Market, *Report of the Alternative Investment Group: Developing European Private Equity*, July 2006, available at <http://bvca.co.uk/doc.php?id=393>.

IV. CONCLUSION

If Merkel truly means to “ramp up”¹⁷⁸ U.S. investment in Germany, she will have to contend with a number of issues. Because her government and the one(s) that preceded it failed to accept a European takeover directive that would have increased cross-border M&A in Germany,¹⁷⁹ this recent opportunity to open Germany to some forms of investment, especially strategic cross-border mergers, has probably passed. However, U.S. private equity firms, one of the “[f]oreign investors . . . vital to German companies’ financial revolution,”¹⁸⁰ may be able to capitalize on the Merkel government’s “business-friendly”¹⁸¹ nature. There are few industrial or “strategic” buyers with whom they must compete,¹⁸² and their unique position as potential partners in running a business¹⁸³ might make them attractive to German companies in ways that strategic buyers are not. Further, as generally friendly buyers¹⁸⁴ that are also less likely to create the problems with redundancies that strategic buyers pose,¹⁸⁵ private equity firms may, in some ways, make potential targets more comfortable with their approach.

The problem for private equity firms in Germany is essentially two-fold. From a public relations standpoint, they will have to find a way to burnish their reputations with politicians like Müntefering, who considers them “asset-stripping locusts,”¹⁸⁶ and wishes to keep all (or at least most¹⁸⁷) of them out of the country to the greatest extent possible. From a legal standpoint, they will have to rely on Merkel’s promise, enshrined in her coalition agreement¹⁸⁸ to make Germany more open to private equity investment. While Merkel has started this process by working with her cabinet to propose tax reforms that would encourage private equity investment,¹⁸⁹ she will have to do more than reform the tax laws to make private equity in Germany realize its full potential. Specifically, Germany should encourage transactions that involve management partnering with

178. Serafin, *supra* note 2.

179. *See supra* Part II.

180. *New Fuel for An Old Engine*, *supra* note 177, at 75. *See also Anglo-Saxon Attitudes: Private Equity in Germany*, *ECONOMIST*, Dec. 17, 2005, at 69 (“Germany’s fast-growing private-equity industry is dominated by . . . foreign investors.”).

181. *See supra* note 6 and accompanying text.

182. *Anglo-Saxon Attitudes*, *supra* note 180, at 69.

183. James C. Miller, *The Ins and Outs of Private Equity Firms*, *ELEC. WHOLESALING*, June 1, 2004, at 6.

184. *See supra* note 53 and accompanying text.

185. Miller, *supra* note 183, at 6.

186. *See discussion supra* pp. 203–04.

187. Müntefering has started to recognize that not all financial investors are “bad.” *See* Benoit, *supra* note 34 (quoting Mr. Müntefering as saying, “Some [private equity firms] act responsibly, others don’t.”).

188. *See supra* note 47 and accompanying text.

189. Carter Dougherty, *The Buzz on German Private Equity; Industry Flourishes, with Help from Bad Publicity*, *INT’L HERALD TRIB.*, Oct. 21, 2006, at C11.

private equity firms, and liberalize its labor laws so that workers can be, if necessary, dismissed more easily from target companies.

There are many who suggest that German labor authorities would never agree to policies that permit such flexibility in the labor markets.¹⁹⁰ The key, however, is for the Merkel government to find a way it can convince its constituents, particularly workers, that liberalization of labor market policies need not mean a wholesale implementation of Anglo-Saxon free-market ideals, devoid of the social protections that Germans (and other Europeans) view as arguably indispensable to their culture. The Danish “flexicurity” model, which provides flexibility with active labor market policies and a significant social safety net¹⁹¹ illustrates that it is possible to make dismissal of employees easier, while maintaining significant social security safeguards. This “third way”¹⁹² may need adjustment from one country to the next, particularly in Germany where the codetermination powers of German workers will have to be respected and worked around or with. But in its nod to the sanctity of the social market economy, that “specific notion of justice” held by Europeans¹⁹³ that the market should be “fair to all participants, [with] . . . its rewards equitably distributed,”¹⁹⁴ flexicurity maintains a healthy distance from the Anglo-Saxon model’s criticized lack of social protections for the workers that market forces displace. If Germany’s government can begin to give private equity firms the breathing room they need to function in the country’s labor markets, and can do so without upsetting some of Germany’s more ingrained cultural sensitivities, it might find it keeps to its goals and lives up to its “American-business friendly”¹⁹⁵ reputation.

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190. Birk, *supra* note 167.

191. See discussion “Flexicurity, Generally” *supra*.

192. Karlgaard, *supra* note 151, at 39.

193. Stephen C. Siberson, *Article: The Proposed European Constitution: Will It Eliminate the EU’s Democratic Deficit?*, 10 COLUM. J. EUR. L. 173, 202 (2004) (internal quotes and citation omitted).

194. David J. Gerber, *International Law: Integration, Disintegration and the Protection of Competition: Of Images, Stories and Myths*, 68 CHI.-KENT L. REV. 229, 232 (1992).

195. Serafin, *supra* note 2.

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