

**LEGAL ASPECTS OF TAKEOVER DEFENCE TACTICS:
A Comparative Analysis between the English and the
US Systems**

**A THESIS SUBMITTED IN FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF DOCTOR OF
PHILOSOPHY IN LAW**

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DECLARATION BY CANDIDATE

I hereby declare that this thesis is my own work and effort and that it has not been submitted anywhere for any award. Wherever other sources of information have been used, they have been acknowledged.

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ABSTRACT

The primary objective of this research is to make a critical analysis of the current methods of defences for preventing undue acquisitions of small to medium companies by large companies. Although these defences have been practised by the commercial community for a very long time, it is maintained that their effectiveness should still be questioned. The protection of the minority shareholders in a company is one of the reasons for using these defences but, in reality, either they are squeezed out or they themselves surrender to the acquiring company.

Most of the published works tend to support the current defence tactics, but in this research an attempt has been made to demonstrate how these techniques have become rather ineffective and the means by which they may be strengthened. This research also demonstrates that from a societal standpoint the rationale behind acquisitions should be reviewed. As this process simply creates unemployment and most of the merged companies feel rather uncomfortable after acquisitions and mergers. The issue of the protection of the minority shareholders should be taken very seriously so that small shareholders may be encouraged to contribute to the capital formation process in small to medium size corporate entities. The protection of the minority shareholders should also be considered as a part of the concept of corporate social responsibility.

LIST OF ABBREVIATIONS

DIP	Debtor Investment Possession
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IPO	Initial Public Offering
LBO	Leveraged Buy Out
LLC	Limited Liability Company
PMI	Post-Merger Integration
PTM	Panel on Takeovers and Mergers

The Directive Directive 2004/25/EC passed by the European Parliament and the Council of the European Union on 21 April 2004 to regulate takeover bids

TSR	Total Shareholder Return
UK	United Kingdom
US	United States
USITC	United States International Trade Commission.

1. Introduction

As per the analysis presented in the research of Ivanov and Xie, it can be maintained that not all takeovers (whether friendly or hostile) may be eventually welcomed by the target companies.¹ There could be various primary reasons that force the directors of the target companies for opposing any bid. As for instance, they might oppose a bid in order to promote their own personal interests, as after a successful takeover bid, the chances of losing their positions in the business world may become precarious. The analysis of DePamphilis in his book of “mergers, acquisitions and other restricting activities: An integrated approach to process, tools, cases, and solutions” emphasised the fact that the directors might also oppose a bid to promote the interests of the shareholders or they might claim for a number of reasons that the bid undermines the interests of the company.² Eventually, the directors may oppose the bid because it might negatively influence the reputation of the stockholders such as: employees, shareholders, creditors etc. DePamphilis further added that, the target company, in order to defeat the hostile bid successfully, could deploy a range of differing defence tactics against the bidder.³ These tactics refers to either squeeze or buy out the company. Defence tactics could either be approved by the shareholders or the board of directors.⁴ Analysis of Cartwright and Cooper identified various techniques which may be adopted by the shareholders of the target company to ensure

¹Ivanov, V.I. and Xie, F.,. Do corporate venture capitalists add value to start-up firms? Evidence from IPOs and acquisitions of VC-backed companies. *Financial Management* (2010) 39(1), pp.129-152.

² DePamphilis, D.,. Mergers, acquisitions, and other restructuring activities: An integrated approach to process, tools, cases, and solutions. Academic Press. (2009)

³ Ibid 2

⁴ Haleblan, Jerayr, Cynthia E. Devers, Gerry McNamara, Mason A. Carpenter, and Robert B. Davison. "Taking stock of what we know about mergers and acquisitions: A review and research agenda." *Journal of Management* 35, no. 3 (2009): 469-502.

that they present an appropriate defence.⁵These techniques are known as, white knight, Pac man defence, golden parachute and the charter amendment.⁶

Hostile bids often reveal a serious conflict of interests between shareholders and directors, who may have share options.⁷ As a consequence, shareholders are offered a chance to sell their shares, usually at a significantly “above the market price” prior to a bid. Furthermore, employees are always in a mode of resistance owing to their fear of losing their job.⁸ As per the theoretical perspective stated in the research of Bradley et al, directors should only recommend a bid unless they have a good chance of getting a better offer.⁹ The justification for the implementation of such hostile bids, is to replacement of the incompetent management.¹⁰Fund managers are usually rewarded for the technique they adopt to establish a good performance of their funds over a short period of time. They may not find it necessary to stay for a long term.¹¹

This research study includes both, secondary and primary data collection method. However, the research is primarily developed on primary sources of information such as statutory law, the City Code, Federal, State laws on takeovers, and Takeover Directives. The secondary sources of information includes critical analysis of published books, articles and research work based on takeover and comparative analysis of defences in England and United States.

⁵Cartwright, Sue, and Cary L. Cooper. *Managing mergers acquisitions and strategic alliances*. Routledge, 2012.

⁶ Ibid 5

⁷Haleblian, Jerayr, Cynthia E. Devers, Gerry McNamara, Mason A. Carpenter, and Robert B. Davison. "Taking stock of what we know about mergers and acquisitions: A review and research agenda." *Journal of Management* 35, no. 3 (2009): 469-502.

⁸Bradley, Michael, Anand Desai, and E. Han Kim. "Synergistic gains from corporate acquisitions and their division between the stockholders of target and acquiring firms." *Journal of financial Economics* 21, no. 1 (1988): 3-40.

⁹ Ibid 8

¹⁰Buckley, Peter J., and Pervez N. Ghauri, eds. *International mergers and acquisitions: A reader*. Cengage Learning EMEA, 2002.

¹¹Gaughan, Patrick A. *Mergers, acquisitions, and corporate restructuring*. John Wiley & Sons, 2010.

In order to understand the defence acts and techniques used by the targeted companies it is highly important to understand the concept of takeovers and its influence on that company. Study of Shleifer, Andrei and Robert stated that takeovers are a critical strategy adopted by many large businesses in the current corporate environment.¹² To comprehensively understand takeovers as a corporate strategy, it is also pivotal to identify a company as a legal entity recognised by law which is carrying out its operations independently.¹³ The company is considered to be a separate legal entity from those who formed it, having the capacity to take any legal actions against or towards the business operation. As per the perspective of business law, corporations can be defined as a legal entity that is designed in accordance with the laws of a particular jurisdiction. The company that is primarily established as a separate legal entity has its own liabilities to settle and privileges to thereto.¹⁴

The term “takeover” is rapidly becoming very common in the light of increasing globalisation in the business world.¹⁵ Concept of takeover is adopted and implemented by the large companies as an expansion strategy. In business, the term takeover is taken to mean the purchase of a company.¹⁶

The acquiring company has the financial strength to push the management of the target company to sell off the company and therefore helps in improving the operations of the

¹²Shleifer, Andrei, and Robert W. Vishny. "Takeovers in the '60s and the '80s: Evidence and Implications." *Strategic management journal* 12, no. S2 (1991): 51-59.

¹³R. Kraakman, P. Davis, H. Hansmann, G. Hertig, K. Hopt, H. Kanda and E. Rock. *The anatomy of corporate law: A comparative and functional approach*. Oxford University Press, New York (2004)

¹⁴Carow, Kenneth A. "Citicorp–Travelers Group merger: Challenging barriers between banking and insurance." *Journal of Banking & Finance* 25, no. 8 (2001): 1553-1571.

¹⁵Ellis, Jesse, Sara B. Moeller, Frederik P. Schlingemann, and René M. Stulz. *Globalization, governance, and the returns to cross-border acquisitions*. No. w16676. National Bureau of Economic Research, 2011.

¹⁶ Ibid 15

company.¹⁷ A bidding company in this context is used to refer to the company that has publicly made its intention and ability to buy the target company prior the real purchase.

From the perspective of Leverage buy out (LBO), an acquirer company takes over a target company using capital that is borrowed. The Highest percentage of the acquisition capital is obtained from leveraged or borrowed sources.¹⁸ Under the practices of LBO, the company that intends to acquire a target company borrows money from a number of lenders and utilise the resources of the target firm to assure the repayment of the borrowed amounts.

In majority of cases, the assets used as securities of the LBO loans by far exceed the value of the loan hence provide assurance to the lenders.¹⁹ Takeover practices under LBO are highly preferred for companies intending to acquire other substantial companies since they allow potential profitable takeovers. Such transactions enable the acquiring company to engage in the takeover bid without necessarily committing a large amount of its money hence eliminating the risk of shareholders with regards to losing their investment from any risks arising from the transactions.²⁰

However, in this particular research term “mergers” is consistently used by the researcher that refers to the mutual consent by two companies operating in the same industry to combine together, hence the previous entities cease to exist independently.

¹⁷Y. Amihud. *Leveraged Management Buyouts: Causes and Consequences*. Dow Jones/ Irwin, Homewood, Illinois (1989), pp. 14 - 26.

¹⁸R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers (2006)*. 4 December 2006.

¹⁹ Ibid, pp. 24 - 27.

²⁰Burkart, Mike, Denis Gromb, and Fausto Panunzi. "Large shareholders, monitoring, and the value of the firm." *The quarterly journal of economics* 112, no. 3 (1997): 693-728.

In mergers, two entities that resolve to come together may apply for a new identity and decide to move forward as a single entity through mutual consequences.²¹ The integration of businesses allows having the access of combined control of resources and activities of the entities. Identically, acquisition is used in the same context to refer to the action of a company in implementing the corporate strategy of taking over the control of another firm by buying all the assets and establishing itself as the latest proprietors.²² As per the legal perspective, the target company, which is the core subject of takeover, terminates to exist and the new owner takes control of the business operations by adopting new strategies.²³ Acquisition is initiated by

a dominant entity which has the financial resources to buy out the assets of the target. Resources may be cash rich from previous asset sale or financial power to raise bank finance.²⁴

The major dissimilarity between various types of takeover that exist in the business community arises from the source of acquisition of capital.²⁵ The LBO uses capital obtained from borrowed sources while Acquisitions and Mergers implements various sources to finance

²¹Smith, Roy C., and Ingo Walter. "Global patterns of mergers and acquisition activity in the financial service industry." In *Bank mergers & acquisitions*, pp. 21-36. Springer US, 1998.

²² Ibid 17

²³M. Ginsburg and J. Levin. *Mergers, Acquisitions and Leveraged Buyouts*. Commerce Clearing House, Chicago (1989), pp. 23 - 35.

²⁴Zollo, Maurizio, and Harbir Singh. "Deliberate learning in corporate acquisitions: post-acquisition strategies and integration capability in US bank mergers." *Strategic Management Journal* 25, no. 13 (2004): 1233-1256.

²⁵Lubatkin, Michael. "Mergers and the Performance of the Acquiring Firm." *Academy of Management review* 8, no. 2 (1983): 218-225.

the arrangements.²⁶ However, despite adopting different techniques the outcomes attained are identical. In most cases, the terms “acquisition” and “mergers” are normally used together and are always referred for the same or identical purpose. However, research of Nahavandi and Malekzadeh identified the fact that they are slightly different since the acquisition involves completely buying one company and taking full control of it²⁷. Research of Ginsburg and Levis stated the fact that, in both the cases of Acquisitions and Mergers, the target entities are extinguished completely and the dominant company obtains all the privileges, assets, rights and liabilities previously owned by the merged or acquired company.²⁸

Through the research of Ginsburg and Lewin it is evident that fundamental differences exist between takeovers and acquisitions, despite the fact that they both are involved in the purchase of the assets formally belonging to a target company.²⁹ The takeovers are transacted on the publicly traded companies that are ranked in well-known stock exchanges. For instance: New York Stock Exchange and the London Stock Exchange.³⁰ The acquisition, alternatively, involves procuring the assets of private companies through private negotiations. The focus of this study is however on the takeover of target companies that is listed in the stock exchange.

²⁶United States International Trade Commission.. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992) Vol. 4, p. 9/17.

²⁷Nahavandi, Afsaneh, and Ali R. Malekzadeh. "Acculturation in mergers and acquisitions." *Academy of management review* 13, no. 1 (1988): 79-90.

²⁸M. Ginsburg and J. Levin. *Mergers, Acquisitions and Leveraged Buyouts*. Commerce Clearing House, Chicago (1989), pp. 42 - 67.

²⁹ Ibid 26

³⁰Travlos, Nickolaos G. "Corporate takeover bids, methods of payment, and bidding firms' stock returns." *The Journal of Finance* 42, no. 4 (1987): 943-963.

This research concentrates primarily on takeovers as a corporate strategy adopted by different corporations and used as an avenue for expansion, growth risk reduction and proper management. In this regard, takeovers are considered as a strategic plan by a dominant company to solely or partially procure a target company considered to be less dominant, either by mutual understanding with the management or by forceful means that involves legal battles.³¹

There are two types of takeovers which are generally referred to as a “friendly takeover” or “hostile takeover”.³² Both of these types of takeovers have a similar sole objective that is to attain the control of the target company’s management, operations and resources. Similarly, a takeover bid shall be taken to mean any strategic venture, platform or attempts by a dominant company to purchase a target company, wholly or to a substantially large part, in a bid to gain absolute control of such a company’s management, operations and resources.³³

Takeover law with regards to this research has been considered to represent the legal standings, directives and code of conduct as enshrined in the company law that primarily governs the way, takeover bidders and target companies behave during takeover activity. The activities and proceedings must be part of the whole takeover process including the rights, obligations and resources available to all the stakeholders in the takeover process.³⁴ Takeover bids are subject to

³¹R. Brealey and S. Myers *Principles of Corporate Finance*. Fifth Edition. McGraw-Hill, New York (1996), pp. 112 - 183.

³² Healy, Paul M., Krishna G. Palepu, and Richard S. Ruback. "Which takeovers are profitable? Strategic or financial?." *Sloan Management Review* 38, no. 4 (1997): 45.

³³G. Morse. *Company Finance, Takeovers and Mergers: Essential business law*. Sweet and Maxwell, London (1979), pp. 68 - 79.

³⁴ *Ibid*, pp. 115 - 133.

various regulations in the market as a result of conflicts that frequently arise from different prevailing interests between the directors and the shareholders of the company.³⁵ As for instance, in England there is the “City Code on Takeover and Mergers” that seeks to govern the whole process of making an offer to takeover a company.

Within the current corporate structure and increasing potential competition, takeovers are not only restricted to friendly and hostile ones; there are other types of takeovers that are implemented by the companies. However, this particular research is based on presenting a critical emphasis and analysis on friendly and hostile takeovers to keep the research objectives specific and attain the answer of the research questions.

A friendly takeover could be referred to the procedure in which the bidding company negotiates with the management of the target company.³⁶ They commence the process by making a purchase offer, which seeks to inform the board of directors and shareholders of the intention to purchase. Ideally, the board of directors of the target company takes charge of the whole process of accessing the offer and determining whether accepting the offer will serve the best interest of the shareholders of the company. In addition to that, friendly takeovers also takes the initiatives in which the bidder and the target company’s directors or shareholders, both in regard to the intended purchase as well as the value, readily arrived at a mutual agreement and agreed terms of the purchase offer.³⁷

³⁵ Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

³⁶Schnitzer, Monika. "Hostile versus friendly takeovers." *Economica*(1996): 37-55.

³⁷ Ibid, pp. 115 - 133.

According to legal experts, in the case of a friendly takeover the agreement reached can be termed as synergistic, since they are dealings that occur whenever the management finds that a merger with another company is likely to enhance and bring to life a far more competitive entity.³⁸ The management has the principal role of acting with the best intentions of the shareholders and the firm while negotiating in such transactions. As has been demonstrated in the course of this research, most US jurisdictions proffer the decision rights to accept a takeover bid solely on the directors, of considerable consultation that takes place with the shareholders.³⁹ Alternatively, In England often confer the rights to take decisions whether to accept or reject a takeover bid to the shareholders, rather than the directors.⁴⁰

Judging from the two perspectives of friendly takeovers between the US and the E.U, the United States International Trade Commission stated that:

“... whereas in the United States substantial powers are left to the board of directors to decide whether and how to fight (or to accept) a takeover bid, European law or codes of conduct seem to curtail the power of the board in favour of the shareholders.”⁴¹

Incidentally Article 8 of the 13th European Directive on Takeover 2004 requires that the board of directors restrain themselves from making decisions regarding a takeover bid, without the express consent of the company’s shareholders, during an emergency shareholders’ general

³⁸A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, New Jersey (1995), pp. 11 - 32.

³⁹ Ibid 25

⁴⁰A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 5 - 23.

⁴¹ S. Sudarsanam and A. Mahate. Are Friendly Acquisitions Too Bad for Shareholders and Managers? Long-Term Value Creation and Top Management Turnover in Hostile and Friendly Acquirers. *British Journal of Management* (2006), Vol. 17, No. 1, p. 7.

meeting. This prevents the board from conducting company business in their own interest but in the best interest of the all the stakeholders in the company.⁴²

Hostile takeovers being different in approach discussed above are used to mean an instance in which the bidding company approaches the “target company” with the intention of acquiring full ownership during a period when the directors and shareholders of the target company are willing to accept.⁴³ In a hostile takeover, the dominant company uses its financial strength to influence the acquisition of a less dominant company.⁴⁴

Hostile takeover can be executed through various strategies. One of the most common ways is by serving a tender offer to the target company.⁴⁵ A tender offer is made when the dominant company expresses interest publicly to purchase the target company at a fixed price usually above the current value of the company’s stock.⁴⁶ In the U.S, the tender offers are regulated and set by the Williams Act 1968; hence there is proper channel to follow while undertaking such a takeover.⁴⁷ The other avenue of initiating a hostile takeover is through the establishment of a proxy fight which involves persuasion of a simple majority of the company’s shareholders to replace the existing management with a new management so that it approves the

⁴²Ibid, pp. 7 - 23.

⁴³ Ibid, p. 9/19.

⁴⁴ Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32.

⁴⁵ Gilson, Ronald J., and Reinier Kraakman. "Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?." *The Business Lawyer* (1989): 247-274.

⁴⁶ M. Bradley. Interfirm Tender Offers and the Market for Corporate Control. *Journal of Business* (1980), Vol. 53, No. 4, pp. 345-376.

⁴⁷ Brown, Meredith M. "The Scope of the Williams Act and Its 1970 Amendments." *Bus. Law.* 26 (1970): 1637.

takeover.⁴⁸ The foremost and primary aim is to analyse the strategy that could replace the existing management that can offer opposition to the takeover.

The other hostile takeover method available as a third option involves the silent purchase of large stocks on the open market which is also referred as a creeping tender offer.⁴⁹The final step has a sole intention of effecting the change in management through quiet acquisition of the shares of the target company. This is generally witnessed when the stock volume acquired from the target company commands an adequate voting strength hence the dominant company offers the tender offer, which is automatically accepted by the shareholders. The basis for all these hostile takeovers lies in the fact that the bidding company has the legal backing to pursue the taking of control of the target company.⁵⁰

Finally, it is also important to find out about other takeovers despite being rarely applied in the corporate world. A reverse takeover involves a transaction in which the private companies acquire a publicly traded company through instigation of the highly dominant private company.⁵¹ The sole objective of the reverse takeover is to allow the private company to efficiently float its position on the market while avoiding the expenses and time involved in transaction of the initial public offering (IPO). In a reverse takeover, the acquiring company takes the role of transforming its management and establishing the documentation to allow for new management

⁴⁸Ibid, p. 9/19.

⁴⁹J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32.

⁵⁰ M. Bradley. Interfirm Tender Offers and the Market for Corporate Control. *Journal of Business* (1980), Vol. 53, No. 4, pp. 345-376.

⁵¹J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32.

with the same period of acquisition⁵². The other rare term used in takeovers is the “back flip” transaction that is considered to be more appropriate. In this case, the target company gains the control of the acquiring company, and assumes the role of controlling the whole operation.⁵³

Through the above discussion, it can be concluded that two types of takeover including friendly and hostile are primarily the most common types of takeovers applied in the corporate environment.⁵⁴ Kleiman states that the two dominant takeovers that exist are only the “friendly takeovers” and the “hostile takeovers”.⁵⁵ Kleiman further explained the fact that in a friendly takeover, the board of the less dominant company is prepared to consent to the acquisition if the interest of the shareholders is favourably taken into consideration. In a sharp contrast, a hostile takeover according to Kleiman occurs in an instance when the board is actually against the acquisition but the acquiring company insists by following a legal suite in the courts of law.⁵⁶

In the current business environment, the business experts have noted and tried to project the reasons as to why friendly takeovers are rapidly becoming a popular strategy with many corporations.⁵⁷ Through the search it has been identified that, friendly bidders during a takeover process usually enjoy the cooperation of the existing management of the target company. Hence,

⁵² Ibid, pp. 30 - 32.

⁵³ Ibid, pp. 31 - 32.

⁵⁴ M. Ginsburg and J. Levin. *Mergers, Acquisitions and Leveraged Buyouts*. Commerce Clearing House, Chicago (1989), pp. 47 - 72.

⁵⁵ A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 22 - 73.

⁵⁶ Ibid, pp. 11 - 73.

⁵⁷ Ibid, 1 - 2.

rendered an extensive chance to conduct due diligence before assuming control of the target company.⁵⁸ In the process, the bidding company takes proper time to study the affairs, policies, resources owned, the market and financial capability of the target company to ensure that the takeover bid is financially feasible.⁵⁹

In the process of considering a takeover, the acquiring company's management is expected to conduct a comprehensive, detailed analysis of the target company prior to finalising the actual agreement.⁶⁰ According to Galpin and Herndon, the third phase of acquisitions and Mergers process heavily depends on the due diligence to explore any available information about the company. Both Lajoux and Weston hold the same point of view, but insists that the management of an acquiring company conducts "due diligence" and makes complete use of the findings to come up with the most ideal bid prices when negotiating the deal and provide a basic point for checking the initial integration process.⁶¹

Frequently, it is important for the bidding company to undertake an initial comprehensive "due diligence" on the business operation, financial strength, cultural environment and other strategic issues concerning the transactions.⁶² Legally, the process should not be rushed despite

⁵⁸M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives* (1988), Vol. 2, No. 1, p. 22.

⁵⁹M. Bigelli and S. Mengoli. Sub-Optimal Acquisition Decisions under a Majority Shareholder System. *Journal of Management and Governance* (2004), Vol. 8, No. 4, pp. 373 – 405.

⁶⁰J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32. It depends on the financial and legal systems as in certain jurisdictions owing to the lack of transparency. Therefore proper due diligence may not be carried out.

⁶¹Galpin, T and Herndon, M "The Complete Guide to Mergers and Acquisitions", Jossey-Bass, New York (1999), pp. 11 – 14.

⁶² Ibid, p. 14.

acquiring a thorough knowledge in the target company. The right channels should be followed to conduct the “due diligence” process even if the board of directors is well aware of each other, because any misleading information that does not undergo any authentication is highly likely to render the whole transaction worthless before the courts of law.⁶³ There are a number of assumptions that require authentication at this stage including the state of the market and potential, market portion of the target company. Other factors include the major customers of the target company, the demand factor of the consumers, main competitors of the company, ability and competitive advantages over rivals, the human resource capital and the business practice of the target company.⁶⁴

Furthermore, it is also important to analyse the fact that, hostile bidder on similar basis may not have access to the due diligence process and may be required to make assumptions using the limited available information that is publicly available. It is also clear to point out that the hostile bidders have limited sources to fund the takeover desires as compared to the friendly bidders.⁶⁵ In the research of Galpin and Herndon, it is statistically estimated that most of the takeover transactions are financed by extension of bank loan.⁶⁶ Banks analyse and overview the financial projections themselves before advancing any money themselves.

⁶³ A. Lajoux and J. Weston. Do Deals Deliver on Post Merger Performance? (1998), Vol. 2, No. 1, pp. 34 - 38.

⁶⁴ A. Lajoux. (1998b). *The Art of Integration: A Guide to Merging Resources, Processes, and Responsibilities*. McGraw-Hill, New York (1998), pp. 54 - 73.

⁶⁵ Galpin, T and Herndon, M, “*The Complete Guide to Mergers and Acquisitions: Process Tools to Support M&A Integration at every level*” , Jossey-Bass, New York (1999), pp. 11 – 14.

⁶⁶ Ibid, pp. 11 – 14.

In this research, primary attention has been paid towards the strategic legal and practical platforms that are available for the companies to fight both friendly and hostile takeover bids. The application of takeover defences is available to both the takeover processes as the companies seek to deter the change of ownership to the aggressive bidders.⁶⁷ In fact, this type of takeover sometimes is considered to be more of an acquisition than a takeover.⁶⁸

Kleiman further stated that:

“...in the market for corporate control, management teams vie for the right to acquire and manage corporate assets and strategies, but when an outside group acquires control of a target company, the transaction is often termed a takeover.”⁶⁹

In the course of the study, a review of the literature and other relevant materials on hostile takeovers are also used to explain the legal framework, within which bidders and target companies may sometimes decline or accept the takeover attempts depending on their own interest in the whole deal.⁷⁰ Examples of such situations include instances, when an acquiring company is seeking to buy out its competition in the market and gain control of the market in terms of supply, or when the acquiring entity that is attempting a hostile takeover is driven by bad faith.⁷¹ In both, the US and English legal frameworks, it is vital to note that target companies

⁶⁷J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32.

⁶⁸Y. Amihud. *Leveraged Management Buyouts: Causes and Consequences*. Dow Jones/ Irwin, Homewood, Illinois (1989), pp. 22 - 27.

⁶⁹M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives* (1988), Vol. 2, No. 1, pp. 22 - 31.

⁷⁰J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review* (2000), Vol. 19, No. 1, pp. 29 - 32.

⁷¹R. Bruner. The poison pill anti-takeover defence: The price of strategic deterrence. *Working Research Paper*. The Research Foundation of The Institute of Chartered Financial Analysts, Charlottesville, VA, (1991). pp. 14 - 46.

have usually a number of legal strategies available to them to apply in a bid, to reject the offers and retain its independence against the prospective bidders.⁷²

The background information and discussion have demonstrated an understanding of the takeovers in the current corporate environment hence establishing an important foundation to the subsequent issues and interests raised in the course of the research. Further insights into the actual process of takeovers have been detailed and evaluated.

At this point, it is indeed vital to agree that the literature and insights into the definitions of takeover to a relatively succinct level by law, directives, codes and regulations is currently used to govern the whole process of takeovers in England. Significant analysis has also been made on hostile takeovers in both the US and England. It is indeed of significance to note that the rapid increase in takeovers as strategy by companies in the current business world has precipitated the emergence of legal tactics against the takeover processes both in the US and England. This shall form the principal factor of interest to this research.

2. Literature Review

There are various articles and books on takeover defence tactics in England and the US. While studying and investigating secondary data for this research study it is worth mentioning that the following authors John Armour, David Skeel, Klaus Hopt, Eddy Wymeersch, Alexandros Seretakis, David Kershaw, Aswath Damadoran and others had concluded various data relevant to this particular topic. Therefore, in this research, all these publications have been critically discussed and analysed.

⁷²R. Bruner. *Applied*. John Wiley and Sons, Hoboken, New Jersey (1991). pp. 68 – 74.

Empirical evidence of takeovers in both the US and England suggest that takeovers create significant returns for target shareholders.⁷³ However, in spite of this common goal, the US and the English systems contrast sharply in their takeover regulations. As per the US system, Damadoran argued that the regulations allow managers of a target company to employ a variety of takeover defence tactics to discourage bidders from acquiring the company.⁷⁴ One of the widely used and the most successful defence tactics in England is the shareholder rights plan or the “poison pill”⁷⁵. Through which, it is a shareholder rights agreement that intentionally increases the price of a takeover in an attempt to discourage bidders for acquiring the target company⁷⁶. It achieves this either by favouring existing shareholders to regulate the equity of the company by acquiring shares at a very low price, or by compelling the bidder to purchase the shares of existing shareholders at a higher price.

As identified, the differences between the two systems lies as to the means prescriber by takeover regulations. Within the US corporate system, response of the managers of the target companies is considered seriously. However, the situation is completely different in England.⁷⁷ When a bidder launches a hostile bid and believes that the managers of the target company are

⁷³Altunbaş, Yener, and David Marqués. "Mergers and acquisitions and bank performance in Europe: The role of strategic similarities." *Journal of Economics and Business* 60.3 (2008): 204-222.

⁷⁴ Damadoran, A. “Acquisitions and Takeovers”. In F. J. Fabozzi vol. 2., *Handbook of Finance, Investment Management and Financial Management*, 2008.

⁷⁵ Malatesta, Paul H., and Ralph A. Walkling. "Poison pill securities: Stockholder wealth, profitability, and ownership structure." *Journal of Financial Economics* 20 (1988): 347-376.

⁷⁶ Ibid

⁷⁷ Iyer, Venkataraman M., and Govind S. Iyer. "Effect of Big 8 mergers on audit fees: Evidence from the United Kingdom." *Auditing* 15, no. 2 (1996): 123.

improperly resisting the bid, the bidder files a claim with the Takeover Panel, which comprises of representatives from the Bank of England, the Stock Exchange, institutional investors, and major merchant banks⁷⁸. The Takeover Panel differs from the Delaware Court in various important aspects. Hopt and Wymeersch argued that the English panel as a formal defence can attend to takeover issues faster than in the U.S, which follows procedural court proceedings and can delay takeover disputes. The English takeover disputes are handled in a more professional way, as the panel consists of business financial experts, the cost of litigation is lower as compared to the U.S system.⁷⁹

Achievement of synergy gains is the major explanation of takeovers.⁸⁰ However, takeovers have not always been used to generate value, but are used by the management for self-interest.⁸¹ Seretakis noted that most managers might engage multiple acquisitions just to maximise their power and reputation. He also viewed takeovers as another creation of monopoly power, which is currently prohibited by competition laws, and therefore, the target of hostile takeovers are inadequately run companies, which a bidder can reshuffle. A market for corporate control, especially to companies that are not affected by lack of management seems not to apply in the explanation of hostile takeovers.⁸² This power of the shareholders in England pertaining to takeover authorisation is what Seretakis think would bring conflict between shareholders and

⁷⁸ Ibid

⁷⁹ Hopt, K. and Wymeersch E., *European Takeovers – Law and Practice*, Butterworths & Company, 1992.

⁸⁰ Ibid 63

⁸¹ Seretakis, Alexandros. “Hostile Takeovers and defensive mechanisms in the UK and the US: a case against the United States regime”. *The Ohio State entrepreneurial business law journal*.

⁸² Ibid 81

directors. He further maintained the U.S judicial regulations of takeover defences as weak as it does not contain any regulatory rule pertaining to defensive tactics created by managers.⁸³

Armour and Skeel argued that takeovers tactics in U.S and England have been made different by differences in the mode of regulation. In England, they argued that takeovers have been coined under self-regulation driven to promote institutional investors, while in the U.S, the judicial law-making has greatly favoured managers by complicating shareholders' ability to influence the rules.⁸⁴ After a cross-examination of the two takeover regulations in the U.S and England, the authors argued that prospective acquirers could easily enter into negotiations with the company's board and arrive at a friendly transaction in the U.S than in England where hostile offers are directed to the shareholders. Also, it is easier for the board members to work on the interest of shareholders, only if the board members are well incentivised.⁸⁵ Armour and Skeel argued that, in either way, both the U.S and England takeover regulations have been directed to fulfil the interests of board members and shareholders.⁸⁶

Kershaw analysed the illusion of reconsidering England's takeover defence prohibition and argued that generation of value in a company, which is the main purpose of takeover regulations that cannot be achieved without solving the disputing forces between shareholders

⁸³ Ibid 81

⁸⁴ Armour, John, and David A. Skeel. "Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation." *The Georgetown Law Journal*, 2007; pp1727-1794.

⁸⁵ Ibid 4

⁸⁶ Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

and board members.⁸⁷ He also noted that the scope of restructuring or selling of an asset is restricted to a board of an English company without the approval of the shareholders. Therefore, this defence can be used by the shareholder to buy more time to control the sale process, or as a bargaining mechanism. Also, the management to counter attack an excellent value offer in a quest to protect their jobs can use it.⁸⁸ The ability of the management to exploit collective action problem is limited under the English takeover regulation for the approval of a sale of an asset. This appears in cases where shareholders, who are inactive and have poor financial incentives may have low interests with the company's activities and can block future takeover bid that may have benefits for the company. Therefore, the author argued that shareholder defence is unnecessary and lacks justification, and instead, the English takeover regulations should be reshuffled and centred to managers' incentives.⁸⁹

Armour and Skeel reviewed the U.S and English divergences of takeover regulations and argued that the U.S federal regulations have been meant to benefit managers, while in England, they are meant to benefit investors.⁹⁰ The authors also argued that it is due to these unintended consequences of regulation designs that have limited the effectiveness of takeover objectives. The self-regulation mechanism under both, U.S and English systems are portrayed as incentives to entities and individuals providing the rules. Therefore, the regulators incentives are not in line

⁸⁷ Ibid 75

⁸⁸ Ibid

⁸⁹ Chatterjee, Sayan, et al. "Cultural differences and shareholder value in related mergers: Linking equity and human capital." *Strategic management journal* 13.5 (1992): 319-334.

⁹⁰ Armour, John, and David A. Skeel. "Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation." *The Georgetown Law Journal*, 2007; pp1727-1794.

with social welfare, and, therefore, cannot work in areas exhibited by rapid change. The authors considered the English takeover regulation as weak as it promotes institutions rather than private individuals.⁹¹ Just as the companies themselves, shareholders invest and monitor activities. The U.S takeover regulation is also a limiting factor towards achievement of value in a company. This is because the court determines the defence mechanism against the sale of asset.⁹²

3. Objectives of the Study

The takeovers and acquisitions have rapidly gained momentum in the last decade as business corporations are undertaking expansion of stripping of assets strategies to operate beyond their borders in a bid to increase their revenues and profitability⁹³. The activities have not only been noted in the US but also largely experienced in England until most recently when economic recession came into the platform.⁹⁴ There are several reasons that have led and encouraged the current consolidations witnessed in business including potential revenue stability of diversification, accruing the benefits of operating in economies of scale, ego-oriented desires of the business leaders to control a particular market niche etc.⁹⁵ On the same note, the aftermaths of the takeovers are not only numerous and distinct but also may lead to loss of

⁹¹ Ibid.

⁹² Ibid

⁹³ Ibid 70

⁹⁴R. Ruback. An Overview of Takeover Defences. In A.Auerback, ed., , University of Chicago Press, Chicago (1988), p. 49.

⁹⁵Ibid, pp. 49 - 68.

investments by the shareholders depending on the formation of a particular company, the management styles of the leaders and the sole purpose of carrying out of the takeover transactions.⁹⁶

Notwithstanding the uniqueness, which, serve to highlight the contrasts between corporate reorganisations and acquisitions, all takeover scenarios have at least one fundamental similarity, creation of a new legal entity of the death of a previously existing legal entity.⁹⁷ The dominant company views the hostile takeover of the target company as an opportunity to expand their operations beyond their own boundaries.⁹⁸ After a successful acquisition, the entities lose their original legal identities and a new company results from the consolidation.

The current research aims at establishing and distinguishing between the several takeover bids, which are rationally oriented and psychologically driven. The takeover bids are sometimes thought to be motivated by the desire to control or power struggle.⁹⁹ Takeover bids sometimes come unexpectedly without having to explain their motives despite being financially unappreciated.¹⁰⁰ It is of immense benefit to the shareholders, national economies and target companies if the target companies have the ability and possibility of declining the takeover bids

⁹⁶ Ibid, pp. 49 – 68

⁹⁷ United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268 (1992), Vol. 4, p. 9/19.

⁹⁸ I. Erel, R. Liao and M. Weisbach. World Markets For Merger and Acquisitions. *Working Paper Series*. National Bureau of Economic Research, Inc., Institute for Financial Research (2009), pp. 4 – 7.

⁹⁹ N. Mangold and K. Lippok. The Effect of Cross-Border on Shareholder Wealth: Evidence from Germany. *Journal Of International Business And Economics* (2008), Vol. 8, No. 3, pp. 315 - 330.

¹⁰⁰ A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 5 - 23.

by the dominant company.¹⁰¹ The other important issue to note at this point is the fact that legal and practical parameters exist in the form of defence tactics, which may seek to protect the target company from unfair and hostile takeovers that are rapidly increasing.

From the study, it is critical to note that target Company may implement all the takeovers, regardless of whether it is friendly or hostile.¹⁰² The directors of a target company are sometimes considered to have different motives in opposing the takeover bids. For instance, sometimes they are thought to oppose the bid in order to promote their personal desires since with a successful takeover bid, they are most likely lose their positions and social class due to change of management.¹⁰³ Alternatively, “golden parachutes” or “share options” that trigger to make substantial financial gains for them.

From another critical point, the directors of the target company may oppose such takeover bids on the grounds that the bid is likely to undermine the interest of the company and cause damage to the different stakeholders of the company like the shareholders, creditors and the employees.¹⁰⁴ Further reasons for the decline are discussed in detail in other parts of this research. A target company may decide to reject a takeover bid in order to avoid the continued aggression of a hostile bid, hence deploying a range of differing defence tactics against the bidder; a process otherwise technically known as “squeezing out” or “buying out” potential

¹⁰¹ Ibid.

¹⁰² K. Ravichandran. Effect of Financial Crisis over in GCC Countries. *Working Paper Series G34* (2009), pp. 45 - 59.

¹⁰³ Ibid.

¹⁰⁴ R. Ruback. An Overview of Takeover Defences. In A. Auerback, ed., , University of Chicago Press, Chicago (1988)., pp. 49 - 68.

acquirers.¹⁰⁵ In the case of the European jurisdictions, the shareholders of the company that is being targeted or the board of directors in the context of the US jurisdictions must approve the defence teams providing the tactics.¹⁰⁶

It is worth noting from the research that there are a number of viable takeover defences obtained from a diverse and highly sensitive literature in the legal environment.¹⁰⁷ The significance of these two settlements can be noted in making an inventory of the takeover defences in contemporary use and providing a critical analysis to what needs to be done in England and the US to facilitate the adoption of these viable defences. The hostile takeover bids in most cases expose an ugly conflict of interests between the board and shareholders; hence the aftermath is borne by the shareholders who have made their investments in the target company.¹⁰⁸

From their points of view, the reaction to pursuing anti-takeover amendments becomes much more negative in instances when the board of directors is dominated by executives or by externally sourced members with a close affiliation with the executives.¹⁰⁹ They also found that in circumstances where the board is chaired by the chief executive, the anti-takeover

¹⁰⁵ Ibid, pp. 52 - 68.

¹⁰⁶ N. Mangold and K. Lippok. The Effect of Cross-Border on Shareholder Wealth: Evidence from Germany. *Journal Of International Business And Economics* (2008), Vol. 8, No. 3, pp. 315 - 330.

¹⁰⁷ Ibid 28

¹⁰⁸ J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge (2006), pp. 3 - 6.

¹⁰⁹ A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 5 - 23.

amendments are regarded highly since the board sees a chance to increase their stock ownership or amplifying share value in the firm if the takeover is allowed to sail.¹¹⁰ This study reveals that vigilant monitoring by the government authorities is important and other outside and independent stakeholders whenever a company seeks to challenge a takeover bid or when takeover defence measures are ignored, especially when CEOs chair the board of directors or when most of the board members are stakeholders of the target company.¹¹¹ It is in this understanding (of potential subjective reactions to takeover bids by a board of directors) that experts concur that in most corporate control decisions, the decision making process through which directors accepts a deal, often proves questionable. It is important for such a research undertaking to clarify the available takeover defences, discuss their appropriate applicability and contextualise the best available defences against the contemporary legal structures. In order to create potential awareness, public knowledge and practitioner accountability within the English and the US context as well as highlight possible areas of improvement.¹¹² The intent of this research has been twofold. Firstly, to review and explain an importance of takeover defence tactics and to propose regulatory changes which will allow the Takeover Panel (reviewed in greater detail in subsequent sections of the research) to protect and balance the rights and interests of the shareholders in takeover bids. Second, to review the most common takeover defence tactics and to analyse the fiduciary duties of directors of English and US corporations towards minority shareholders under the

¹¹⁰ United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, Vol. 4 (1992), p. 9/19.

¹¹¹ C. Zannetos. *An appraisal of hostiles Takeover Defence Tactics*, London King's University, London (1990), pp. 45 - 57.

¹¹² Ibid 100

respective legal systems during a takeover attempt.¹¹³ To propose methods of achieving a fairer, more effective means of controlling such defences and also propose new types of takeover defence tactics. It is necessary to carry out research on this topic and propose new types of takeover defence tactics, thus explaining the fundamental role that the findings of this study can complement the contemporary literature in the area.¹¹⁴

It is worth noting that, while reviewing both the US and English takeover defences, this research made the informed assumption that the US takeover legal framework was at an advanced stage as compared to that of England. In effect, therefore, this study was biased towards evaluating takeover law in England, specifically in regards to takeover defence laws, in contrast to advances made in the US on the same.¹¹⁵ This bias was consequent upon the realisation that Europe has been lagging behind in creating and implementing effective takeover regulation policies particularly in the last decade, at a time when the US has advanced to amend and even overhaul its regulation on takeovers and mergers.¹¹⁶ According to the United States International Trade Commission, "takeovers have not been as common in Europe as they have been in the United States, and more importantly hostile takeovers have been fairly rare in

¹¹³ Blackburn, Virginia L., James R. Lang, and Keith H. Johnson. "Mergers and shareholder returns: The roles of acquiring firm's ownership and diversification strategy." *Journal of Management* 16.4 (1990): 769-782.

¹¹⁴ Bae, Kee-Hong, Jun-Koo Kang, and Jin-Mo Kim. "Tunneling or value added? Evidence from mergers by Korean business groups." *The journal of finance* 57.6 (2002): 2695-2740.

¹¹⁵ C. Zannetos. *An appraisal of hostiles Takeover Defence Tactics*, London King's University, London (1990), pp. 45 - 57.

¹¹⁶ Allen, Linda, et al. "The role of bank advisors in mergers and acquisitions." *Journal of Money, Credit and Banking* (2004): 197-224.

Europe”.¹¹⁷ The Commission further states that, “only in the United Kingdom is the hostile takeover a common occurrence”.¹¹⁸

An Illustration of this comparative highlight is the fact that in 1987, a total of 250 takeovers were recorded in England, while most of the EU regions recorded virtually no takeover activities.¹¹⁹ One of the reasons offered to explain this phenomenon is the fact that takeovers are predominantly in publicly traded companies and there are more of these companies in the US and England than in other EU states. In Germany, for instance, there were only 440 publicly traded companies in 1987, most of which were held by families and bank groups. This can be compared with over 3,000 publicly traded companies in the UK during the same period.¹²⁰

Consequent to the occurrences of takeovers and the level of the controversial hostile takeovers, the EU region has seen most “member states reluctant to develop extensive takeover regulations”.¹²¹ The 13th Directive presented to the Council on 19 January 1989, thus became an attempt by the EC Commission to create relevant and adequate takeover regulation based on Article 54 of the Rome Treaty (primarily giving the Council a mandate to abolish all restrictions previously hindering inter-nation freedom in the establishment of the European Community,

¹¹⁷ Ibid.

¹¹⁸ A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 5 - 23. A. Auerbach. *Corporate Takeovers: Causes and Consequences*. University of Chicago Press, Chicago (1991), pp. 5 - 23.

¹¹⁹ Barney, Jay B. "Returns to bidding firms in mergers and acquisitions: Reconsidering the relatedness hypothesis." *Strategic Management Journal* 9.S1 (1988): 71-78.

¹²⁰ Ibid.

¹²¹ Sudarsanam, Sudi, Peter Holl, and Ayo Salami. "Shareholder wealth gains in mergers: effect of synergy and ownership structure." *Journal of Business Finance & Accounting* 23.5-6 (1996): 673-698.

through the issue of relevant directives under its authority).¹²² It would take up to May 2004, for the European Council of Ministers to finally adopt the Directive, and make it a binding legal framework governing takeover activities in the EU.¹²³

This researcher thus saw the need to investigate this area with the purpose of providing succinct and valid recommendations into the defences available to those of the companies that seek to defend themselves against hostile or friendly takeover bids, within the European jurisdiction. Towards this end, it will be important to review the existing takeover defences allowed in England, as well as those available in the US (the US being the most exemplary case study of takeover law (in both principle and practice) by virtue of having the highest number of corporate control market deals every year).¹²⁴

The purpose of the present study is thus construed as to conduct a comparative review of defences in the US and English legal contexts and by so doing, evaluate the available takeover defences in the US jurisdiction as provided for by their takeover law.¹²⁵ The research further purposes to ultimately recommend the best available takeover defences in the US legal context.

This research is meant to identify the takeover defences that are applicable in both the English and US jurisdictions¹²⁶. The study proposes to recommend the missing links in both

¹²² United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, Vol. 4 (1992), p. 9/17.

¹²³ L. Bebchuk, J. Coates and G. Subramaniam. The powerful anti-takeover force of staggered boards: theory evidence, and policy. *Stanford Law Review*, (2002). Vol. 54, No. 5, pp. 887-951.

¹²⁴ C. Markides. How much-hated takeover defences can unlock hidden value. *Multinational Business*, (1992). Vol. 5 pp 21-29

¹²⁵ Ibid 91

¹²⁶ Ibid 110

English and the US defence context. There are a good number of defences available in both jurisdictions to cater for the takeover but the study is meant to design a comprehensive analysis of strategies of defending the target companies from takeovers and counter the cases presented by the dominant companies in the courts of law. It follows from the study that the listed objectives will guide the research and help to build a comprehensive argument against takeovers of the target companies.

- To review and explain the significance of the takeover defence tactics and propose regulatory changes which would allow the takeover Panel to protect and balance the rights and interests of shareholders in a takeover bid.
- To review the most common takeover defence tactics and analyse the fiduciary duties of directors of both the English and US companies towards minority shareholders. It further proposes an effective means of controlling such defences and discusses possible new types of takeover defence tactics.

The major objectives and aims of the study are broken down into narrow goals in a bid to enhance the understanding and attainment of the general objectives. It aims to identify and analyse the most relevant contemporary literature on each count, and use this to build an analytical argument towards a valid conclusion. The two major hypotheses are as listed below:

- a. To evaluate the role of takeover defences in contemporary corporate control market.
- b. To identify and explain the available and emergent takeover defences in both English and the US jurisdictions.

This research has been developed through the following chapters:

Chapter 1. A comparative study between English and the US practices of acquisitions and mergers.

Chapter 2: An examination of the usual rationale behind Acquisitions and Mergers.

Chapter 3: Historical growth and development of Acquisitions, Mergers, and Defences thereto.

Chapter 4: Types of common takeover defence tactics in England and the US.

Chapter 5: Interests and protection of minority shareholders.

Chapter 6: Comparisons between the English and US systems in takeover bids.

CHAPTER 1: A comparative study between the English and the US practices of acquisitions and mergers.

1.1 Introduction

Maximisation of share prices is the prime target of most of the large and medium sized corporate entities; it is odd to mention that corporate control is often directed by these corporate entities in this direction. Depending upon the moment of share performance, often the issues of takeovers and mergers receive attention in the corporate world even in disregard of the interest of minority shareholders. Although in England, the protection of minority shareholders is attempted to be protected by statutory and regulatory measures, the shareholders often voluntarily give-in in a take-over or merger process.

In discussing take-overs and mergers, most business people, consciously or unconsciously refer to Anglo-American model, including the defence tactics relating to the process, failing to realise the differences that exist between the two processes.

Where the UK takeovers are regulated by the City Code on Takeovers Mergers which was developed and is administered by the Panel on Takeovers and Mergers, popularly known as the Takeover Panel, most of the US takeovers are governed by the Courts of Delaware. Whereas in England, proceedings before a Takeover Panel are conducted in a flexible and an informal way by the chosen members of the City of London and/or other professional communities, in the US, these activities are performed in courtroom atmosphere – but this is often dictated with the atmosphere of a dispute resolution.

The contrasts of takeover regulation remarkably differ between England and the US in that in England, the Takeover Code considerably tends to lean towards protecting the interests of shareholders, which makes an impact on undue acquisitions or takeovers whereby shareholders'

interests particularly those of the minorities, are attempted to be protected from coercive bids. Management in the US has flexibility in engaging into defensive tactics (provided that these can be justified by referring to their fiduciary duties). In England, in contrast, the Takeover Code prohibits management from employing any defensive tactics which would effectively frustrate an actual or anticipated bid.¹²⁷ Defensive tactics employed by management in the US have more flexibility provided of course the tactics do not run counter to the fiduciary duties of management. One of the interesting contrast between the two systems being that whereas in England, the takeover or merger regulation is shareholder contract, in the US there exist significant management discretion in this matter combined with the judicial oversight.

In London, institutional investors tend to avoid the need for litigation by developing certain norms and principles re-enforced by sanctions, in the US institutional investors do not seem to own a large number of stocks as have their English counterparts. Furthermore, the US seems to have been hostile to self-regulation, which works very well for England. In fact, Federal securities legislation enacted during the 1930s prohibited in the US any application of self-regulation as it was viewed by them as “soft law”; England, on the other hand, has been a supporter of self-regulation which promoted, inter alia, collective investment vehicles. In view of the trust that institutional investors have put in the system of self-regulation, there is no reason for substituting it by any other regulatory system which might simply disturb a very stable financial market in the City of London.

Returning to the theme of this research, it may be pointed out that it still remains a matter of speculation particularly amongst the academic scholars, the extent to which defensive tactics

¹²⁷ See Armour, J and Skeel, Jo DA “Who Unites the Rules for Hostile Takeovers, and Why – the Peculiar Divergence of US and UK Takeover Regulation”, Centre for Business Research, University of Cambridge, Working Paper No 331.

should be permissible in the fact of a hostile bid. Armour and Skeel maintain that the Takeover Code's "no frustrating action" rule is likely to be preferable, but on the other hand, opposition to it, as stated earlier, still exists.¹²⁸ But, the basic differences between the English and the US systems primarily triggered by the institutional shareholders-dominated corporate entities will remain at least in the foreseeable future, which also directly impact the issue of shareholders defence tactics in the case of acquisitions and mergers of small to middle-sized corporate entities in England.

1.2 The Differences between the Takeover Regulations of England and the US

Hostile takeovers should not be the norm; they may not be encouraged in a market which believes in corporate governance and self-regulation. One of the principal objectives of acquisitions and mergers is to increase a firm's value. Before the process starts, a tough examination of the prospectus of reaching that objective (due diligence) is essential. In this process, the value-orientated business policies, and the promotion of a market should be taken into consideration. In other words, the business policies and the business ethos of a particular business community may not be changed overnight. Furthermore, in England, the issue of the protection of minority shareholders may not be disregarded; in fact, they have been provided with statutory rights and remedies by the Companies Act 2006.

During the due diligence process, the target company should seriously consider the benefits and disadvantages of acquisition, particularly in regard to the existing employees (a social issue,

¹²⁸ op. cit, at 4

which has received attention in a section of this work,¹²⁹ in addition to the prospects of striking a beneficial synergy between the possible conflicts in terms of the operation of the business after the acquisition, the projected dent that the acquisition may create on the customer's world, and whether a "we-they" situation might be created within the new company so to say. Much of the defence tactics would depend on these issues. The lack of transparency on the part of either or both the companies concerned may present a hindrance to "due diligence". Synergies may however take place between companies dealing in totally different product. The merger between Cadbury and Kraft would be a clear example to sustain this argument.

Academics have, however, come up with various suggestions as to how best to regulate the take-over market; for example, Easterbrook and Fischal have supported takeovers, by maintaining the managers should not be allowed to defend against a takeover, so that the company's shareholders would have a free hand to decide whether to accept the bid.¹³⁰ The logic behind this practice has been that otherwise managers' interest in preserving their employment would override the best interests of the acquiring company. The counter-argument to this has been that managers should be allowed to defend a take-over only to the extent necessary to achieve the best possible price for the company's shareholders. In other words, according to this latter view, managers know best.

Whereas in the United States, the shareholder-orientated approach has been favoured in academic debates, the Delaware Courts have discussed this approach stressing the fact that a company is managed and controlled by its directors. By contrast, England favours the

¹²⁹ See Section 2.14

¹³⁰ F H Easterbrook and D R Fischel, "The Report Role of a Target's Management in Responding to a Tender Offer", 94 Hansard Law Review (1981) 1161; see also H Manne, "Mergers and the Market for Corporate Control", 73 Journal of Economics (1965) 110

shareholder-orientated approach in order to recognise that otherwise the English practice would unduly disregard the contributions made by the shareholders to the company concerned.

Furthermore, the US regulations allow bidders complete flexibility in bidding for as small or as large a percentage of the target company's stocks as they wish, but their bidding practice must maintain equality whereby bidders would be required to pay the same price for each of shares they may acquire; incidentally, each bid must be kept open for at least 20 days.¹³¹

In so far as the managers of a target company are concerned, they are allowed to use a variety of defences against a take-over bid, and the most popular defence is the "poison pill" or "shareholder rights plan". This defence is designed to dilute a hostile bid, for example, if the bidder acquires more than a specified percentage of target stock, which are usually 10 or 15%. The managers of a company that may have a "poison pill" and a responsible board of directors will have almost complete discretion to resist an unwanted take-over bid.¹³²

It is worth mentioning that in the US, in addition to the traditional defences, target firms are also permitted to take resort to other defences too, namely, "break-up" fees and other "lockup" provisions which are designed to cement a deal with a favoured bidder, and keep the hostile bidders at bay.¹³³ But, the nature of discretion exercised by target-company's managers is not absolute; managers may sanction fact compelled to remove takeover defences, particularly where the defences, in fact, tilt towards one bidder; on the other hand, overall, in the US, bidders,

¹³¹ For a brief summary of the US tender regulations (which were enacted in connection with the Williams Act, 1968, which amended the Securities and Exchange Act, 1934) see M A Eisenberg, Corporations and Other Business Organisations: Cases and Materials 1136-40 8th edition (2000).

¹³² See further L A Bebchuk, J C Coates IV and G Subramanian, "The Powerful Anti Takeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants, 55 Stanford Law Review (2000) 885

¹³³ See further David A Skeel Jr "A Reliance Damages Approach to Corporate Lockups", 90 Northwest University Law Review (1996) 564; see also J Costes & G Subramanian, "A Buy-side Model of M & A Lockups: Theory and Evidence", 53 Stanford Law Review (2000) 307.

in general, have extensive discretion in acquiring a target company – it is really a situational issue. The good news is that almost every State in the United States has enacted anti-takeover legislation in order to prevent unwanted takeovers.

In England, on the other hand, takeover regulation is primarily shareholder-oriented.¹³⁴ Once a take-over bid has materialised, target companies in England are not allowed to take any “frustrating” action, without the consent of the shareholders; poison pills are strictly forbidden.

In England, the compulsory corporate governance system operational within the “listed companies” restricts directors’ discretionary powers in regard to biddings for take-overs and defends against them. English company law requires directors to seek authority from the general meeting to issue new shares which are usually dominated by institutional investors. The pre-emption rules have also oblige directors to offer any new shares first to the existing shareholders in proportion to their current shareholdings; furthermore, shareholders have the right to remove directors at any time by ordinary resolutions, and the “golden parachute” procedure.

It is also to be emphasised that the golden parachute provisions in directors’ service contracts can restrain the powers of managers in this issue.¹³⁵ Like the US, in England, bidders are subject to an equal treatment rule whereby they are required - to pay the same price to all shareholders who may intend to accept a tender offer. In England, promotion of equal treatment of the shareholders in a target company is accorded a very high priority; for example, if anyone plans to purchase a controlling stake in a target company, which is usually to the extent of 35%

¹³⁴ See generally, the Takeover Code (2006); see also W Underhill (ed) Weinberg and Blank on Take-overs and Mergers (latest edition).

¹³⁵ See the Companies Act, 2006; Chapter 4A, ss 226B. See also Directors’ Remuneration Report Regulations, 2002; the Listed Companies are required to publish detailed report on directors’ remuneration and voting pattern at general meetings of the company – the Combined Code on Corporate Governance (2008).

or more of the voting rights in the target's share capital (this system is usually known as the mandatory bid system). The mandatory bid rule however effectively forces bidders to raise enough money to acquire entire company – the minority shareholders may thus be “squeezed out”. In sum, compared to the US takeover regulation, the English practice on this matter seems to be more shareholder-oriented. There exists in England a built-in system to allow hostile takeover tactics¹³⁶.

However, despite certain basic differences between the US and English system of equal tactics in hostile take-over bids, in both countries, in general, hostility is the exception rather than the rule. In fact, in England, managers seem to prefer the regime developed by the Takeover Code that does not allow managers to use defensive tactics¹³⁷ - returned to shareholders being the primary concern of corporate entities. In both the US and England hostile takeover bids have provoked controversy. Whereas in the US these are more or less subject to regulation, in England, the Takeover Code governs this, but in the latter case in a mellowed way to ensure that the minority shareholders rights are respected. In a subsequent section of this work, the adverse effect of takeovers has been briefly discussed. It would be opportune at this stage to examine the reasons for takeovers.

¹³⁶ See further R Kraakman et al, The Anatomy of Comparative Law: A Comparative and Practical Approach (2004).

¹³⁷ See further Ronald J Gilson, “Unocal Fifteen Years Later (and what we can do about it”,) 26 Delaware Journal of Corporate Law (2001) 491; and Luciar Agu Bebhuk, “The Case against Board Veto in Corporate Takeovers”, 69, University of Chicago Law Review (2002) 973.

1.3 Why Takeovers?

Takeovers, whether friendly or hostile, are executed for a variety of reasons, namely, this is a tactic of removing underperforming managers in a company¹³⁸; the desire to achieve more efficient between an acquiring company and the target company, but this need not happen when two companies are in the same business; the classic example to justify this point would be the takeover between Cadbury and Kraft. Thirdly, the desire of “empire building” by bidding managers which may not guarantee the creation of any value for their shareholders – under the English practice, this process might not receive much support; and finally, a desire to police a market, which incidentally runs counter to the competition policy in business. But the most sustainable justification for takeovers may be “value connection” for both the corporate entities concerned.

Controversies surround the issue of whether bidder shareholders gain much in the process of takeovers or lose. According to Andrade, Mitchell even where losses accrue, to them they are insignificant to the gains to target shareholders, implying that such transactions nevertheless create a significant amount of net value for shareholders.¹³⁹

Sundarsanam & Mahobe’s studies on the effect of hostile takeovers in the UK and a corresponding study carried out by Bhagah et al in the US suggest that the effect of hostile takeovers provide positive return to acquirer shareholders.¹⁴⁰ According to Aramour and Skeel

¹³⁸ See further Roberta Romano, A Guide to Takeovers, Evidence and Regulation, 9 Yale Journal on Regulation, (1992) 125-155.

¹³⁹ G Andrade, M Mitchell & E Stafford, “New Evidence and Perspectives on Mergers” 15.2 Journal of Economic Perspectives (2001) 103; see also J R Franks & R S Harns, “Shareholder Wealth Effects of Corporate Takeovers: The UK Experience”, 1955-85, 23 Journal of Finance and Economics (1989) 225.

¹⁴⁰ S Sundarsanam & A Mahale, “Are Friendly Acquisitions Too Bad for Shareholders and Managers?”

(Jr) English restrictions on defensive tactics would be preferable to the US approach.¹⁴¹ Indeed, US acquirers now seem to be more likely to enter into negotiations with target companies' Brands than to make a "hostile offer direct to shareholders".¹⁴² Briefly, whereas the English system requires managers to remain more directly accountable, to shareholders, in the US, it may be possible for corporate entities to conduct around manager-friendly regimes but at high financial costs. It is ingrained in the English system of corporate governance and all other aspects of corporate issues to protect the shareholders' interests.

1.4 The Modes of Takeover Regulation

In the US, judicial authorities and regulators are involved in all aspects of takeovers; however the tender offer itself is regulated mainly by the Securities and Exchange Commission. In the event of a take-over bidder believing that a target company's managers are unduly blocking the bid, the bidder may file suite in the Delaware Chancery Court, claiming that the managers have breached their fiduciary duties, and that the managers may not be allowed to rely on their defences in order to ensure that the shareholders of the target could consider the viability or pros and cons of the proposed takeover bid. In the US, again, takeover issues fall to be considered by lawyers and judges; but lawyers who can inform the parties concerned of the hurdles and costs to which they may be subject if they allow the courts to deal with the differences put forward by targets. The best example in support of this view would be the battle of Oracle to take over PeopleSoft in which case ultimately, the managers of PeopleSoft agreed to

¹⁴¹ op. cit., at 13

¹⁴² 13 See further G W Schwert, "Hostility in Takeovers: In the Eyes of the Beholder"; 55 *Journal of Finance* (2000) 2599.

the takeover. However, many hotly contested takeover cases are still resolved by lawyers in the Supreme Court in Delaware.

By contrast, hostile take-over defence cases are dealt with by the Takeover Panel in England which consists of representatives from the London Stock Exchange, the Bank of England, the major merchant banks and institutional investors. Of course, Panel will come into the picture only when a hostile bidder launches a takeover bid and believe that the target's managers are interfering with the bid, which prompt the hostile bidder to lodge a protect with the Takeover Panel. Thus appointed and is governed by the City Code on Takeovers and Mergers. Despite the implementation of the EU's Takeover Directive which has been given a statutory status. The new law has been designed with the express objective of maintaining the features of self-regulation. In England, lawyers' role in such cases is almost nil; hostile takeovers bids and the defences thereto are treated as fact-based issues¹⁴³.

The basic differences between the US and English practice on this issue may be summarised in the following ways:

Takeover Panels in England deal with the takeover issues promptly; the Panel's Executive requires participants to give it regular updated on compliance. Panels seem to dislike a target Board's interference with a bid or advise the bidder to provide additional disclosure. Panels work on a very informal basis.

On the other hand, Delaware Courts also provide a very prompt service in response to takeover challenges; it has to be pointed out however that although the challenge hearings take

¹⁴³ See also G K Morse, Controlling Takeovers – “The Self-Regulation Option in the United Kingdom”, Journal of Business Law (1998) at 58; T Peter Lee, “Takeover Regulation in the United Kingdom, European Takeovers: Law and Practices”, Klans Hope & E Wyneersch (Eds) 1992, at 133; and Lord Alexander of Weedon, Takeovers: The Regulatory Scene, Journal of Business Law (1990) at 20.

place without much delay, and the cases is decided as soon as the oral arguments of the parties concerned are completed, the overall process usually takes weeks and sometimes months.

In England, the takeover panel is able to adjust its regulatory responses to the parties as well as the changing dynamics of business within the City of London. As the Panels are actively engaged with the parties, the Panel's Executive are able to tailor the regulatory requirements (for example, compliance conditions or waiver rules etc.) to adjust to the circumstances of each case.

Finally, in England, lawyers play rather insignificant role in Takeover Panel oversight. The Panel's members are derived from the principal shareholder and financial groups and the staff are primarily business and financial experts – in order to ensure that the Panel is business-oriented; whereas in the US, in takeover issues lawyers are very heavily engaged. Furthermore, as stated earlier that the Panel is very conscious of the fact that time is of the essence; thus, in order to minimise the time-scale of uncertainty for the target company, the Panel strictly adheres to the Takeover Code as to the time-scale prescribed by it for each stage involved in a take-over bid. Again, for the sake of resolving bidding situation as quickly as possible, tactical litigations are usually avoided.

Unless the shareholders' consent has been obtained, the Panel usually forbids the target board from initiating legal action regardless of the perceived merits of the claim in question. The Panel's decision is however subject to judicial review if a party should wish to challenge it.¹⁴⁴

It is worth noting however that in England, according to the Court of Appeal, relief, if any granted at the judicial review stages, would only be declaratory as to the future conduct of

¹⁴⁴ *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815

the parties before a Panel rather than having any reflection on the validity of the decision which has been taken.¹⁴⁵

By contrast, the US take-over market is not code-bound; there does not exist any limitation of time as to how long an offer may remain open or as the times for which a bid may be repeated. In the US, litigation as a defensive tactic is often employed by target boards. For example, when in 2003, Oracle bid for PeopleSoft, the latter's first response was to sue Oracle on the alleged grounds of deceptive business practice and tortious interference¹⁴⁶ grounds PeopleSoft persuaded the US Department of Justice to challenge the proposed acquisition on antitrust grounds. Eighteen months later the government's antitrust challenge had been rejected, and Oracle's grounds prevailed. Under the US practice, target managers are allowed to use defences as stalling tactics.

As to the litigation costs, in so far as England is concerned, this cannot be a worrying issue because hostile takeovers are hardly litigated in England; the Takeover Panel usually offers guidance to resolve the problems free of charge. Their operations are funded by a free charge in relation to formal offers and shall levy paid on significant dealing in shares on the London Stock Exchange.¹⁴⁷

By contrast, hostile takeovers in the US are litigated and litigations there are extremely expensive. Thus, in England, the balance tilts towards friendly solutions of hostile takeover incidents

¹⁴⁵ op. cit., at 841-842

¹⁴⁶ D Millstone & G Subumanian, Oracle v PeopleSoft: A Case Study, 7 September 2005, available at SSRN. Com.

¹⁴⁷ The Appendix to the Takeover Code is an instructive document which details these charges.

Whereas the English regulatory regime is proactive to responding to market developments – the US system, in general, is extremely regulatory. Furthermore, in England, the Code of Committee of the Takeover Panel meets several times a year to familiarise itself with the most important market developments, and the operation of the market, in order to determine whether any amendments to the Takeover Code would be necessary, but in the US, changes in the market place lead to litigation, and the courts' main practice would be to pronounce on the behaviour of the parties concerned in regard to hostile takeover bids.

In sum, in the US, whether to defend a bid or not is a matter of target managers, whereas in England, shareholders' decision on this matter would be a deciding factor. The principal decision-makers in the US are Congress and the Delaware Courts, in England, by contrast, informal regulation by the Takeover Panel becomes the most important factor. The English system is more informal and market-oriented than the US system.

1.5 Some of the Causes of Differences between the US and the UK Defences against Takeover Bids

1.5.1 The US position

Although the US takeover regulation came to the limelight when a number of Delaware takeover cases which came before the Delaware Courts in the 1980s. The history of such regulation may be traced much earlier. A series of New Deal banking and Securities law reforms in the 1930s were initiated in the US. Three decades later, after the emergence of hostile tender offers by virtue of the corporate law reforms and the amendments by the Williams Act to the securities laws the Congress to pass new securities laws the following year. The takeover regulation issues were then left to the Delaware courts.

The 1929 crash preceded by the early years of depression led the US to correct the incidence of market abuses of the 1920s by imposing an anti-fraud regulation¹⁴⁸ in consequence of which the 1933 and 1934 Securities Acts were passed. The 1934 Act established the Securities and Exchange Commission to serve as the principal regulatory body for regulating the market. During the same period, the then Congress also enacted important banking legislation which separated commercial banking from investment banking, and established deposit insurance to protect US savings.¹⁴⁹

One of the objectives of the banking reforms was to break the near monopoly of, for example, JP Morgan and a small group of other banks had on US corporate finance and to diminish banks' role in the governance of the largest corporations in the US.

In the US, takeovers did not enter the market in any significant way until 1954, where Robert Young launched his movement for control of the New York Central Railroad. Although Young's initiative for contract of New York contract railroad was quite successful, Wall Street believed in bidder's powers and the satisfaction of company's shareholders.

Hostile tender offers became increasingly common in the US in 1960s rising from 79 between 1956 and 1960, to nearly twice this number from 1964 to 1966¹⁵⁰ which was primarily because of the fact that the governance benefits of takeovers were defended at a governmental level. However, the Wall Street investment banks and law firms refused to represent bidders in a hostile takeover; however, some small firms became the leading takeover lawyers by taking cases which larger firms refused to deal with.

¹⁴⁸ See further the work by Skeel, op, cit at 75-106

¹⁴⁹ See also Glass-Steagall Act and the Banking Act, 1935.

¹⁵⁰ See note "Case Tender Offers", 83 Harvard Law Review, (1969) at 377

In 1967, amendments to Delaware's General Corporation Law were made and as a result of the recommendations of a "Revision Committee" of 1967, Delaware passed its most radical corporate law reforms since the end of the nineteenth century. By virtue of the 1967 amendments, the following developments occurred, in particular: (a) a sharp expansion of the powers of corporations to indemnify their directors; (b) reviews of self-interested appraised rights.¹⁵¹ These reforms were aimed at addressing concerns that were frequently raised by managers.

By the early 1960s, the pre-eminence of Delaware as the leading State of incorporation had started to decline. The 1967 amendments triggered an increase in incorporation and re-incorporation,¹⁵² but ironically, by the 1980s, judicial challenges to hostile takeovers began, and these were primarily dealt with in the Williams Act, 1968 which required disclosures by any party who had made a tender offer of more than five per cent of the target company's stock; gave the shareholders the right to withdraw stock they had initially tendered to the bidder but this right was limited to the first seven days of the offer; this Act also requires a bidder to purchase stocks on a pro-rata basis, rather than purchasing first from the shareholders who tendered first; the offer would be kept open at least for forty days.¹⁵³ The overall purpose of this Act was to prevent bidders from requiring shareholder to take a rapid decision, and making the offer available on a first come, first served basis (the so-called "Saturday night special" tender offers) by introducing

¹⁵¹ See further S Samuel, A & WK Stapleton, "Delaware's New General Corporation Law: Substantive Changes", 23 Business Law (1967) at 75

¹⁵² See, for example, W W Bratton and J A McCaleny, "The Content of Corporate Federation" (unpublished manuscript) 2009 at 21-22.

¹⁵³ See further Note in 86 Harvard Law Review (1973), 1250, 1254-60

this rule, the Act aims at preventing bidders from using tactics that they had sometimes employed. Managers of corporate entities benefited from the new rules, since they under the Act had enough time to launch their campaign against a hostile bidder.

The 1980s saw another takeover boom in the US; this was primarily for the following reasons: (a) discovery of the financing potential of high yield debt; (b) deregulation; and (c) a rather lenient approach adopted by the Reagan Administration to anti-trust regulation. Target managers were able to fight back with a variety of defensive strategies, the most important of which was implementation of poison pills pioneered by Marty Lipton of Wachtell. As poison pills seemed to be capable of shopping bidders, they challenged pills and other defences as an impermissible interference with their efforts to make a tender offer to target shareholders.

In 1985, the Delaware Supreme Court issued three important decisions that completed the US tender offer regulation. In *Moran v Horse hold International Inc*,¹⁵⁴ the Supreme Court held that poison pills were not per se impermissible, despite the fact that any discriminate between the tender offer bidder and other shareholders of the target company.

In *Unocal* and *Redlock*,¹⁵⁵ the same Court identified the initial limitations of target manager's use of poison pills and other defences. In order to defend against a takeover, managers were now required to demonstrate that the hostile offer represented a threat to the corporation and that the defence was reasonably proportionate to the threat. If the proposed takeover became clear, target would still be allowed to get the highest price for their shareholders. In other words, the take-over bid must be fair to the shareholders.

¹⁵⁴ 500 A 2nd 1346 (Del 1985)

¹⁵⁵ 493 A 2nd 946 (1985); *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2nd 173 (Del 1985)

The Delaware decisions seem to have persuaded other States also in the US and by the end of the 1980s, over forty States enacted anti-takeover legislation that protects the managers of the companies incorporated in the State. Briefly, by that time, state legislatures provided managers of target corporations with new tools for resisting takeover bids which would be considered to be unwanted.¹⁵⁶

1.5.2 The English Position

In England, hostile takeovers began in the early 1950s, which was triggered by opportunities for asset arbitrage which was really occasioned by the economic upheavals of the post-war period.¹⁵⁷ Charles Clove's takeover of shoe retailer of Sears in early 1953 is a good example. Clove realised that owing to inflation, Sears' portfolio of city central assets were substantially undervalued in its accounts.¹⁵⁸ Investor's valuation of shares was largely based on dividend yields, but this was not regulated in its share price. Thus, Clove made a tender offer directly to shareholders, which was an enormous shock for city establishments, in general.

¹⁵⁶ See further "Corporate Managers' Success in persuading state legislatures to pass anti-takeover statutes is analysed in Roberta Romano, "The Political Economy of Takeover Statutes", 73 Vanderbelt Law Review (1987) 111

¹⁵⁷ Dividend restrictions imposed by the government in the UK prompted many companies to hoard cash; see The Economist, Accounting Principles and the City Code: the Case for Reforms (1970); however, surging post-war inflation increased the value of fixed assets, see "The Shareholder Today", The Economist, December 19, (1993) at 904; see also Brian R Cheffins, Dividends as a Substitute for Corporate Law: The Reparation of Ownership and Control in the United Kingdom, Working Paper, University of Cambridge, Faculty of Law, 2005 – the value of corporate assets arose, dividend restraints caused share prices fall.

¹⁵⁸City Notes, The J Sears offer, The Times, 5 February, 1953 at 10

Although the Sears board promised to increase dividends and to revalue the firm's property to reflect its higher value, the large majority of Sears accepted Clove's offer.¹⁵⁹

Initially, the advent of the takeover bid outrages the British Business Community to such an extent that they believed that they were harmful for industry. But, things started changing when in 1953, Harold Samuel, another financier specialising in take-overs began buying shares of Savoy Hotel Ltd. Samuel's intention was to convert the Savoy's Berkley Hotel into commercial offices, and the Savoy's board arranged instead for the Berkeley Hotel to be sold to a new entity, Worcester (London) Ltd and leased back to Savoy on condition that the building would be used only as a hotel.¹⁶⁰ The voting shares in Worcester were allotted to the trustees of Savoy's Pension Fund; this proved to be difficult for Mr Samuel to convert the label into offices even if he succeeded in ousting the Board.¹⁶¹

The Savoy episode was found to be extremely controversial by the City of London; indeed, this led to an investigation of the Board of Directors' conduct initiated by the Board of Directors.¹⁶² The investigation report which was prepared by Mr E Milner Holland, QC concluded that the Savoy Directors had overstepped their power as their motive was to disable the stockholders from varying the decision of the Board of Directors; however, by virtue of not being a court judgement, that finding had no legally binding force.¹⁶³ Savoy, on the other hand,

¹⁵⁹ See City Notes: J Sears' Property Sales, The Times, 5 March 1954 at 13

¹⁶⁰ Savoy Group's New Company, The Times, 7 December, 1953, 12 December 1953 at 832-832

¹⁶¹ See LCB Gover, Corporate Control: The Battle for the Berkeley, 68 Harvard Law Review (1955) 1176

¹⁶² The Economist, Battle for the Savoy, 12 December, 1953, 831-832

¹⁶³ Gower, op. citg., at 1192-1193

sought advice from another practising barrister, Ronald W Moon, according to whom the scheme was perfectly lawful.¹⁶⁴

Then came the British Aluminium (BA) episode. In 1958, the British Aluminium was approached by two rival companies - US Reynolds Metal Company and the Aluminium Company of America (ALCOA). Without notifying their shareholders British Aluminium's Board rejected US Reynold, and agreed to deal with ALCOA, indeed BA issued about one-third stake in the company to ALCOA. But Reynolds having known this deal between BA and ALCOA, Reynolds directly made an offer to BA shareholders, which prompted BA to offer its shareholders a generous dividend increase. This act on the part of the BA obviously angered the business community particularly on the fact that ALCOA had been permitted to buy a large block of shares at an undervalued price.¹⁶⁵ Incidentally, under the BA's constitution, issuance of new shares did not require shareholders' approval.

It was the British Aluminium incident that provoked calls for takeover regulation in the UK. In July groups representing merchant banks, institutional investors, the largest commercial banks and the London Stock Exchange to develop a Code of Conduct to regulate takeover bids. Presumably, the business politics behind it was to ensure that this matter should not have been taken out of the hands of the City of London by legislation.

In the autumn of 1959, the Bank of England's Committee announced the "Notes on Amalgamation of British Businesses", which contained a series of guidelines in order to

¹⁶⁴ Ronald W Moon, Business Mergers and Take-over Bids: A Study of the Post-War Pattern of Amalgamations and Reconstructions of Companies, (1976 – 5th edition) at 128-132

¹⁶⁵See The Economist, Battle for British Aluminium, 6 December, 1958 at 913-915; see also The Economist, Choice in British Aluminium, The Economist 13 December, 1958 at 1005-1006; "British Aluminium Reveals Contract with Alcoa"; The Times, 29 November 1958; also "British Aluminium Board's Statement, The Times, 6 December, 1958

safeguard the interests of shareholders. It is important to note that the first of the Notes announced by the Bank of England contained four main principles:¹⁶⁶

- (a) that there should be no interference with the free market in shares;
- (b) that it was for the shareholders themselves to decide whether or not to sell their shares;
- (c) that the shareholders must be provided with sufficient information in order to enable them to reach a considered decision; and
- (d) That the principle of shareholder primacy and the board neutrality must be maintained¹⁶⁷.

This Note of the Bank of England seems to have the effect of demands for legislation to have intervention. However, the Notes were generally well-received by the City of London but were revised and improved in 1963¹⁶⁸ ¹⁶⁹ but the at the material time, the UK takeover market lacked the mechanics for adjudication and enforcement.

In 1967, a battle between two bidders for the control of Metal Industries Ltb (“MI”), started, but a third party bought a block of shares in the market and sold them to one of the

¹⁶⁶ the Editorial of the Times entitled “Take-over Ethics” dated 31 October, 1959 at 7. Incidentally, although the Jenkins Committee made more extensive proposals in relation to takeovers, they were never implemented. See further Board of Trade, Report of the Company Law Committee (The Jenkins Report) Cmnd 1749 (1962) at 265-294.

See, for example, “City Code of Conduct on Take-over Bids”, The Times, 31 October, 1959 at 5-6; see also The Economist, 31 October, 1959 at 440-442

¹⁶⁸ See The Revised Code on Take-over Practices, The Times, 31 October, 1963; see also Take-over Bids: Principles and Procedures, The Economist, 2 November, 1963 at 511.

¹⁶⁹ But, the Queensbury Rules (named after the drafter of the Rules, the Marquess of Queensbury) were also drafted to regulate prize-fighting, but it did not seem to have produced long-lasting effect on the City; see further The Economist 31 October, 1959 at 442.

bidders in order to allow it to secure control over the Metal Industries Ltd,¹⁷⁰ which efforts were analogous to the British Airways.

The Bank of England's first Note did not last long primarily owing to widespread evasion of it.¹⁷¹ In July 1967, Prime Minister Harold Wilson emphasised that statutory rules would not be the answer to regulate the City.¹⁷² Within days, the Bank of England's Working Party had recommended starting the drafting of a new set of take-over rules, which led to the formation of a new Code which was very shareholder-oriented, but one of its special features was that its form was rather specific.¹⁷³ It consisted of ten general principles, which were primarily based on the experience in the takeover transactions of the previous years. Generally speaking, none of the important issues in take-over bids, namely, issuing of shares by companies, disposal of material assets or entering into important contracts would not be allowed without the approval of the shareholders; and that the principle of equal treatment of shareholders must be maintained. Moreover, a body of individuals were entrusted with the task of "adjudicating" disputes arising from the application of the rules. The City Panel on Takeovers and Mergers was thus born on 27 March, 1968 – the Panel members (nine in number) would be drawn from city experts who were pro-actively involved in mergers and take-overs. There were yet certain criticisms of the new system, namely, on the grounds that aggressive bidders were still running

¹⁷⁰ The Times, Coup Behind the New Bid for MI of 8 June, 1967.

¹⁷¹ The Times, "Time for a Tough Line in the City", 10 July, 1967 at 23.

¹⁷² The Economist, (1967) at 338

¹⁷³ "A Momentous Stride forward for the City", The Times, 27 March, 1968 at 27

“coach and horses through the Code”,¹⁷⁴ but the then Parliament approved the introduction of any legislation to the City along the lines of the US, but would be prepared to enter amendments into the Code, if necessary. Interestingly enough, within the next few months, the Panel was given a full-time executive staff paid for by the City institutions. The former Attorney-General and President of the Board of Trade (Lord Shawcross) was appointed a non-executive Chairman, and an experienced take-over specialist, (Mr I Fraser from SG Warburg) was also appointed as an Executive Director-General.¹⁷⁵ An Appeal Committee was also constituted, but most importantly, the Stock Exchange was given the power to censure, suspect or expel a company from the Official List, and the Board of Trade had similar authority over licensed share dealers. Moreover, the various trade associations represented on the Working Party agreed to impose sanctions upon recalcitrant member and even to expel them from the Association concerned, if asked to do so by the Panel.¹⁷⁶ This action, in effect, introduced what may be described as a “clean-up” process of the securities market. The Code’s Preamble incorporated rather

“The Code has not, and does not seek to have, the force of law, but those who wish to take advantage of the facilities of the securities markets in the United Kingdom should conduct themselves in matters relating to take-overs according to the Code. Those who do not conduct themselves cannot expect to enjoy those facilities and may find that they are withheld.”

¹⁷⁴ “Familiar Techniques of a Quaint World in the Ear”, *The Times*, 15 June, 1968 at 13 6

¹⁷⁵ Enter the New Police Chiefs”, *The Economist*”, 1 March, 1969 at 76

¹⁷⁶ “Support Grows for City’s New Code”, *The Times*, 30 June 1969 at 19.

Despite the much welcome Code, the City had a fear that the Labour governments of the 1970s would provoke legislation intervention.¹⁷⁷

In 1971, David Rowland, a shareholder in Venesta International, started to purchase its shares heavily in the markets. But his view was that by so doing he planned to preserve the value of his investment so that the company did not face any takeover – a kind of attempt to pre-empt a takeover of the company. Eventually, he obtained a controlling interest in the company without making the bid. The Panel came to the conclusion that Rowland’s open market purchases denied the Company’s shareholders the opportunity to sell at favourable terms which Mr Rowland offered.¹⁷⁸ The Panel responded to this problem by requiring any person who purchased 40% or more of a company’s share to make a bid for the remainder, and this threshold was amended to 30% in 1974, which has still remained the practice in the City.¹⁷⁹ Unlike the US, where this kind of problems are governed by regulations and courts’ involvement is almost invariably compulsory, in the UK on the other hand, self-regulation of the dealers remained the norm and the Panel would be invited to rule on any misconduct in relation to take-overs and mergers. Sir John Donaldson, MR (as he then was) remarked on the Panel in the following way:

“The Panel on Take-overs and Mergers is a truly remarkable body. Perched on the 20th floor of the Stock Exchange building in the City of London, both literally and metaphorically it oversees

¹⁷⁷ “Who should regulate the City?”, 30 May 1974, at 1; The Times; The Stock Exchange Attacks Alarming Prejudice of Labour Green Paper”, 18 July 1974 It 21; see also Take-over Panel, Report for the Year Ended, 31 March 1975, and 1976 at 3

¹⁷⁸ See, for example, The Times, “New Problem for the Panel”, 18 December 1971, at 19

¹⁷⁹ The Times, “Revised City Code Sets Out New Rules on Mandatory Bids”, 6 June, 1974 at 19

and regulates a very important part of the United Kingdom financial market. Yet it performs this function without visible means of legal support.”¹⁸⁰

This discussion of the Code-based conduct and regulation -based on conduct would be enough to draw certain conclusions in regard to both the market.

1.5.3 Summarising the Similarities and Difference between the two systems

Both the US and the English Take-over and Merger markets share certain common features as they also differ between themselves on certain issues. The common features between them would be making of capital whether for the securities market and/or for incidental beneficiaries. Both the markets support the idea that the securities markets must be clean in order to invite investors in them, but the differences exist between them on the method(s) of keeping the markets clean; but the intentions of both the markets are the same. In both the markets, the issue of ethics in business is a point of concern. Furthermore, both the markets seem to believe in the soundness and predictability of the market; after all, without investors, securities markets would come to a standstill, in consequence of which economies will adversely suffer. But, market regulation is largely an issue of market traditions; this is where the difference in the methods of regulating securities markets arise.

Whereas the US system does with the managers of corporate entities to extent their control over the take-over regulation, primarily because corporate managers may otherwise always look for better opportunities if the state is insufficiently attentive to the managers’ needs; hence in the US, lawmakers have powerful incentives to keep corporate managers happy.¹⁸¹

¹⁸⁰ *R v Panel on Take-overs and Mergers, ex parte Datfin plc* [1987] QB 815 at 824

¹⁸¹ J Armour and David A Steel, Jr op. cit, at 42

By contrast, in England (and the UK) which maintains a loose federalist structure, corporate managers exert far less influence.¹⁸² Interestingly enough, as stated earlier that in the US, corporate managers do influence the shape of state corporate law, particularly with respect to takeover bids, yet, under the US federation Delaware law seems to be more manager-friendly than the laws of other States.

Next, that in both the jurisdictions take-over laws do not seem to differ much in substance but in the mode of regulating the markets; whereas the US looks to the formal law believing that courts would be most effective institutions to enforce the law, the English (the UK) market believes in good conduct of the players on the security markets by means of Codes of Conduct¹⁸³ - a self-regulation system by the institutional investors.

Incidentally, by the 1990s, the UK corporate governance system was in place, and indeed, the large British companies, including the financial institutions became a catalyst for the development of corporate governance, the effect of which was to provide more confidence in the minds of investors;¹⁸⁴ furthermore, their role in developing formal and informal norms which, actually work for the City of London, still govern the operation of corporate enterprise. This last practice is not so conspicuously available in the UK financial markets. Again, it was through the financial institutions and large corporate entities, in the main, that, for example, both pre-emption rights and take-over defences, the introduction of the Combined Code on Corporate Governance (which also dealt with the issues of board structure, tenure and compensation) in addition to

¹⁸², G Miller, "Political Structure and Corporate Governance: Some Points of Contrast between the United States and England", Columbia Business Law Review (1998) at 51.

¹⁸³ See also J Armour and David A Steel, Jr op. cit at 43

¹⁸⁴See, for example, Sir Adrian Cadbury, Report of the Committee on Financial Aspects of Corporate Governance ("The Cadbury Report") (1992); see also Paul L Davies, "Institutional Investors in the United Kingdom" in Contemporary Issues in Corporate Governance (D D Prentice and I R Hollands eds) (1993) at 69

strengthening of Listing Rules requiring shareholder consent for major corporate transactions occurred.¹⁸⁵

In England, a kind of co-ordinated lobbying for rule that would maximise the benefit and welfare of institutions investors are taken seriously. In this context, it ought to be pointed out that institutional investors were involved at every stage of the drafting of the Take-over Code, as these investors have a clear interest in rules which would maximise the expected points to shareholders. One can therefore maintain that England maintains a pro-shareholder approach to takeover regulation.

The Battle for British Aluminium was enough for the City to withdraw their support for any pre-management agenda – the total support must be preserved for the shareholders in corporate entities. Indeed, the Bank of England also seems to have received the message, and at subsequent Working Party meeting the City organisations became very heavily involved in drafting of Notes.¹⁸⁶ This must be accepted as a major difference between the approaches at takeovers by City organisations in England and the organisations in the US. Furthermore, this attitude towards shareholder-orientate markets has been ingrained in the mind of the City for a very long time indeed.

The pro-management take-over deals had its weaknesses also, in addition to much reliance on rules which were often in breach by the US corporate world. The New Deal reformers (1935) believed that that NYSE's regulatory efforts were inadequate in that more disclosure was needed. As part of the campaign to modify the existing practice as well as to minimise the influence of Wall Street insiders in US corporate governance, the reformers

¹⁸⁵ See generally, B Black & J C Coffee, "Hail Britannia?" Institutional Investor Behaviour under Limited Regulation"; 92 *Michigan Law Review* (1994) 1997

¹⁸⁶ See, for example, The Economist, "Rules for Take-overs", 17 October 1959 at 270

hardened up the Securities Act, providing in it, inter alia, that the primary source of securities regulation would be mandatory, and that the US Congress must have the power to oversee the behaviour of the securities market in the US securities market.¹⁸⁷

The English practice of organising the financial world had directly or indirectly shaped the US finance world in that closeness of the players on the market by concentrating in a small geographic area, known as the City of London, prompted the players on the US financial markets to concentrate in Lower Manhattan whereby they could jointly reach their decisions made more promptly than ever before, although unlike in the UK directors' fiduciary duties are still regulated by some of the States (example: Wilmington and Delaware). But the US still maintained its basic practice – management-dominated and not shareholder-dominated financial market. Furthermore, in England, the financial market may not disregard the role of corporate governance in keeping the market orderly and predictable in its movement.¹⁸⁸

In so far as the takeover bids are concerned, the US SEC's authority was limited to ensuring adequate disclosure and policing of fraud. In other words, at the end of day, it is for the courts to decide whether a bid was fair or unfair; this is where the differences emanate from a Code-based market and a regulation-based market.

The US justification for regulation-based markets has been that by so doing the courts will be final decision-makers on take-over bids, and that in their decision-making process, they will be governed by the possibility whereby the financially stronger party may compel the other

¹⁸⁷ See the Securities Exchange Act of 1934; see also Roberta Karmel, "Realizing the Dream of William O Douglas: The Securities and Exchange Commission takes Charge of Corporate Governance", 30 Delaware Journal of Corporations (2005) 79

¹⁸⁸ See further J Armour and D R Steal, *Jn op. cit.*, at 56

side to come to the court, and win the game.¹⁸⁹ This view also maintains that this system would be better than Code-based conduct system to protect the interests of individuals or a group of litigants. But one must also overview that the first bidder will have no choice other than worrying about the high costs involved in litigation. From this point of view, a decision of the Take-Over Panel would be quicker and less expensive. Furthermore, according to Coffce, judicial precedents tend to exhibit a pro-management bias owing to judges' unwillingness to give multi-million dollar liabilities on directors where their conduct is not morally reprehensible.¹⁹⁰

There exist certain similarities however between the two systems particularly in regard to the issue of proportionality of defence to the perceived threat. In *Criteria Properties plc v Stratford UK Properties LLC*. This case was eventually referred to the House of Lords, the decision of which was similar to that of the Court of Appeal but on different grounds. It is a defence against a bid to a take-over plan, the target company implements an onerous lock-up agreement, as a 191“poison pill” in the context of a defence against a prospective take-over bid. Carrwalter, LJ who rendered the leading judgment stated that a lock-up might be justifiable against a hostile acquirer who threatened the company's existing business, but also stated that the arrangement in question was disproportionate to the perceived threat; the action was directed not only at the particular bidder, but also aimed at bringing in changes in the management of the company. In *Unocal*,¹⁹² the Delaware Courts also applied the “proportionality test”.

¹⁸⁹ See further M J Bailey and P H Rubin, “A Positive Theory of Legal Change”, 14 *International Review of Law and Economics* (1994) at 467; see also K N Hylton, “Information, Litigation and Common Law Evolution”, 8 *American Law and Economics Review* (2006) at 32

¹⁹⁰ John C Coffce, Jr and Donald E Schwartz, “The Survival of the Derivative Suit: An Evaluation and a Proposal for Reform”, 81 *Columbia Law Review* (1981) 261, 316-318

191 [2009] 1 WLR 2108; see also [2004] 1 WLR 1846

¹⁹² See further B Clarke, “Regulating Poison Pills”, 4 *Journal of Corporate Legal Studies* (2004) 51

Despite the merits and disadvantages between the defence tactics between the US and English systems, the reasons for which have already been identified and critically examined, the fact remains that take-over defence tactics in any jurisdiction seem to be very much guided by the business policies practiced by a financial world over a long period of time. Thus, it would be difficult to expect any radical changes to be introduced into either of the systems discussed above.

CHAPTER 2: An Examination of the usual rationale behind Acquisitions and Mergers.

2.1 Introduction

In this chapter an attempt is made to examine the validity of the rationale that is usually put forward by an acquiring company in justifying the acquisition of the target company with a view to merging it in the future. In the business world there seems to have developed certain identifiable practices including defences against mergers in the process of Acquisitions and Mergers and this chapter thoroughly examines those processes. Fundamental objective of this chapter is to identify the rationale for acquisitions and mergers of such companies. The primitive reason for this activity is to attain the expertise of smaller companies by a larger company. But in this process everybody belonging to the latter mainly employees, management staff, shareholders and stakeholders will have same impact on each of them.¹⁹³

In the context of this chapter, it is not deemed necessary to go into details of all forms of acquisitions and mergers. But a brief account of the process has nevertheless been identified to justify the need for takeover defences. Furthermore, under the English Companies Act 2006, it is obligatory to protect the interests of minority shareholders of the company. The perception requires the need for raising defences against acquisitions and mergers.

2.2 Acquisitions

An Acquisition refers to the process of a firm or business entity acquiring another firm or a business entity. When the two companies merge to form one business entity given that the

¹⁹³ Ibid 97

previous companies cannot survive on their own, then the fore mentioned firms are said to be consolidated.¹⁹⁴

In some of the acquisition deals, the acquiring firm may buy the target company with cash, stocks or even a combination of the two. The offeror acquires all the resources of the target firm. In this process, when the acquiring firm purchases all the assets of the target firm with cash, the target firm will eventually have only cash and perhaps some debts too. Consequently, the target firm is more of a skeleton company and can eventually liquidate or invest in another type of profitable business.

It can however be hard to comprehend certain types of acquisitions. A reversed acquisition is one such type that happens in a very dramatic way. It occurs in such a way that a private firm acquires a publicly listed firm.¹⁹⁵ It happens when the private company has strong financial projections and is eager to expand, therefore purchases a skeleton of publicly listed company usually with limited assets.

Despite different organisational structures, they share a common goal. They are destined to develop a synergy that would make it worth for the joint firm to be competitors over other companies in the same business. Provided, this synergy can be achieved, then the mergers or acquisitions are likely to become a profitable venture.¹⁹⁶

¹⁹⁴Ericsson, K. Anders, Ralf T. Krampe, and Clemens Tesch-Römer. "The role of deliberate practice in the acquisition of expert performance." *Psychological review* 100, no. 3 (1993): 363.

¹⁹⁵Ravenscraft, David J., and Frederic M. Scherer. "The profitability of mergers." *International journal of industrial organization* 7.1 (1989): 101-116.

¹⁹⁶Ravenscraft, David J., and Frederic M. Scherer. "The profitability of mergers." *International journal of industrial organization* 7.1 (1989): 101-116.

2.3 The differences between acquisitions and mergers

Commonly, the terms “acquisitions” and “mergers” have been used to denote the same concept.¹⁹⁷ Even so, the truth is that there exist differences in the meaning of the terms. Whereas, acquisition means taking over another company completely, merger refers to consolidation of the businesses. In acquisitions, the overtaking firm clearly establishes itself as the eventual owner of the firm. From a legal standpoint, the target firm no longer exists. On the other side, a merger happens when two firms, notably the acquirer and the target correspond together and move forward as a single corporate entity instead of operating themselves independently.

An actual merger of matches is something rare to come by. It usually happens when one of the companies buys the other. One major reason that promotes the rationale behind considering acquisitions as mergers is the negative reputation associated with being bought. This has therefore led to deals that are more of acquisitions being considered as mergers for the sake of making the takeover appear more agreeable. But ultimately it is not pleasant as one side’s management is more dominant of the other side’s management, and they invariably lose their jobs. Another point is that often an acquisition triggers divestments.¹⁹⁸ As the acquirer may not want the entire acquired package of companies and separate themselves of the companies that do not fit into their core business.

The occurrence of Mergers is also initiated by Chief Executive Officers (CEOs) to push a decision from the shareholders when the management believes and agrees that their union is in the best interest of each of the firms. In a situation where the deal turns out to be aggressive it is

¹⁹⁷Eccles, Robert G., Kersten L. Lanes, and Thomas C. Wilson. "Are you paying too much for that acquisition?." *Harvard Business Review* 77, no. 4 (1999): 136.

¹⁹⁸ The meaning of “divestment” is the action or process of selling off subsidiary business interests or investments. p58, Oxford Dictionary of English, Oxford University Press, Second edition, 2005

considered as a hostile acquisition.¹⁹⁹ A deal may be considered as either an acquisition or a merger depending on whether it is aggressive or friendly and also on how it has been communicated. All the same, the distinction lies on how the deal has been announced and perceived by the targets firm's shareholders, board of directors and shareholders are among others.²⁰⁰

2.4 Synergy

The term "synergy" refers to those factors that create room for enhanced cost efficiency of the new business. It is usually a symbol of revenue enhancement and saving cost.²⁰¹

Unfortunately, synergy is more of an ideology than an aspect in practice. They may not talk of synergy, but that is what they want by restructuring/rationalisation etc. Its opportunities only occur in the minds of the corporate leaders and those involved in striking the deal. This has great influence on the activities of mergers as it is the base upon which a merger is formed. The CEOs and the investment bankers have been looked down upon when it comes to facilitating mergers. Investment bankers double-check the cash flow and assumptions before financing such operations. They do not want to be "locked in" to a bad loan and risk getting their investment

¹⁹⁹ Ibid pp. 201

²⁰⁰Nguyen, Han, and Brian H. Kleiner. "The effective management of mergers." *Leadership & Organization Development Journal* 24.8 (2003): 447-454.

²⁰¹Weber, John A., and Utpal M. Dholakia. "Including marketing synergy in acquisition analysis:: A step-wise approach." *Industrial Marketing Management* 29, no. 2 (2000): 157-177.

stuck. Even where there is no value to be created, the CEOs and the investment bankers who are most likely to benefit from the deal do create an image of enhanced value.²⁰²

Quite often when two companies merge, they expect to gain from several aspects of the union:

I. *Economies of scale*

This has an advantage when it comes to making purchases of the newly formed firm's operations such as stationary supplies and other orders.²⁰³ This is due to the vast size of the operating firm, which implies enhanced power of acquiring orders at lower prices and effective negotiation ability. In the long run, the firm is able to save more on cost and expenses.

II. *Improved market proximity and industry visibility*

One of the major reasons which motivate the firms to combine is that they expect to reach new markets and improve their earnings and revenues. A merge has the potential of expanding the marketing and distribution capacity of the two firms, availing the anticipated increased new sales. It has the ability to raise a company's standing with the investment fraternity.²⁰⁴

III. *Staff reductions*

A merge of two firms has an intermediate effect of the staff with regard to the management of the new firm. In the process, there is staff reduction across the firm.

²⁰² Ibid 122

²⁰³Datta, Deepak K. "Organizational fit and acquisition performance: Effects of post-acquisition integration." *Strategic management journal* 12.4 (1991): 281-297.

²⁰⁴ Where bigger firms have more advantage raising capital as compared to the small firms

The law of redundancy differs in the US between the component States. In England, the law is much stronger and this is not allowed to happen, in case they do, they have to pay the statutory legal minimum in England. CEOs/Directors often have a much better deal than others.

IV. *Reduction/Rationalisation of officer or manufacturing capabilities*

It is important to be up to date with the technological advancements. Such motives create lucrative opportunity for a larger firm to take over another firm may it be small or large but have unique technological systems and applications.²⁰⁵ The reason for the acquirer opting for this may be that in their case they have not been investing in research and development and have been paying high dividends. Any acquisition opportunity to acquire technology or new products aids them out of this problem.²⁰⁶

Even so, it is not that easy to achieve synergy as it is often perceived by the business community. Occasionally, and contrary to the business community's expectation, some of the firms fail to acquire economies of scale.²⁰⁷ It is noted that in many instances the mergers have resulted with the value of the final merger being less than the value of the two firms combined.

2.5 Types of Acquisitions

The types of acquisitions are defined principally by the kind of business structure that the acquisition exists in. In this context, one should consider more aspects, which are distinguished

²⁰⁵Nahavandi, Afsaneh, and Ali R. Malekzadeh. "Acculturation in mergers and acquisitions." *Academy of management review* 13.1 (1988): 79-90.

²⁰⁶ Ibid 67

²⁰⁷Cartwright, Sue, and Cary L. Cooper. "The psychological impact of merger and acquisition on the individual: A study of building society managers." *Human relations* 46.3 (1993): 327-347.

by the relationship that exists in between the companies that are acquiring. Acquisitions can take the following main forms; horizontal, vertical market extension, product extension, conglomeration, purchase and consolidation.²⁰⁸ The perception that usually prompts an acquiring company to take a target company over is mainly to benefit through synergy, the assets and expertise in the last company with a view to make larger profits by taking a larger share in the concerned market. In this process as stated earlier, the target company totally disappears from the market as it converts onto the other one. The latter company must be very particular about identifying the defences needed to be put forward against proposed acquisitions. Where an acquisition and takeover process derogates from the legislative requirements, it is for the Takeover Panel to consider that issue and deliver their solution on it.²⁰⁹ Thus, defences against acquisitions and takeovers have a regulatory protection mechanism. When an acquisition and takeover process becomes hostile, the issue of defences becomes ever more significant. However, before going into the details of acquisitions and takeovers, it is very necessary to briefly examine the basic characteristics of acquisitions and takeovers.

Horizontal acquisition: This acquisition refers to an acquisition where the merging corporations share the same product lines and markets. The products produced by the firm are similar and hence are said to be strategically fit to operate as a single entity.²¹⁰ Although there are examples

²⁰⁸ Ibid 112

²⁰⁹Fowler, Karen L., and Dennis R. Schmidt. "Determinants of tender offer post-acquisition financial performance." *Strategic Management Journal* 10.4 (1989): 339-350.

²¹⁰Ibid 121.

to establish that companies manufacturing different products can also merge such as Cadbury UK Limited and Kraft Foods Group Inc.

Vertical acquisition (forward or backward integration): This is an acquisition in which a company may acquire with its customer (forward integration) or similarly a company may acquire with its suppliers (backward integration).²¹¹ A more literal example is where a bakery may come together with a wheat vending firm. Two companies along the same value chain combined is a vertical acquisition, for example: a supplier and manufacturer acquiring. They are commonly done to gain economies/synergy and to increase competitive advantage within the marketplace.

Market extension acquisition: Here exists two firms dealing in the same product line but have different geographical markets. In this acquisition, the firms operate in different location, but management is centralised.²¹² The different firms serve different market locations depending upon the requirements and the needs. This means that it is a “risk reduction” strategy and that they are not dependent economically on one geographical area and also would not be vulnerable to currency movements.

Product extension acquisition: This acquisition involves firms dealing in distinct but related products, which they sell in a common market. The products can be related in various ways and aspects²¹³. They can obtain synergy by using the same distribution channels for the products.

²¹¹Hennart, Jean-Francois, and Young-Ryeol Park. "Greenfield vs. acquisition: The strategy of Japanese investors in the United States." *Management science* 39.9 (1993): 1054-1070.

²¹²Cartwright, Sue, and Cary L. Cooper. *Managing mergers acquisitions and strategic alliances*. Routledge, 2012.

²¹³ Ibid 99

Conglomeration: This particular type of acquisition is one that has its constituent dealing in totally different business areas. In conglomeration, a company owns the controlling stake in the company that is being acquired with. Conglomerates “core” business is closely associated with management. The management of very diverse types of businesses comes into this category.²¹⁴

Another form of classification that may categorise the acquisition is based on how the acquisition is financed. Each category has associated implications on the involved firms and the investors.

Purchase Acquisitions: Purchase acquisitions occur when one firm buys out the other. Considering that the sale is cash or rather through issuance of some sort of debit instrument, it is taxable.²¹⁵ This acquisition is highly preferred by the acquiring firms owing to its ability to provide them with tax benefits. Similarly, the assets that have been acquired can be written up to genuine buying price, and the disparity between the purchase price and the book value may appreciate annually, thereby, lowering the taxes payable by the acquiring firm.²¹⁶

Consolidated Acquisition: In this type of acquisition, a new firm comes into existence and the two companies are bought into one. In the end of the process, there only exists one major

²¹⁴Marks, Mitchell Lee. "Consulting in mergers and acquisitions: Interventions spawned by recent trends." *Journal of Organizational Change Management* 10.3 (1997): 267-279.

²¹⁵McDonald, Michael L., James D. Westphal, and Melissa E. Graebner. "What do they know? The effects of outside director acquisition experience on firm acquisition performance." *Strategic Management Journal* 29, no. 11 (2008): 1155-1177.

²¹⁶ Ibid 43

firm. In this case, the terms and conditions of the taxes are the same as those of a purchase acquisition.²¹⁷

Regardless of the structure or the category, that they may fall in, all the acquisitions have a common objective. They are designated to develop a synergy that combines the value of the joint firms exceeding the sum of the two firms individually. An achievement of a synergy determines the success of an acquisition.²¹⁸

2.6 Reasons for Acquisitions

When the process of execution and takeover process becomes friendly then there is hardly any need for a target company to put any defences. It may be safely presumed that making the management of the target Company and shareholder has reached a decision on this issue whereby no defences are required²¹⁹. Defences are very much required in the case of hostile acquisitions and takeovers.

Every successful acquisition is associated with certain merits in which both companies have considered towards making that decision²²⁰. The research of Sammons emphasised on the fact that the main purpose for or rather rationale behind acquisition is increasing the revenue by optimising the production standard and increasing the value of the firm to an extent that is greater

²¹⁷Roll, Richard. "The hubris hypothesis of corporate takeovers." *Journal of business* (1986): 197-216.

²¹⁸ In a case where the synergy is not achieved, the merger or acquisition is likely to fail or the acquirer themselves becomes vulnerable for a subsequent takeover by someone else.

²¹⁹Pinker, Aron, C. Smith, and Jack Booher. "Selecting effective acquisition process metrics." *Acquisition Review Quarterly* 4, no. 2 (1997): 189-208.

²²⁰ Ibid 117

than the sum of the values of the two firms combined.²²¹ Furthermore, it was also analysed that the principle fostering acquisitions is: $3 + 3 = 10$.²²² In a more realistic example we may take two firms that could be supposed as C and D, where C has a value of 3 billion and D has 3 billion British pounds. When the two firms merge, their total value becomes 6 billion. Even so, in the joining, the acquisition of a company is expected to create additional value, which is referred to as “synergy” benefits.²²³

As per the research of Chatterjee, synergy could be defined as the concepts that the esteem and execution of two organisations consolidated will be more prominent than the whole of the different individual parts.²²⁴ Synergy is a term that is regularly utilised as a part of the setting of mergers and acquisitions.

A synergy value may have three phase names; revenues, expenses and cost of capital. It is expected that when a company is acquired, higher revenue than the one including of the sum of the two firms should be achieved.²²⁵ Alternatively, the expenses are expected to go down as compared to when the two firms work separately e.g. productivity, redundancies.

Out of the three contributors to the synergy value, expenses play the most important role. Often firms acquire in order to minimise the costs resulting from avoiding recurring costs such as Accounting,

²²¹Sammons, Peter A. *Buying Knowledge: Effective Acquisition of External Knowledge*. Gower Publishing, Ltd., 2005.

²²² Ibid 119

²²³ Ibid 99

²²⁴Chatterjee, Sayan. "Types of synergy and economic value: The impact of acquisitions on merging and rival firms." *Strategic management journal* 7, no. 2 (1986): 119-139.

²²⁵ Ibid 89

Information Technology, Human Resources and also increased bargaining power²²⁶. Effective and efficient acquisitions are associated with a number of strategic reasons for acquisition amongst others strategic positioning, gap filling, organisational competencies, and broader market access.

Simple positioning implies taking advantage of opportunities that may arise and can be exploited when the firms come together²²⁷. For example, where a telecommunications company would improve its position in the market in future by acquiring a broadband service company. Firms have to develop strategies in order to take advantage of the emerging trends in the market place. Due to changing environmental factors such as technological change, and change in legislation. One of the firms may have a weakness in an area such as logistics unlike the counterpart, which may be stronger because they have more advanced technology.²²⁸

Organisational competencies involve acquiring human resources and intellectual capital would in developing creative thinking within the firm. However, there is no guarantee that strategic individuals will stay post the merger of two companies.²²⁹

Similarly, cross border acquisitions provide opportunity of internationalisation of markets but this might be restricted by the corporate direct investment legislation of the country. Beside the strategic

²²⁶ Ibid 100

²²⁷Cartwright, Susan, and Richard Schoenberg. "Thirty years of mergers and acquisitions research: Recent advances and future opportunities." *British journal of management* 17, no. S1 (2006).

²²⁸Weber, Yaakov, and David M. Schweiger. "Top management culture conflict in mergers and acquisitions: A lesson from anthropology." *International Journal of Conflict Management* 3.4 (1992): 285-302.

²²⁹Schilit, Bill. "Why e-Read? Finding opportunities in the merger of paper and computers." *The Future of Print Media* (1999).

principles and reasons behind takeovers, acquiring companies look to acquire assets on the cheap diversification, short-term growth and undervalued targets.²³⁰

Beginning with a bargain purchase, it may be quicker to acquire distinctly another firm as compared to making internal investments. For example, when a company is planning to reinstate fabrication facilities and there is a firm somewhere with the much-needed facilities that are lying futile. It would be more affordable and quicker to acquire the company with the idle facilities than construct a new one altogether. Diversification is another basic reason for takeovers.²³¹ A company may look for cash flow and maintain long-term growth and profitability. This is the case with the exhaustive firm where further growth is very unlikely owing to the lack of investment, old technology or a stagnant industry.

When target firms become oppressively undervalued, when they themselves are not exhibiting “synergy”, they tend to be potential investment targets for companies. Some acquisitions are undertaken for strategic reasons; e.g. financial reasons. A vivid example is Kohlberg, Kravis and Roberts taking over the poor performing firms and replacing their management.²³² Restructuring the company, initiating asset sales or spinoffs. Often in the case of leveraged buyouts²³³ they are under pressure from the banks via covenants in syndication documents to sell off parts of the company to get the level of debt to a much more manageable level. They ultimately in leveraged buyouts want to get

²³⁰Giacomazzi, Franco, et al. "Information systems integration in mergers and acquisitions: A normative model." *Information & management* 32.6 (1997): 289-302.

²³¹Weber, Yaakov, Israel Drori, and Shlomo Y. Tarba. "Culture-performance relationships in mergers and acquisition: The role of trust." *European Journal of Cross-Cultural Competence and Management* 2.3-4 (2012): 252-274.

²³² “Kohlberg, Kravis and Robert’s History”, <http://www.fundinguniverse.com/company-histories/kohlberg-kravis-roberts-co-history> accessed on 22 June 2016

²³³ The meaning of “Leveraged buyout” is the purchase of a controlling share in a company by its management using outside capital. p1006, Oxford Dictionary of English, Oxford University Press, Second edition, 2005

the value of the asset sales and remaining company before re listing worth more than they paid for the total company in the first place.

2.7 The stages of acquisitions

Stage 1: Pre Acquisition Review

An assessment of the firm's financial performance is usually important in determining whether an acquisition is profitable. Where a firm may foresee future difficulties in maintaining core competencies, return on capital, market share or any other performance element, then acquisitions would be a recommended resolution.²³⁴ This is not necessarily the case, companies may employ a "company director" or "turnaround specialist" to bring a company back from the brink²³⁵.

Similarly, it is important for a firm to consider its value and whether the firm has "hidden" assets²³⁶. It is upon the management of the firm to maintain or improve the value of a firm, if they fail to do so then they are not achieving synergy and they may find themselves on the receiving end of an acquisition bid. Consequently, any prior measures that should be undertaken by a firm include valuation of the company including assets difficult to value such as brand names, undervalued property or new products about to come on stream. Further, should the

²³⁴Lodorfos, George, and Agyenim Boateng. "The role of culture in the merger and acquisition process: Evidence from the European chemical industry." *Management Decision* 44.10 (2006): 1405-1421.

²³⁵Pallonen, Unto E., James O. Prochaska, Wayne F. Velicer, Alexander V. Prokhorov, and Nelson F. Smith. "Stages of acquisition and cessation for adolescent smoking: an empirical integration." *Addictive behaviors* 23, no. 3 (1998): 303-324.

²³⁶ Hidden assets are intellectual property etc.

acquisition be appropriate the target should also gauge whether the activity would increase the value of the firm.²³⁷

The major focus of the acquirer in the first stage is to gauge whether certain growth targets over a period of time are achievable. As for instance, an acquiring firm would want to see whether it is possible to have 20% growth in the next few following years.²³⁸ If that were not the case, then the acquisition team would identify and establish criteria through which the acquiring firm can grow by a way of acquisition. An effective plan is highly essential to the pre-acquisition stage. It should define the way in which the growth will be achieved through an acquisition.²³⁹ This may entail the firm collecting data on the target. At this early stage it is possible that a number of targets may be identified for initial tracking /investigating further.

Stage 2 - Search and Screen Targets

In this phase, the major business involved in the process for active search of possible takeover candidates. The target companies have to accomplish a set of criteria so that the Target Company becomes a “good strategic fit” with the acquiring company. For instance, the target and facilitators of performance may complement if the acquisition is friendly.²⁴⁰ The ability to be compatible and fit should be assessed across a range of criteria depending on the size, type of business, capital structure, organisational strengths, core competencies, market channels, etc. The acquiring company undertakes

²³⁷Stevens, Donald L. "Financial characteristics of merged firms: A multivariate analysis." *Journal of Financial and Quantitative Analysis* 8.2 (1973): 149-158.

²³⁸ Ibid 118

²³⁹Ibid 142

²⁴⁰Bruner, Robert F. *Applied mergers and acquisitions*. Vol. 173. John Wiley & Sons, 2004.

the process of search and screening by conducting through research and evaluation.²⁴¹ This identical process can also be done by an investment bank, which will search for takeover candidates because they want to finance the deal and obtain substantial advisory fees in a protracted takeover battle. Alternatively, they may employ outside advisers to identify targets. These are often revealed to the top managers of their “lead bank” who they require to help by putting the financial package together as the syndicate leader. This information is highly confidential and involves “Chinese walls” with other areas of the bank to prevent insider-dealing occurring. However, it is also evident that “Chinese walls” may not work if insider dealing is allowed.²⁴²

Stage 3 - Investigate and Value the Target:

The third phase involves the performance of a comprehensive and detailed analysis of the target company. At this point, the acquiring company is concerned with making sure that the Target Company is actually a good fit with the acquiring company. This requires a comprehensive assessment of operations, strategies, financials, and other aspects of the Target Company. The comprehensive review process is known ‘due diligence.’²⁴³ In particular, first phase of the process, “Due Diligence” is commenced immediately when the target company is proposed and selected. The focal objective is to identify different synergy values that can be realised through the Target Company. The investment

²⁴¹Larsson, Rikard, and Sydney Finkelstein. "Integrating strategic, organizational, and human resource perspectives on mergers and acquisitions: A case survey of synergy realization." *Organization science* 10.1 (1999): 1-26.

²⁴²Braem, P. Boyes. "Acquisition of the handshake in American Sign Language: A preliminary analysis." In *From gesture to language in hearing and deaf children*, pp. 107-127. Springer Berlin Heidelberg, 1990.

²⁴³Forstmann, Stephan. "Managing cultural differences in cross-cultural mergers and acquisitions." *DE GRUYTER STUDIES IN ORGANIZATION* (1998): 57-84.

bankers are often involved at the beginning advising the acquirer company of the viability of the takeover venture.²⁴⁴

One of the significant aspects of “due diligence” is the valuation of the target company.²⁴⁵ In the preliminary phases, the acquirer determines the total value for the joint company. The value of the acquiring company is determined as well as all other costs associated with. The calculation can be summarised as follows:

Value of Our Company (Acquiring Company)	xxx
Value of Target Company	xxx
Value of Synergies per Phase I Due Diligence	xxx
Less Cost (Legal, Investment Bank, etc.)	xxx
Total Value of Combined Company	xxx

Controversies exist as to effectiveness of the due diligence when it is one of certain jurisdictions which do not believe in transparency.

Stage 4 - Acquire through Negotiation

This stage involves the process of negotiating acquisition. Questions formulated will be used to develop a negotiation plan for the transaction:

- How much resistance will be encountered from the Target Company?
- What are the benefits for the Target Company?

²⁴⁴Weber, Yaakov, and Israel Drori. "Integrating organisational and human behaviour perspectives on mergers and acquisitions: Looking inside the black box." *International Studies of Management & Organisation* 41.3 (2011): 76-95.

²⁴⁵ Ibid 110

- What are the benefits the acquiring company is trying to achieve as this may influence any strategy?
- What will be the acquiring company's bidding strategy?
- How much is offered in the first round of bidding?

The general approach used to acquire another company for the management of both companies is to reach on an agreement through which a negotiated merger is to be formulated.²⁴⁶ The negotiated arrangement is often known as a "bear hug." In situations where opposition is expected from the target, the acquiring firm will obtain a limited interest in the target; otherwise referred to as a "toehold position."²⁴⁷ This toehold position ensures that the target company initiates negotiation without sending the target into panic mode. Sometime acquirers build up a holding quietly just below the threshold and after which they are required to launch a bid.²⁴⁸

In situations where the target is expected to push over any takeover attempt, the acquiring company will advance a tender offer directly to the shareholders of the target, avoiding the target's management. Tender offers are bear in mind the following:

- The price presented is above the target's prevailing market price.
- The offer applies to significant and outstanding amount of shares of stocks.
- The offer is open for a definite period of time; and,
- The offer is made to the public shareholders of the target.

²⁴⁶Berger, Allen N., et al. "The effects of bank mergers and acquisitions on small business lending." *Journal of financial Economics* 50.2 (1998): 187-229.

²⁴⁷Hogarty, Thomas F. "The profitability of corporate mergers." *The Journal of Business* 43.3 (1970): 317-327.

²⁴⁸ Ibid 133

The tender offers are generally more expensive than negotiated Acquisition's due to the opposition of target management and the fact that the target is vulnerable and are likely to attract other bidders.

The other vital element when two companies merge is Phase II of the Due Diligence process. As mentioned earlier, Phase I Due Diligence starts when the acquirer chooses the target company. The Phase II Due Diligence sets off an intensive negotiating process that will ultimately lead to the takeover. The merger and acquisition involving the two companies will launch a very detailed review to determine if the projected merger materialises.²⁴⁹ This requires a very detailed review of the target company - financials, operations, corporate culture, strategic issues, etc. Statutory accountants carrying out this process can be deemed guilty of "professional negligence" if something later comes out of the woodwork.

Stage 5 - Post Acquisition Integration:

The two companies make an announcement concerning the agreement to merge the two companies in an instance of successful negotiation. The contract is completed in a formal merger and acquisition agreement.²⁵⁰ This results to the fifth and final phase of the process represented as the merger of the two companies.

The companies are different in terms of culture, information systems and strategies. This makes the Post Merger Integration Phase the most "complicated" one in the process. The two companies are brought together in order to work as a single unit. This requires widespread planning and design

²⁴⁹Keeton, William R. "Do bank mergers reduce lending to businesses and farmers? New evidence from tenth district states." *Economic Review-Federal Reserve Bank of Kansas City* 81.3 (1996): 63.

²⁵⁰Datta, Deepak K. "Organisational fit and acquisition performance: Effects of post-acquisition integration." *Strategic management journal* 12.4 (1991): 281-297.

throughout the entire organisation.²⁵¹ This may be completed over quite a long timeframe. The integration process usually passes through three stages which are full, moderate and minimal levels. At the full level, the functional areas include operations, marketing, finance, human resources etc. In this level, all these areas are merged into a single new entity. The new company will adopt the best practices used by either of the companies. At the second level, major functions or processes like production and management are merged together. The strategic decisions are centralised in a single company, but day to day operating decisions will remain independent. Unlike the two levels already described, at the final stage it involves the selection of particular functions that are merged together in order to minimise redundancies. At this level, the strategic and operating decisions are decentralised. In a situation of successful post-merger integration, synergy values should be generated. It is important to understand the realities of acquisitions before undertaking a formal acquisition programme.²⁵²

One should also consider that whether integration always takes place in completing a merger process, in view of failure of mergers in England this issue deserves some attention.

2.8 Strategic Alliances

A strategic alliance is simply an agreement or a consensus between two or more individual companies, launched so as to develop common goals and as well secure common interests.²⁵³ An example of an alliance is an “airline alliance” which is defined as agreement between two or more airlines on a significant level to advance their goals and protect their

²⁵¹ Ibid pp. 22

²⁵² Ibid pp. 23

²⁵³ Ibid pp.24

interests. The companies involved maintaining their legal independence, particularly, the singled out airline alliances are the: Star Alliance, One world and Sky Team. Alliances do avail a communication network and convenience for the international persons. As a result of their legal independence these arrangements cannot be deemed to be an acquisition.²⁵⁴

2.9 Critical Analysis on the Types of Take Overs

2.9.1 Friendly-Takeovers

Morck, Randall and Robert in their research highlighted the fact that, acquirer prior to proposing a bid consults the board of directors of the target company.²⁵⁵ With regards to whether the offer suits the interest of the shareholders or not, the board makes a decision to accept or reject the offer. The research further emphasised on the fact that, an ideal situation is formulated when the board feels that the offer made meets the interests of the shareholder and protect the stakeholders of the target company, it recommends to the shareholders to accept the bid.

This group of takeovers are common for private corporations in which the board is formed by the shareholders.²⁵⁶ Coupled with this fact, the agreement between the acquirer and the target company is easily as well as quickly manoeuvred. In that case, when a bid is proposed, the board

²⁵⁴King, David R., et al. "Meta-analyses of post-acquisition performance: Indications of unidentified moderators." *Strategic management journal* 25.2 (2004): 187-200.

²⁵⁵Morck, Randall, Andrei Shleifer, and Robert W. Vishny. "Characteristics of targets of hostile and friendly takeovers." In *Corporate takeovers: Causes and consequences*, pp. 101-136. University of Chicago Press, 1988.

Ibid 136

²⁵⁶Ranft, Annette L., and Michael D. Lord. "Acquiring new technologies and capabilities: A grounded model of acquisition implementation." *Organization science* 13.4 (2002): 420-441.

evaluates the provisions and whatever decision they arrive at serves as a stand of the company's shareholders.

2.9.2 Reversed-Takeover

Weidenbaum and Stephen presented research opposite to the above discussion by emphasising on the fact that, a reversed takeover is only implemented when a private company acquires or merges with a public company.²⁵⁷ This happens when a large company is influenced, with an intended aim of the private company floating itself effectively while at the same time avoiding some of the experiences and time consumed in conventional Initial Public offering (IPO). Reversed takeover warrants special attention when it comes to due diligence Merger. Reversed takeovers are a very popular way for small start-up companies to "go public" without all the trouble and expense of an Initial Public Offering (IPO).²⁵⁸ Reverse mergers, as the name implies, work in reverse whereby a small private company acquires a publicly listed company (commonly called the Shell) in order to quickly gain access to equity markets for raising capital. This approach to capitalisation (reverse merger) is common practice with Internet companies like stamps.com, photoloft.com, etc.

For example, I charge it; an e-commerce company did a reverse merger with Para-Link, a publicly listed distributor of diet products. According to Jesse Cohen, CEO of I charge it, "an

²⁵⁷Weidenbaum, Murray, and Stephen Vogt. "Takeovers and stockholders: Winners and losers." *California Management Review* 29, no. 4 (1987): 157-168.

²⁵⁸ Ibid 138

IPO would have cost the company 3 -5 million US\$ and taken over one year. Instead, the company acquired a public company for \$ 300,000 and issued stock to raise capital”.²⁵⁹

Quite a few of these transactions happened in the 1960s when plantation owning companies were stripped of assets by newly independent governments leaving London Stock Market listings with no assets in them.

The problem with reverse mergers is that the shell company sells at a serious discount for a reason; it is riddled with liabilities, lawsuits, and other problems. Consequently, very intense due diligence is required to "clean the shell" before the reverse merger can take place. This may take six months. Another problem with the shell company is ownership. Promoters who hold the stock in “street name” which mask’s the true identity of owners sometimes push cheap penny stocks. Once the reverse merger takes place, the promoters reject this idea and the stocks’ price drastically drops down. Therefore, it is absolutely critical to confirm the true owners (shareholders) of shell companies involved in reverse mergers.

2.9.3 Back Flip Takeover

A back flip takeover refers to any kind of takeover in which the acquirer turns itself into a subsidiary of the target company. This type of takeovers is uncommon among raided firms and normally occurs when the acquired company is far better or rather larger than the acquiring company.

²⁶⁰ One reason that keeps firms away from certain defence strategies such as this, is the after implementation benefit. It is essential to ensure that when singled out the diverse defence strategies,

²⁵⁹ Joseph McCafferty, “Shell Games: Reverse mergers are making a comeback, but so are the scam artists that peddle them” <http://www.cfo.com/printable/article.cfm/2987622>> accessed 19 November 2015

²⁶⁰More information in: <<http://www.businessdictionary.com/definition/backflip-takeover.html#ixzz1kgtTBFPJ>> accessed 12 March 2016

there are certain issues such as whether they are their timely, worth the effort and monetary value that must be considered. This will be indeed being helpful in determining the kinds of funding option that will precede the takeover defence adopted.

2.9.4 Hostile-Takeover

In the case of hostile takeovers defences become very important. A hostile takeover raises issues relating to corporate governance. In this scenario, the defence mechanisms that have developed to challenge the takeover are considered in detail. These defence strategies are complex corporate weapons and have the sole aim of securing the target companies from a hostile acquisition. Despite of their popularity and implemented generally, many of these defence tactics remain controversial²⁶¹. According to the advocates of these anti-takeover techniques, they heighten the ability of the target company's management to extract higher prices for the shares or see off the bidder and also to protect the labour contracts and pensions of the employees in the target company.

In regard to the laws of the State, firms in the United States, through the boards of directors of target companies often implement the defence techniques when responding to hostile tender offers. One such defence is "White Knight" where the company seeks a friendly acquirer. Others are "poison pill", "crown jewel", the selling of the company's most valuable assets, "green mail", paying off the hostile acquirer for accepting to quit, "Pac Man", and "Golden Parachute".²⁶² Further illustration of these concepts has been presented in the third chapter of the thesis.

²⁶¹ Franks, Julian, and Colin Mayer. "Hostile takeovers and the correction of managerial failure." *Journal of Financial Economics* 40, no. 1 (1996): 163-181.

²⁶² Ibid 142

2.10 Due Diligence

In general, business practice the target company usually do not carry out due diligence over the acquiring company but this issue needs a thorough review. The term “due diligence “is one with diverse meaning and varies according to the context in which it is applied.²⁶³ However, in this case it shall be regarded within the context of corporate takeovers. An ordinary definition within the legal framework refers to it as a measure of discretion and prudence, regarding an activity in the way it is carried out by a sound and circumspect person, and its measurement is based on relative facts surrounding the situation and not on any absolute standards. It can also be said to be an analysis undertaken by or on behalf of the investors by their statutory accountants with the intention of understanding the prospects of success in an investment with respect to issues such as operation and management, and the verification of material facts.²⁶⁴ To a potential acquirer, due diligence would mean the surety of reaping from the investments they have made.

A common example of due diligence in various industries is the process through which a potential acquirer evaluates a target company or its assets for acquisition. The term "due diligence" first came into common use as a result of the United States' Securities Act of 1933.²⁶⁵ In Section. 11 of this Act, referred to the "Due Diligence" defence, which could be used by broker-dealers when accused of inadequate disclosure to investors of material information with

²⁶³Angwin, Duncan. "Mergers and acquisitions across European borders: National perspectives on pre acquisition due diligence and the use of professional advisers." *Journal of World Business* 36, no. 1 (2001): 32-57.

²⁶⁴ Ibid 145

²⁶⁵Larsson, Rikard, and Sydney Finkelstein. "Integrating strategic, organizational, and human resource perspectives on mergers and acquisitions: A case survey of synergy realization." *Organization science* 10.1 (1999): 1-26.

respect to the purchase of securities.²⁶⁶ As long as broker-dealers exercised "due diligence" in their investigation into the company whose equity they were selling, and disclosed to the investor, they would not be held liable for non-disclosure of information that was not discovered in the process of the investigation.²⁶⁷

The entire broker-dealer community quickly institutionalised, as a standard practice, the conducting of due diligence investigations of any stock offerings, in which they were involved. Originally, the term was limited to public offerings of equity investments, but over time it has come to be associated with investigations of private offerings as well.²⁶⁸ The term has slowly been adopted for use in other situations.

The framework of due diligence can be categorised into various classes notably: Production Audit, Financial Audit, Macro-environment audit, Marketing audit, Information Systems Audit, Production Audit, Management Audit, Legal or Environmental Audit and recently Compatibility Audit and Reconciliation Audit.²⁶⁹ If the failures are to be avoided then the concept of shareholder value analysis should be associated with due diligence.²⁷⁰ Two audit areas have surfaced with the passage of time, which are referred as, compatibility audit and

²⁶⁶Helfat, Constance E., and Margaret A. Peteraf. "The dynamic resource-based view: Capability lifecycles." *Strategic management journal* 24.10 (2003): 997-1010.

²⁶⁷Barkema, Harry G., and Freek Vermeulen. "International expansion through start-up or acquisition: A learning perspective." *Academy of Management journal* 41.1 (1998): 7-26.

²⁶⁸ Ibid 99

²⁶⁹Harvey MG and Lusch RF, "Expanding the Nature and Scope of Due Diligence", *Journal of Business Venturing* 1995, 10: 5–21. Kroener PH and Kroener MH, "Towards more successful ", *International Journal of Technology Management* 6(1/2) 1991: 33–40

²⁷⁰Gillman, Luis *Due Diligence, a Strategic and Financial Approach* (2nd ed. 2010). Durban: LexisNexis. ISBN 9780409046991

reconciliation audit. The compatibility audit is charged with the responsibility of overseeing the strategic components of a transaction and especially those that sum up shareholder value. The reconciliation audit unites other audit areas through a formal valuation, so as to determine whether there will be an increase in value for the shareholders.²⁷¹

In any potential business investments, due diligence process has a varied framework each depending on the nature of the company, even though, the vital areas of concern do include the legal, labour, tax, IT, financial, environment and market situation of the company. In addition to intellectual property, insurance and liability coverage, real and personal property, debt mechanism review, employee benefits and labour concerns, immigration, and international transactions.²⁷²

In acquisitions the role of due diligence entails understanding of all the obligations conferred on a firm. These are debts, long term customer contracts, warranties, leases, employment contracts, distribution agreement, pending and viable law suits and compensation agreement amongst others. Due diligence, therefore will answer many diverse questions raised by a potential investor. It is supposed to investigate and appraise a business investment; it denotes a general duty to exercise care in any business dealing; as such, it involves carrying out a detailed analysis into all the significant aspects of a target company in the past, current and in the future.²⁷³ Due diligence sounds extraordinary, perhaps owing to the process that has to be

²⁷¹Sirower, Mark L. *The synergy trap: How companies lose the acquisition game*. Simon and Schuster, 1997.

²⁷²Gary M. Lawrence, *Due Diligence in Business Transactions*, (Law Journal Press 1994, updated as needed). ISBN 978-1-588-1.

²⁷³Hayward, Mathew LA. "When do firms learn from their acquisition experience? Evidence from 1990 to 1995." *Strategic management journal* 23.1 (2002): 21-39.

undergone though it. Eventually it transforms into an opinion about the prospective business and ensuring that the acquirer is not duped.

Even so, in some instances due diligence is hard to comprehend and create difficulties in an acquisition and merger process. Investing in software companies is a controversial issue. Getting into a deal over something that is one cannot see or touch and one is yet to invest fortune into it.²⁷⁴ Any ordinary investor without technical knowledge and experience in software would view it as a viable investment. It is there a requirement to have due diligence programs in place to ensure “effective and efficient” transactions.

It seems that due diligence merely involves understanding of a target firm in all aspects even though it requires a pool of professionals to examine the entire process. These professionals may be accountants, investment bankers, lead and co-investors, corporate development staff, bank loan officers and lawyers who may be required to undertake an independent due diligence.²⁷⁵ Quite often the “management of the target” assist the concerned individuals that are apprehensive by providing due diligence information that might be relevant to this. There are considerable risks if the acquirer takes any information provided by target at its face value, as they may have vested interest in seeing the target sold.

The emergence of a potential business opportunity can be the commencement of a due diligence process.²⁷⁶ It is characterised by the collection of varied data from different sources and the commencement of the due diligence evaluation which continues until the final decision is made to acquire or reject the project. Prior to the signing of a binding contract, a comprehensive

²⁷⁴ Its creativity and development lies in ideas of the employees of that software firm.

²⁷⁵ Ibid 140

²⁷⁶Porter, Michael E. "From competitive advantage to corporate strategy." *Readings in strategic management*. Macmillan Education UK, 1989. 234-255.

due diligence has to be conducted. This is done after the involved parties have considered over the proposed deal and have consented to proceed with the deal.

In conducting a due diligence, the professionals provide a checklist of all the required and relevant information required by the possible acquirer on the target.²⁷⁷ It is the obligation of the target firm that the management prepares and provides some of the information such as audited financial statements, business plans and other documents. Interviews and site examinations are conducted, where necessary. Of value to the process to acquire information are the suppliers, trade organisations, industry experts, receivables and market research firms among others. Receivables and bad debt analyses are particularly important and of interest to the acquirers lending banks.

The degree to which the due diligence might be required to be conducted is not within an arguable range as the factors considered are many and vary with the situation. These factors may include initial experiences, the chances of closing a deal, the magnitude of a transaction, cost factors, risk tolerance, and availability of resources. It may not be possible to gather all the information about a particular firm.²⁷⁸ It is recommended that the acquirer gains enough information at an appropriate level to allow a well informed decision, so as to keep any possible risks at bay. Unnecessary an excessive due diligence on a target firm is also not advisable as it may turn away the target from engaging in the deal. It also causes what is known as “analysis paralysis” which hinders the completion of a transaction or allow for time in which a competitive offer may materialise. Accordingly, due diligence should be conducted with the aim of covering

²⁷⁷Haleblian, Jerayr, and Sydney Finkelstein. "The influence of organizational acquisition experience on acquisition performance: A behavioral learning perspective." *Administrative Science Quarterly* 44.1 (1999): 29-56.

²⁷⁸Roodman, David. *Due diligence: An impertinent inquiry into microfinance*. CGD Books, 2012.

the most critical aspects, accompanied by a sensible level of trust in the target company's honesty.

The completion of due diligence is a by-product of various factors such as the circumstances surrounding the deal and agreements involved. Numerous preliminary agreements identify the time line by which the due diligence should be conducted. The period under which an offer is usually open is short and therefore the acquirer should consider allocating adequate time for the due diligence process. The professional undertaking of the investors should give due attention to the various priorities if all the due diligence objectives are to be achieved. For instance, when pursuing a company for a new product that is yet to introduce into the market, the current status of any projected completion date of the product is important. The product may, for example, in the case of new pharmaceutical products have to be cleared through any clinical testing stages in both the US and England in order to be sold.²⁷⁹

After understanding the entire process of due diligence, come the costs involved in the process. Often the bankers financing a transaction run their own financial models checking cash flow assumptions or checking any asset sale plans within a particular timeframe. Therefore, the banks conduct their own "risk analysis" of the takeover to ensure they are not making a bad investment.

For due diligence process to accomplish its tasks, it has to harmonise with other aspects of the deal. This simply implies that it should avoid anything that might sabotage the deal such as "confidentiality". Particular activities in the due diligence process have a tendency to infringe on

²⁷⁹ Ibid 124

the confidentiality expected.²⁸⁰ In many situations, the experts involved in the due diligence process have to go on the basis of customers' feedback on the nature of that satisfaction of the targeted product. More often than not it has triggered networking rumour concerning the sale of the company. It is uncommon that an acquirer during the due diligence process realises that the target is near to liquidation. They walk away from the target only to go back 6 months later to “cherry pick” the parts of the company buying them from the liquidator at a much more advantageous price.

The success or failure of a transaction with respect to due diligence is an idea that cannot be guaranteed. Having a well conducted due diligence plan in place does not mean an automatic success, but merely improves the chances of success. Risks to business deals can never be completely being eliminated and that explains why success can never be assured. Would failing to conduct due diligence in turn be a criminal offence? The answer to this question is very obvious in the framework of the contemporary litigious world. One may be sued against just any issue and failure from undertaking an adequate procedure.²⁸¹ The parties concerned may be surprised when the their clients, investors, customers, suppliers, employees and other stakeholders sue them for failure to have in place proper due diligence programme or pursuing a liability that was imprudently assessed by the due diligence. Poor due diligence carried out by

²⁸⁰Healy, Paul M., Krishna G. Palepu, and Richard S. Ruback. "Does corporate performance improve after mergers?." *Journal of financial economics* 31.2 (1992): 135-175.

²⁸¹ Ibid 105

accounting firms on behalf of the acquirer may subsequently result in professional negligence cases.²⁸²

2.10.1 Application of Due Diligence

Evaluating the viability of any proposed acquisition, it would be useful to go through the following stages: A careful analysis of the target company should make it clear that an investment in that company likely to fulfil the investment needs and objectives. The management of the offeror company undertakes an insightful research into the viability of making their investment in the target company before proceeding to make the offer to the company. This procedure is known as “investment fit”²⁸³. On the other hand, a strategic fit is used to represent the plans, objectives and goals formulated by both companies intending to merger and carrying out their activities together. The managements combine their efforts by advancing their weaknesses and strengths in terms of running the operations of the firm. The functioning of the acquirer undertakes the spirit of synergies to operate towards achievement of the set goals. Strategic fit therefore details a situation where the strategies set by the two merging companies tally with one another to ensure the smooth combination of activities despite functioning independently²⁸⁴. Acquiring company is also carry out a marketing fit exercise which involves a process of determining the way services and products produced by both the companies are able

²⁸²Healy, Paul M., Krishna G. Palepu, and Richard S. Ruback. "Does corporate performance improve after mergers?." *Journal of financial economics* 31.2 (1992): 135-175.

²⁸³Lebedow, Aaron L. "M&A: Due Diligence: More than a financial exercise." *Journal of Business Strategy* 20, no. 1 (1999): 12-14.

²⁸⁴Angwin, Duncan. "Mergers and acquisitions across European borders: National perspectives on preacquisition due diligence and the use of professional advisers." *Journal of World Business* 36, no. 1 (2001): 32-57.

to complement with one another in the market. In a marketing fit, the management is charged with determining the way of combining the various aspects attached to the marketing strategies of the firm such as promotions, prices, matching the demand of the market etc. This is also essential to determine the way the operations of the two merging firms can be carried out together without compromising the normal activities. The management in this case determines whether the different departments of the firm are able to function together to achieve the desired goals. This exercise is known as “operating fit”²⁸⁵.

When the management of the merging companies evaluates the existing management of the two companies and identifies the desirable talents or expertise that can run the operation of the business after the mergers. The management therefore will be able to work together if the leadership styles, strategic thinking and ability to adopt change by both firms are compliant.²⁸⁶

Often one side’s management is stronger in an acquisition and in that event a large numbers of redundancies will occur. There is no guarantee that the target company’s management will stay unless they are satisfied with continuing career prospects and financial compensation. An acquiring company must also do what is known as a “financial fit” to examine the validity of the proposed acquisition. This involves looking at whether the sales, profitability, return on capital; cash flow of the two firms can be improved to work together towards achievement of similar objectives.

The aspect of Due diligence is broad and specific. It goes beyond the functional areas such as the finance, production, human resources etc. This is very vital since due diligence is particularly meant

²⁸⁵Harvey, Michael, and Robert F. Lusch. "Beyond traditional due diligence for mergers and acquisitions in the 21st century." *Review of Business* 19, no. 3 (1998): 17.

²⁸⁶ Ibid 117

to highlight all the major risks related to the proposed merger. The areas of risk that requires investigation are markets, customers, competition etc.²⁸⁷

The due diligence process must be aggressive in terms of collecting as much information as possible concerning the target company. In other instances, the process requires some undercover work, such as sending out people with false identities to verify vital issues. It is important that most information be collected in order for due diligence to work. This information is: financial records, tax records, regulatory (compliance), debt records, asset records and unemployment.

The failure by an offeror to conduct due diligence can be disastrous. The status of the acquiring company can be severely damaged if a publicly announced merger is written off.

The merger between Hospitality Franchise Systems Incorporation and Comp-U-Card (CUC) International Inc exhibits an instance where situations may go wrong. A few months after the merger was announced, it was disclosed that there were considerable accounting discrepancies. After the discovery, the newly created company, Cendant, lost \$ 14 billion in market value. In the late 1998, Cendant's Chairman had tendered his resignation, investors had filed over 50 lawsuits, and nine of fourteen Directors for CUC had also tendered their resignation.²⁸⁸

The process of due diligence is extremely crucial for uncovering potential problem areas, revealing risks and liabilities, and to ensure that there are no surprises after the merger is announced.²⁸⁹ However, in the current rapid business environment, some companies may overlook the due diligence

²⁸⁷Woodcock, C. Patrick, Paul W. Beamish, and Shige Makino. "Ownership-based entry mode strategies and international performance." *Journal of international business studies* 25.2 (1994): 253-273.

²⁸⁸ David J. Morrow "Cendant finds \$115 Million Accounts Error", 16 April 1998, The New York Times, <http://www.nytimes.com/1998/04/16/business/cendant-finds-115-million-accounts-error.html> accessed 10 May 2016

²⁸⁹Chatterjee, Sayan, et al. "Cultural differences and shareholder value in related mergers: Linking equity and human capital." *Strategic management journal* 13.5 (1992): 319-334.

process and make an offer based on competitive intelligence and public information. This can be very risky. The statistics below show the trend in due diligence processes.

Results of a Survey on Due Diligence by Braxton Associates:²⁹⁰

Duration of Due Diligence - Successful Mergers	4 to 6 months
Duration of Due Diligence - Failed Mergers	2 to 3 months

2.10.2 Financials

The major goal of due diligence is to eliminate distortions from the financial statements of the target company. This is essential so that the acquiring company can establish a more sensible value for the target.²⁹¹ There are several issues pertaining to the Balance Sheet as outlined below:

- Understating of liabilities like pensions and allowances for bad debts.
- Low quality assets - what are the relative market values of assets? Some assets may be overvalued or undervalued.
- Hidden liabilities, such as contingencies for lawsuits not recognised.
- Overstatement of receivables - receivables may not be collectable, particularly inter-company receivables. Level of bad debts/possible writes offs.
- Overstatement of inventories - increasing levels of stock over time indicates obsolescence and poor marketability. The application of LIFO reserves may lead to distortion of inventories.

²⁹⁰ Ravindhar Vadapalli "Mergers Acquisitions and Business Valuation", p19, First Edition, Excel Books, New Delhi, India (2007)

²⁹¹Dyer, Jeffrey H., and Harbir Singh. "The relational view: Cooperative strategy and sources of interorganizational competitive advantage." *Academy of management review* 23.4 (1998): 660-679.

- The valuation of short-term marketable securities – in situation where the Target Company is holding marketable securities, is they properly valued? If the target is holding investments that are not marketable, are they overstated?

2.10.3 Intangibles

Some of the intangibles like the brand names can be extremely undervalued. Brand names can be the reason for a takeover in the first place as a less utilised brand name can be put on to other products. In most cases, significant differences exist between book values and market values. If the two are not considerably different, then due diligence should conduct insightful research to ensure that there is no manipulation of values. Similarly, the Income Statement should comprise of "quality" earnings. The integrity of the income statement is determined by the consideration given to cash earnings and the accrual earnings.²⁹²

The mergers are in most cases projected towards reduction of costs, while the process of due diligence might result in numerous upward adjustments to earnings for the target company. This is particularly true where the target company is a private company and the excesses are common. The examples of this situation include:

- The officer's salaries are excess in respect to the work performed.
- High salaries with high pension commitments.
- Bonuses, expensive travel, and other perks.
- The vehicles and other assets that are available are said to be unnecessary.

²⁹²Trautwein, Friedrich. "Merger motives and merger prescriptions." *Strategic management journal* 11.4 (1990): 283-295.

- When family members are on the payroll of the company and they play no role in running the business.
- The consultants with close ties to management are providing needless services.

The process of due diligence requires insightful and comprehensive research; this may also comprises of issues such as cultural and human resource. It is these individuals' oriented issues that are exceptionally important when it comes to actually integrating the two companies.²⁹³ It is from this viewpoint that the process of due diligence gains relevance as it helps to set the foundation for post-merger integration of the companies. Many post takeovers have an "integration" team, which looks at the issues that arise integrating post the takeover.

Cultural due diligence focuses on corporate cultures and attempts to ascertain an organisational fit between the two companies intending to merge. Each of the two merging company post a takeover possess their own culture, obtained from several components - corporate policies, rules, compensation plans, leadership styles, internal communication, physical work environment, etc. Cultural due diligence attempts to deduce the reasons change and the manner of adapting to a different culture. When the cultural gap becomes wide, the integration of the two companies becomes even more complicated. As a result, cultural due diligence identifies issues that are decisive to integration and assists the management in planning the necessary actions for resolving these differences before the merger is made public.

On the other hand, human resource due diligence attempts to identify and evaluate the way people are managed between the two companies. The following issues require analysis for an understanding of this aspect.

²⁹³Vermeulen, Freek, and Harry Barkema. "Learning through acquisitions." *Academy of Management journal* 44.3 (2001): 457-476.

- The mechanism of ensuring the continuation of maximisation of the value of human resource capital;
- The appropriate mix of pays and benefits for the new organisation;
- The incentive programmes needed to retain the necessary personnel after the merger is made public;
- The mechanism of compensating the employees by the target company;
- A comparison between base pay and the marketplace fragments;
- The ways of dealing with the pension plans and severance pay. Pension plans post a takeover may create difficulties for example; the target employees may find themselves transferred from a “final salary” scheme to a “money purchased” scheme. This may result in less pension benefits.

It is vital to get the Human Resource Department engaged in the merger and acquisition process in time because they have insights into cultural and human resource issues. The failure to tackle cultural, social, and human resource issues in Phase II Due Diligence is a major reason behind failed mergers. It is important to include the "people" issues in Phase II Due Diligence (which commence the moment the Letter of Intent is signed). This issues is explained by Galpin and Hendon in the book The Complete Guide to: ²⁹⁴

“In an era of widespread acknowledgement that mergers entail disproportionate risks and failures, the surprising fact is not that "culture" should become such a critical issue during integration, rather what is surprising is that organisational culture and other issues essential to integration have not yet become more central to executive-level deal making.”

Social effect on unemployment job cuts during takeovers

²⁹⁴Galpin, T and Herndon, M 1999, *The Complete Guide to* , second edition, Jossey-Bass, New York

Though mergers and takeovers are ways of improving productivity and profitability in some companies, they may not be good for employees. Mergers and takeovers are associated with company redundancies, which leave social tension concerning their positions or changing culture of the company. Employees need to prepare for anything when they get to know that their company is likely to undergo Acquisitions and Mergers. Redundancy is likely to occur when companies combine since the acquiring company has the mandate to reduce the number of employees. If employees have the required skills in the new company, they are likely to be retained. The general point is that merger and acquisition may result in unemployment, which negatively affects the society.

2.11 Shareholders 'Interests

Shareholders are institutions including corporations or persons who legally own shares or part of the stock in a firm or company though not the company it. They are also known as the stockholders and are constituents of the stakeholders in a company.²⁹⁵ Shareholders are of various categories namely, the controlling shareholders (majority shareholders) and the non-controlling shareholders (minority shareholders). They are usually accorded special privileges based on the class of shares and such rights include:

1. The right to buy new shares issued by the company;
2. The right to sell their shares or part of the stock of the company;
3. The right to the dividends whenever they are declared;
4. The right to the assets that might remain after liquidation has occurred;
5. The right to vote on those directors nominated by the board;

²⁹⁵ Stakeholders in a company among others include directors, employees, suppliers, consumers, creditors.

6. The right of nominating directors which is however difficult in practice owing to the protection of minority shareholders; and
7. The right to propose resolutions

It is worth noting that those stockholders in the primary market who purchase Initial Public Offering shares (IPOs) avail capital to the companies. Even though, most of the majority shareholders fall in the secondary market, which provides no direct capital to the firms. Perhaps, it may seem peculiar to consider the situation in US Public corporations, which is contrary to the common opinions regarding the shareholders. They are not owners of the firms, neither the claimants of the profits nor investors but are considered as the “contributors of capital”.

2.11.1 Majority Shareholders interests

Majority shareholders are the controlling shareholders or owners of a firm. They are attributed with vast interest in the activities of a firm. They are the investors who have obtained most of the stocks in a firm.²⁹⁶ Thus the majority shareholders or groups of shareholders have rights to make decisions and to oversee the entire operation of the firm. In the US takeover regulations regarding trust and equity, the fiduciary duties of shareholders. The delegated duties require that the majority shareholders be expected to be loyal towards the rest of the investors and employees of the firm. In particular, they should act in way that would not devalue the investments that have been made by other shareholders and would interfere with the financial

²⁹⁶Vermeulen, Freek, and Harry Barkema. "Learning through acquisitions." *Academy of Management journal* 44.3 (2001): 457-476.

stability of the organisation.²⁹⁷In England the bulk of the majority shareholders are institutional investors such as fund managers, pension, insurance funds, and investment trusts etc.

2.11.2 Minority Shareholders Interests

These are the non-controlling shareholders in a firm, who have very minimal interests in the activities of the firm. They can also be identified as shareholders owning minority stakes in a company that is under control of majority shareholders. The majority shareholders influence the value of shares in a firm; it can be a group of connected shareholders. In this way, the minority shareholders are more than often deprived of any say in the management of the company and the firm is run in such a way that it benefits the majority shareholders at the expense of the minority shareholders.

Owning a large amount of shares may not mean that one automatically becomes a majority shareholder. It therefore means that becoming a majority shareholder may depend on other factors such as the structure of the company.²⁹⁸ A shareholder may have vast amount of shares, but lack control in the activities of the company; this includes non-controlling shareholders. In that regard, there are laws installed to guard minority shareholders even though they are not effective as expected. Perhaps, in a country with an effective judicial system, the minority shareholders may not be flagrantly cheated but there are mechanisms through which majority shareholders can favour themselves. The majority shareholder does prefer dealing with group companies such as the other subsidiaries of the parent company.

²⁹⁷Richard Hall “United States of America Takeover Guide”, Cravath, Swaine & Moore LLP p 7 published in 2014 on <http://www.ibanet.org/Search/Search.aspx?query=takeover%20guide%20usa>

²⁹⁸ Ibid 166

2.12 An Analysis of the Rationale of Takeovers

Those who support takeovers have a variety of reasons for doing so, the reason being the advantages of takeover transactions.²⁹⁹ This research refers to the driving force that make companies opt for takeover deals instead of taking other available options, such as starting new business ventures. In one school of thought, takeovers or the possibility of takeovers are seen by the shareholders as a tool to ensure that directors are accountable. Armour and Skeel argue that takeovers present:

*“A key mechanism for rendering managers accountable to shareholders in the market for corporate control, namely, the threat that if the managers fail to maximise the share price, the company may become an acquisition target”.*³⁰⁰

The only way the shareholders can make gains on their investments when purchasing a company's stocks is when that company consistently pursues a greater share price.

When the share price increases, shareholders make capital gains on their investment and are thus motivated to invest even more in public companies. Without this motivation, such as when the share price remains stagnant or even depreciates, shareholders make losses on their financial investment. This means that most shareholders will have no motivation to commit their finances into such a company³⁰¹. Takeovers come in to threaten executives who may ignore the plight of their shareholders and pursue other subjective goals. If such executives fail to increase the share price, there is always a potential acquirer who could increase that share price and create

²⁹⁹Johanson, Jan, and Jan-Erik Vahlne. "The internationalization process of the firm-a model of knowledge development and increasing foreign market commitments." *Journal of international business studies* (1977): 23-32.

³⁰⁰United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992).Vol. 4, p. 9/17.

the desired shareholder profits. This threat of the possibility of a hostile takeover is according to Armour and Skeel, “a mechanism pivotal to making dispersed ownership viable.”³⁰² In short, the threat of takeovers enables the stock market to function profitably by attracting investors who are in search of capital gains.

Sometimes, the pursuits of an organisation are misdirected and misinformed, consequent to subjective interests of the management. Such a management may collide with the profit-making interests of the shareholders. Often companies appoint incompetent managers who stand to ruin the fortunes of a company if they are not removed. At the time that this becomes apparent, the managers may be galvanised against removal from office by a contract of tenure that may end long after the company is financially dead. At such times, hostile takeovers become a vital tool of replace the incompetent management.³⁰³ A successful hostile takeover bid may see to the removal of the incompetent management, as an alternative to total liquidation of the company before its assets are lost. An injection of a new management by the acquirer may be a successful turnaround strategy.

In discussing the theory of the growth of a firm as early as 1959, Penrose argued that takeovers allow otherwise incapable firms to secure growth opportunities by acquiring the opportunities owned by other firms.³⁰⁴ The same logic applies in modern takeover contexts. By

³⁰² G. Tamburrini . Harmonisation of Takeover Discipline: A Comparative Law and Economic Overview. *June* 2009. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1423762

³⁰³Johanson, Jan, and Jan-Erik Vahlne. "The internationalization process of the firm-a model of knowledge development and increasing foreign market commitments." *Journal of international business studies* (1977): 23-32.

³⁰⁴J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge (2006), pp. 1 - 77.

acquiring IBM's computing division, Lenovo benefited from IBM's technology, human resources, market structures, product lines, goodwill and successful history. It was thus able to enter into a previously impossible market and command the most dominant position in that market within less than six months after the acquisition.

This example illustrates what Penrose must have borne in mind when he described the firm as

"... a collection of productive assets, whereby the long run profitability of the firm is associated with the growth in productive opportunity to use its assets more efficiently (such that) ... the quest for productive opportunity leads the firm to search for new products and markets (via takeovers). It is thus understandable why companies will be willing to take over other companies is such target companies have resources, products and markets that would further their productivity opportunities and thus add value to their operations."³⁰⁵

Besides the foregoing possible motives of corporate takeovers (generalised reasons why companies are willing to engage in takeover bids and why it is important for national and global economies to nurture healthy takeover transactions), scholars have postulated hundreds of other possible motives. In agreement with Seth, Song and Pettit, Porter and Singh argue that,

"... there are three widely accepted motives for takeovers which have been advanced in the literature; synergy, agency and hubris."³⁰⁶

In the synergy motive of takeovers, the hypothesis is that takeovers occur

³⁰⁵ E. Penrose. *The theory of the growth of the firm*. Oxford University Press. Oxford (1959), pp. 23 - 78.

³⁰⁶Joshua Porter and Harminder Singh "An empirical Analysis of the motivation underlying takeovers in Australia", p2

“When the value of combined firm is greater than the sum of the values of the two individual firms involved in the takeover deal.”³⁰⁷

This means that the firm that initiates a takeover anticipates creating more shareholder value by accumulating the asset worth of the target company alongside its present shareholder value.³⁰⁸

The managers of a company who initiates a takeover bid (potential acquirer) always embark on a takeover deal to primarily pursue their own personal interests such as to maximise their own limits of utility. The managers might be pursuing better compensation or to get the benefits and bonuses most often attached to successful takeover bids. According to Porter and Singh, such a subjective motive is always pursued at the expense a company’s shareholders since in the long run; the acquired shareholder value often becomes negative as compared to the shareholders value prior to the takeover transaction.³⁰⁹

Porter and Singh further postulate that, the hypothesis is that while not intent on benefiting themselves from takeover deal managers of the acquiring company may make many unintentional mistakes due to over confidence while negotiating the takeover terms. The target firm might deem so appealing and lucrative that managers do not conduct a thorough due process to establish the realistic worth of the takeover prospect. Other managers may ambitiously over expect benefits to trickle in after the takeover, when such benefits would actually be absent or be

³⁰⁷D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁰⁸D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁰⁹T. Giovanni. Harmonisation Takeover Discipline: A Comparative Law and Economic Overview. *Selected Works of Dr. Giovanni Tamburrini*, November 2009.

delayed for some person in the long term.³¹⁰ When the takeover deal is executed, it soon dawns on the managers and the shareholders, that the deal did not produce as much benefits as had been expected, leading to a great loss of the shareholder value/wealth.

It is possible to empirically determine which of the three ranks as the most common motive for takeovers. Indeed, Berkovitch and Narayanan conducted such an empirical study.³¹¹ Berkovitch and Narayanan's study adopted a unique approach that is common in the contemporary takeover literature when it comes to distinguishing among the prominent takeover motives. The scholars examined the correlation existing between abnormal returns in a target firm and total abnormal returns that are gained by the two companies (target and acquiring) in the post-takeover period.³¹² They also sought to investigate the correlation which may exist between the abnormal returns of both the bidder and target.

It is important to note that the study established that “76% of takeovers are primarily motivated by synergy as the outcomes resulted in positive abnormal gains to both the acquirer and target shareholders.³¹³” It was also found that “agency was the dominant motive explaining the negative total gain among the sub-sample”. These findings were consistent with those generated by Gondhalekar and Bhagwat in their study, which examined the three takeover motives via a correlations methodology. Gondhalekar and Bhagwat found that synergy motives

³¹⁰ Ibid 123

³¹¹Berkovitch, E and Narayanan, M, Motives for takeovers: An empirical investigation, *Journal of Financial and Quantitative Analysis*, Vol. 28, No. 3, 1993 pp. 347-362.

³¹² Ibid.

³¹³United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, Vol. 4, (1992) p. 9/17.

outdo or dominate most takeovers.³¹⁴ Again, Seth, Song and Pettit also posted similar findings after analysing the occurrence of the three motives in the cross border acquisition deals involving US firms (as targets) and foreign firms (as bidders).³¹⁵

Taking another perspective other than the one provided by the Synergy-Agency school of thought, it is worth noting that the contemporary takeover literature concurs in that most takeover initiatives are motivated by the need and search for corporate growth, for strategic expansion, for corporate restructuring processes, for increasing corporate control of the market, and for changes in a company's ownership. Nonetheless, the need and search for growth ranks as the most predominant motivation for most takeover deals (as was also concluded by Seth, Song and Pettit, Gondhalekar and Bhagwat, and Berkovitch and Narayanan. Several benefits accrue from takeovers' ability to yield corporate growth, explaining why these deals are the preferred options when a company is pursuing growth within a particular market niche or geographical area. While some of these benefits/motives are repeated across the various schools of thought, there are certain aspects that can complement the points raised in the foregoing discussion.

Common to all the schools of thought, is that the first takeover benefit is a boost in operating synergy. Synergy refers to the ability of a company to reduce the costs, to combine the resources at its disposal, to increase the sales volume, to acquire a greater purchasing power and to consolidate the facilities and additional skilled resources that the competing companies have, in its current business activities. The second benefit is market power and presence. A company may wish to venture into new geographical areas, to increase its market share and presence, or to access the untapped vertical markets with its existing product and or service portfolio. This will,

³¹⁴Ibid.

³¹⁵Judenhofer, Martin S., et al. "Simultaneous PET-MRI: a new approach for functional and morphological imaging." *Nature medicine* 14.4 (2008): 459.

in turn, translate into market power adequate to conquer the target market to near monopoly levels.³¹⁶ The third benefit of takeovers from a growth perspective is market expansion (which is different from market power in that market expansion refers to increased exploitation of existing not new markets).³¹⁷ In market expansion, a company may wish to add related product or service lines that they currently do not deal with, although the same can be traded to the company's existing customer base. The fourth growth benefit of takeover initiatives is their contribution to strategic planning. Takeover deals can be an initiative to invest in new technologies, to increase the skilled labour in the workforce, to enter into new markets, to reduce competitive forces, to attract a new customer base, to reduce costs or to alter a marketing strategy. Fifthly, takeover initiatives can help a company to obtain a successful new line of products and or services for a new or existing market thus helping it accomplish strategic goals more successfully and faster than would be possible if the product or service line were created from scratch. The sixth benefit is that takeovers can help fill the gaps in a company such as adding competitive technology, improving the efficiency of its sales structure, improving the management structure, amplifying marketing results and gaining better production, distribution and sales channels. Stanley supports this fact by adding another benefit of takeover initiatives namely, amplifying the efficiency of a company's management.³¹⁸ This accrues when a company archives a return of a company's through the purchase of a company ran by inefficient managers with the aim of replacing them and initiating a management change. It can also be done by making the less efficient managers of

³¹⁶ Ibid.

³¹⁷ Ibid.

³¹⁸T. Giovanni. Harmonisation Takeover Discipline: A Comparative Law and Economic Overview. *Selected Works of Dr. Giovanni Tamburrini*, November 2009.

the company to learn and adapt to new requirements set by the acquirer and thus amplifying management efficiency, a process otherwise called “differential efficiency”.

Takeover initiatives can also be motivated by the search for financial synergy, which can be done by acquiring a company with lower capital costs and then improving its cash flow while simultaneously increasing its debt financing capacity.³¹⁹ Takeover can also help an acquirer take advantage of a growth opportunity presented by a company whose purchasing price is undervalued, and whose cost is lower than would otherwise be possible in starting a new company.³²⁰ At other times, takeovers help solve agency problems where the control of assets belonging to an under performing establishment is under inefficiently dispersed ownership. Finally, takeover deals also help companies attain tax efficiency, where they obtain a tax status that is more favourable through acquisitions and mergers than through other growth options. Most of the takeover motives explained above are external to the firm. There are however, some internal takeover drivers/motives that are purely within the firm, and which propel such a firm to seek for takeover opportunities.³²¹ In most cases, internal takeover drivers may be related to management needs or those of the shareholder value of such a company. For instance, takeover initiatives can be motivated by managerial instances, where managers seek to increase their power and income by increasing the size and revenues of their company.³²²

³¹⁹ J. Coates. Takeover defences in the shadow of the pill: A critique of the scientific evidence. *Texas Law Review*, No. 79, No. 2, (2000) pp. 271-382.

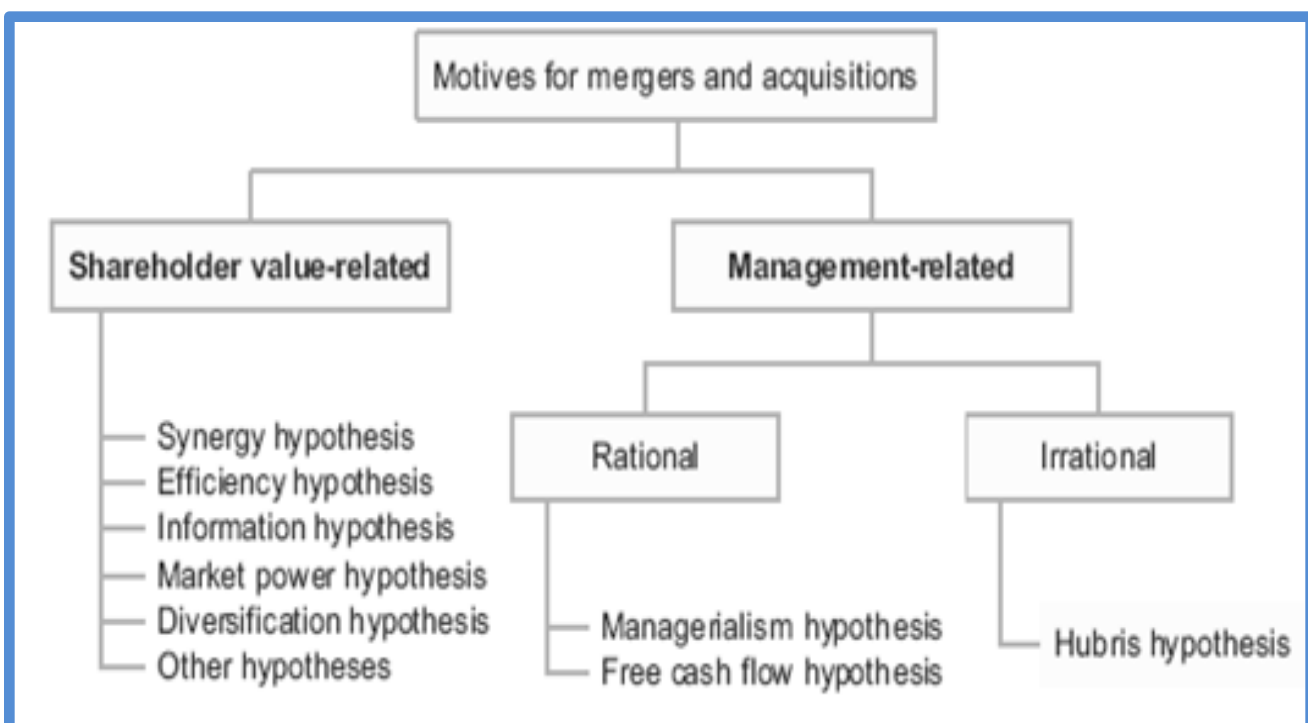
³²⁰ Ibid.

³²¹ Ibid.

³²²R. Ruback. An Overview of Takeover Defences. In A. Auerback, ed., , University of Chicago Press, Chicago (1988), pp. 49 – 68

As already discussed previously, market conditions, such as the fierce competition of contemporary markets, companies may be forced to seek ways to fill their resource gaps (technology, customer base, distribution channels, local expertise etc. or even management) through takeovers.³²³ Other companies may look to gain economies of scale, amplify synergies, reduce costs and invest in opportunistic to financially profitable transactions, through merging with or acquiring other companies. Wubben employs this systemised approach when considering the benefits of takeovers, wherein such benefits are classified either based on shareholder value or the needs of the management.³²⁴ In Wubben's classification, shareholders motives are broken down into eight hypotheses namely, monopoly theory, synergy hypothesis, efficiency hypothesis, diversification hypothesis, information hypothesis, valuation theory, market power hypothesis etc. He further suggests that management have other motives for which there are three hypotheses namely, managerial hypothesis, and hubris hypothesis and finally, free cash flow hypothesis.³²⁵ In the figure below, the motives of takeovers are summarised with a systemised approach to takeovers.

Figure 1.1: A Figure Illustrating a Systemized Approach to the Benefits of Takeovers



ew,

Figure 1: Source: Adopted from Wubben (2007, p. 6)

A CHART ILLUSTRATION

It also emerges that cross-border takeovers although more comprehensive, also include all of the regular takeover motives as discussed in the foregoing paragraphs.³²⁶ However, some additional motives specifically are applicable only to cross-border takeover contexts exist over and above those of general takeover contexts. The diagram above summarises in a graphical manner, the comprehensive motives for takeovers at domestic contexts and further provides the extension of these motives to the specific cross-border contexts.³²⁷ It is important to note that in the following figure, the management and shareholder value motivations also apply to cross-border takeovers and that the indicated cross border motives are in addition to the management and shareholder value motives.³²⁸ According to Mangold and Lippi, there are specific motives for cross-border takeover transactions. These motives

“...are driven by favourable changes in government regulation, currency appreciation and macroeconomic performance of the acquirers’ country (and) economic conditions of the target in foreign countries (like) special tax free industrial zones, or subsidies for special industry sectors like in Italy for example the solar industry.³²⁹”

These motives contribute to flourishing of a product, taking the textile market in Paris as an example. They provide conditions for moderately low labour costs even for highly educated

³²⁶N. Mangold and K. Lippok. The Effect of Cross-Border on Shareholder Wealth: Evidence from Germany. *Journal Of International Business And Economics*, Vol. 8, No. 3, (2008) pp. 315 - 330.

³²⁷ Ibid.

³²⁸ Ibid.

³²⁹ Ibid.

specialist-which elaborates the Eastern Europe labour condition. Also, it offers the possibility of low tax rates for foreign investors and provides favourable foreign exchange rates. Similarly, another cross-border motive is when companies export products to countries where the products are unavailable, this practice is largely common for automotive manufacturers. Pursuing cross-border takeovers allow said automotive manufacturers to ensure timely delivery and intimate customer relationships with their foreign clients.³³⁰These cross-border specific motives have been summarised in the following figure in addition to the general takeover motives.

2.13 Analysis of the Rationale of Takeover Defences

Numerous schools of thought support the idea of takeovers. However, in contrast, there are as many arguments to disregard it. Runback shares his opinion as,

“... It is difficult to determine whether takeover defences are good or bad for stockholders, but one way to assess a takeover defence is to examine the rationale for resistance.”³³¹

While takeovers contain immense economic advantages for both ends, i.e. target and bidding companies and both economies involved in the process of takeovers as well. However, it is also significant to note that not all corporate takeovers are beneficial.³³²

Occasionally, takeover transactions are ill advised for a company. Although, there are times when the company is out of options to avoid the takeover such as, when said firm had been

³³⁰N. Mangold and K. Lippok. The Effect of Cross-Border on Shareholder Wealth: Evidence from Germany. *Journal of International Business and Economics*, Vol. 8, No. 3, (2008) pp. 315 - 330.

³³¹R. Ruback. (1988). An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago, p. 50.

³³² Ibid 266

facing financial crisis. But when the company is determined to not allow takeovers at any cost, both English and U.S jurisdictions provide extensive defence options to avert the acquisition bid.³³³ Takeover defences are thus applicable whenever target companies seek to deter change of ownership to the aggressive bidder.³³⁴ As it has been discussed earlier in the previous sections of this research, this is an evaluation of the contemporary literature on hostile takeovers and the legal limitations which support the target companies to avoid or accept a takeover. Also, acknowledges a bidder company its legal actions during a takeover attempt. It further exaggerates the understanding of the fact that at times a company may recognize their best interest in declining a takeover bid.³³⁵

Shareholders may sometimes encourage their managers to initiate defensive strategies while the managers would prefer to admit a takeover bid. This might happen when offered takeover would solitarily serve the subjective interests of the managers while disregarding the wealth interests of shareholders.³³⁶ For instance, Rei affirms that during 1994 to 2003, 104 takeovers out of 760 in his sample proved to be a failure after the execution in the US.³³⁷ Rei attributes such a dramatic failure rate to the fact that most managers are motivated to complete

³³³R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 50.

³³⁴R. Bruner. The poison pill anti-takeover defence: The price of strategic deterrence. *Working Research Paper*. The Research Foundation of The Institute of Chartered Financial Analysts, Charlottesville, VA (1991), pp. 14 – 46.

³³⁵Ibid

³³⁶R. Caves. Mergers, Takeovers, and Economic Efficiency. *International Journal of Industrial Organisation* , Vol. 7, No. 1, (1989), pp. 151-174.

³³⁷ Ibid, p. 28.

takeover deals based on their incentives of greater pay and more asset control.³³⁸In such cases, it is advised that the target company rather initiates their takeover defence tactics instead. One of the principal justifications to initiate the provisions of takeover defence tactics is to prevent target companies from facing the financial loss of shareholders during the transactions of takeover while independence and greater wealth could have been gained otherwise by practicing the takeover defence tactics. However, this rationale is a reflection of the shareholders' perspective.

Furthermore, takeover defence might be effective to creating more value over shareholder's amount of value, prior to the takeover. This is the second principal rationale for employing takeover defences, from a shareholders' perspective.³³⁹ Ruback argues that,

“There is broad agreement that being a takeover target substantially increases the wealth of shareholders”.³⁴⁰

A historical review of estimates attained on the stock price of target companies consequent to successful takeovers shows that there is an average gain in shareholder wealth by over 30% (when takeover tenders are offered) and 20% when a friendly merger is executed.³⁴¹

Given that most takeovers bids usually offer target company shareholders up to 50% more on their stock, Ruback concludes that:

³³⁸Rei, E Managerial Incentives and Takeover Wealth Gains, *A Working Paper*, Farmer School of Business, Miami University, Oxford, (2008), p. 2.

³³⁹Rei, E Managerial Incentives and Takeover Wealth Gains, *A Working Paper*, Farmer School of Business, Miami University, Oxford, (2008), p. 2.

³⁴⁰R. Bruner. The poison pill anti-takeover defence: The price of strategic deterrence. *Working Research Paper*. The Research Foundation of The Institute of Chartered Financial Analysts, Charlottesville, VA (1991), pp. 14 – 46

³⁴¹R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 50.

“... It does not require a lot of complicated analysis to determine that the right to sell a share of stock for 50 % more than its previous market price benefits target shareholders.”³⁴²

The purpose of a takeover defence tactic is to provide the company privileges to avoid proposed takeover easily. When a defence tactic is executed successfully, the probability of stockholders’ demand of premium offers for their existing shares decreases beside the likelihood of takeover.

Ruback asserts appropriately that:

“... even for an economist, it is hard to argue that shareholders benefit by reducing their chance to sell shares at a premium.”³⁴³

To comprehend the contradictory possibility, Ruback identified that all shareholders have similar superseding concern, regarding, the market value of their shares.³⁴⁴ That market value of the shares is a product of the firm’s value, which in turn is a summation of two different components namely, the value derived from the firm’s conditional retention of the same management team that they had prior to the takeover defence. Then, if there is a change in the company’s corporate control the expected value change will occur. Ruback formulated the following formula to calculate the firm’s value in absence or as a consequence of a takeover that can be applied in such a case.³⁴⁵

³⁴²Ibid, p. 50.

³⁴³Ibid, pp. 50 - 51.

³⁴⁴R. Ruback. An Overview of Takeover Defences. In A. Auerback, ed., . University of Chicago Press, Chicago (1988), p. 49.

³⁴⁵R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 49.

Market Value of the Firm = Value of the Firm with Current Managers Probability of a Control Change X Change in Value from a Control Change

Based on this realistic calculation of firm value, Ruback concluded that,
 “... stockholders are concerned about how takeover defences affect all three components of value: the value of the firm under current managers, the probability of an acquisition, and the offer price if a takeover bid occurs”

To further amplify the effect, it is expected that if the continuity of management and leadership of the firm stays constant, the value of the firm may become even greater than the benefits of the takeover on shareholders. Therefore, contributing to takeover defences the probability to build the price of a firm’s shares.³⁴⁶As Ruback further concludes,

“... while takeover defences may lower the probability of being acquired, they may also increase the offer price ... (in that) “... takeover defences can affect the value of the firm even if it is not acquired, that is, the value with its incumbent management team.³⁴⁷”

The third rationale for adopting takeover defences from a shareholders’ perspective, is to free managers from the worries of hostile takeovers and therefore enable them to concentrate on their responsibility of increasing the price of a firm’s shares.³⁴⁸When managers are constantly worried about potential takeovers, aware of the unpredictability of change in firm’s authority, they are unable to perform accurately and efficiently. For this reason, takeover defences support the incumbent directors to completely eradicate the possibilities of potential takeovers. Hence,

³⁴⁶ Ibid 178

³⁴⁷R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 49.

³⁴⁸Ibid, p. 50.

allowing the managers to perform efficiently, consequently, resulting in benefits for both shareholders and the firm value.

It follows that the firm's market price then entirely consists of its value with the incumbent directors. However, takeover defences can arguably influence the said value towards either of two opposite ways.³⁴⁹ Firstly, takeover defence guarantees may trigger a decrease in the firm's value if the directors enjoy their isolation from the possibilities and inconsistencies of the corporate control market, thus becoming leisurely and unaccountable.³⁵⁰ On the second count, which is relevant to the present argument for rationales of takeovers, there is the possibility that the firm's value could increase since the incumbent managers will benefit from the takeover defence guarantees and instead of wasting their otherwise precious time and valuable corporate resources in worrying about possible hostile takeovers, commit even more devotedly in increasing the shareholder wealth.³⁵¹

Besides considering the merits of takeover defences from a shareholders' perspective, it is also possible to approach takeover defences from a manager's perspective.³⁵² Managers have three differing objectives to defend against takeover bids. To begin with, managers may believe that their firms have hidden values that they could exploit further and more profitably if the

³⁴⁹R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 49.

³⁵⁰Ibid.

³⁵¹Ibid, p. 50.

³⁵²Ibid, pp. 50 - 51.

takeover is not affected.³⁵³ Secondly, managers may believe that in resisting a takeover bid, they will increase the offer price included in the first bid and in so doing stimulate even greater benefits from the takeover.³⁵⁴ Finally, managers may also act out of fear of losing their jobs and in their fear, employ takeover defences in a bid to retain their privileged positions.³⁵⁵

2.14 The Issue of Corporate Social Responsibilities

This research however does not require the need for detailed comprehension on the concept of corporate social responsibility but nevertheless it would only be relevant to identify what may be described as a “total indifference” to the issue of “social responsibility” which is so important to consider in an “acquisition-merger” process. Although, there is a lot of work done and published by numerous authors addressing the issue of corporate social responsibility.³⁵⁶ There hardly exist any published works on the issue of social responsibility regarding the acquisition merger process. Thus, it would be appropriate to briefly identify the reason for the concept of corporate social responsibility falling into the aspect of “defence” against acquisitions and mergers.

³⁵³R. Ruback. An Overview of Takeover Defences. In A Auerback, ed., , University of Chicago Press, Chicago (1988), p. 50.

³⁵⁴Ibid.

³⁵⁵Ibid, p. 50.

³⁵⁶Mallin, C A, “*Corporate Governance*”, Oxford, Oxford University Press, 2010, Kotler P, Lee N “*Corporate Social Responsibility: Doing the Most Good for Your Company and Your Cause*”, 2005, New Jersey, USA, Brennan D “*Corporate Social Responsibility: The Corporate Governance of the 21st Century*”, 2011, United Kingdom, Visser W, Mitten D, “*A to Z Corporate Social Responsibility*”, 2010, United Kingdom

In this context, one is required to reflect on the ulterior motive of an acquisition-merger process - which is primarily an attempt to derive financial benefits by taking over a target company or the company displaying certain unique assets and to simply promote the prospects of amassing more profits; financial and other profits. However, one of the inevitable consequences of acquisition-mergers process has been the loss of employment of several employees working in the target company. In simpler words, the social aspect of the acquisition merger process has been neglected greatly.³⁵⁷

This social issue mentioned above, is of grave importance as a large amount of acquisitions and merger processes fail most of the times. Therefore, it would be fair to treat this as a ground issue for defence against acquisitions and mergers

2.15 Conclusion

This chapter was barely an introduction to the entire research, containing details of the study and defining contextual meanings of the terms that will be used throughout the research and hence, are important to be clarified beforehand. The most important consequent aspect in the chapter is the anticipated image of the final research paper. The chapter begins with a brief introduction followed by the justification behind the study. Certain basic concepts such as mergers, alliances and acquisitions have been illustrated. Mergers are activities that make companies to mutually combine for the cause of releasing high value synergies. Whereas, acquisitions are activities that allows, after their success, the acquirer to gain control over the target company. In contrast, alliances denote an agreement or a

³⁵⁷Capron, Laurence. "The long-term performance of horizontal acquisitions." *Strategic management journal* (1999): 987-1018.

consensus between two or more individuals to initiate common goals and deploy secure common interests.³⁵⁸

The Types of takeover have also been recognised in this chapter; friendly takeovers, reversed takeover and back flip takeovers, to name them. The friendly take overs contribute to the willing acceptance of takeover involving improvement of several factors, such as; value, synergy and others. Due diligence was discussed in the next section and was considered as an analysis undertaken by the investors with intentions of understanding the prospect of an investment with respect to issues, such as; operation and management, and the verification of material facts and figures.

³⁵⁸ In the context of corporate market, they can be the business parties or groups

CHAPTER 3: Historical growth and development of Acquisitions, Mergers, and Defences thereto.

3.1 Introduction

The issue of takeover defences initiated over a century ago through various forms. The procedure regarding takeovers has advanced over time to become one of the corporate strategies that assist small and big businesses to expand their operations either domestically or internationally.³⁵⁹ Takeovers trace their roots to two perspectives including evolution path and timeline. In this section of the research, the two perspectives of the takeovers are discussed comprehensively and their relationship to the current takeovers in the business world are critically analysed. This approach of analysing the history of takeovers particularly looks into the issues surrounding it in a chronological manner.³⁶⁰ A comprehensive analysis of each historical era in the development of takeovers in business is undertaken.

3.2 Historical Background

3.2.1 The First Period of Takeovers (1887 – 1913)

It is believed that the issue of takeovers in the face of business activities began as mergers, acquisitions and buyouts resulting from advantages of operating on a large scale by monopolies in business during that period.³⁶¹ The practice is held to have started between 1887

³⁵⁹Singh, Harbir, and Farid Harianto. "Management-board relationships, takeover risk, and the adoption of golden parachutes." *Academy of Management Journal* 32.1 (1989): 7-24.

³⁶⁰Dickerson, Andrew P., Heather D. Gibson, and Euclid Tsakalotos. "Takeover risk and dividend strategy: a study of UK firms." *The Journal of Industrial Economics* 46.3 (1998): 281-300.

³⁶¹Hannah, Les. "Takeover bids in Britain before 1950: an exercise in business 'pre-history'." *Business History* 16.1 (1974): 65-77.

and 1904 when large business activities began taking shape. During this period, it is noted that initially developed companies accrued the advantages of monopoly at both the national and regional levels. Such monopolies took advantage of consumers to maximise their revenues and heavy manufacturing industries.³⁶²

The first period of takeovers initiated from 1887 is of high importance because this Era introduced the concept of takeovers in the corporate world and the in this Era, companies took the initiative to expand their business through takeovers or mergers. Therefore, it is highly significant to discuss the first period of takeovers.

Initially, they were predominantly horizontal where different companies consolidated their resources to capitalise, redesign their businesses and gain control of the existing market share at the time. It was important that firms commanding a given market niche sought consolidation, partnership or ownership of other firms with the aim of operating effectively in other markets in a bid to further their influence in national and global market. Most of the deals did not materialise as a result of financial collapse resulting from ineffective management of growth and improper objectives of such mergers or deals. The first period is also attributed to the rapid economic meltdown of 1903 that contributed to the collapse of the arrangements. In 1904, the stock markets of the developed economic countries made impacted adversely on corporate financial activities.³⁶³ The control of the market by businesses during this period was characterised by unsupportive legal frameworks in the US. This weakness was rectified by the US Supreme Court with the adoption of the Sherman Act of 1890. The Act was intended to block

³⁶²D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁶³D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

since they were considered not to add value to the corporate market at the time.³⁶⁴ During the first period of takeovers in the US, the regulatory measures to protect the interest of the target business did not receive much attention. Takeovers were conducted with a view to monopolising markets. Particularly after the Sherman Act (1890) came into force, the issue of the minority shareholders rights does not seem to have had much attention during this period.³⁶⁵

The Sherman Antitrust Act governed all mergers and takeovers from 1887- 1913.³⁶⁶ This law was introduced after numerous complaints from firms that some were benefiting from monopolies after. Such takeovers would then raise prices of products and services, produce poor quality goods and lax innovation.³⁶⁷ However, the introduction of the Sherman Antitrust Act of 1890 ensured a level playing field and adequate competition between the merged firms and other independent players. However, the Sherman's Antitrust Act soon developed problems with the workers unions, which did not go down well with most courts. Following a legal battle regarding the Sherman Antitrust Act in the United States v. E. C. Knight Company (1895), there was significant modification of this Act, which targeted its wording.³⁶⁸

³⁶⁴ Ibid.

³⁶⁵ Devogele, Thomas. "A new Merging process for data integration based on the discrete Fréchet distance." *Advances in spatial data handling*. Springer, Berlin, Heidelberg, 2002. 167-181.

³⁶⁶ Bok, Derek C. "Section 7 of the Clayton Act and the Merging of Law and Economics." *Harvard Law Review* (1960): 226-355.

³⁶⁷ Ibid 4

³⁶⁸ United States v. E. C. Knight Co., 156 U.S. 1 (1895)

3.2.2 The Second Period of Takeovers (1914 –1944)

It follows from the initial period that occurred between 1897 and 1913 that the corporate control of market share did not materialise as intended.³⁶⁹ During the period 1914 and 1944 during which there were several were witnessed. The aggressive practice of takeovers is largely adopted by oligopolistic firms that aimed to exploit both new and existing markets. It is worth noting that this period takes “oligopoly” rather than “monopoly” was the critical considerations. An economic factor that helped propel the success of the corporate control market in this phase was the emergent economic boom recorded across the globe in the post-First World War period.³⁷⁰

In this period that initiated from 1914, companies took the initiative to adopt an aggressive strategy against mergers and takeovers. It was the stage when the companies were identifying the concept of takeovers as not only expansion but also to maintain competitive edge in the corporate world.

It was during this period that business firms rapidly engaged in inter-firms strategic arrangements due to the emergence and advancement of technology resulting from issues such as the layout of the railways in different countries, the development of transport aeroplanes and motor vehicles. The development of infrastructure such as transport systems enabled companies to designed growth and expansion strategies through.³⁷¹ The US government was particularly

³⁶⁹Hansmann, Henry, and Reinier Kraakman. "The end of history for corporate law." *Geo. LJ* 89 (2000): 439.

³⁷⁰D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁷¹Gill, Brian, et al. "State Takeover, School Restructuring, Private Management, and Student Achievement in Philadelphia." *RAND Corporation* (2007).

instrumental in developing a series of policy frameworks that encouraged firms to trade in partnerships or form companies, policies that were implemented in the early 1920s.³⁷² Several experts have traced this as the genesis of the American Corporate giants, corporations that currently the global trade scene.³⁷³

During the second period acquisitions and mergers were mostly horizontal and took place between entities that were equal of size in terms of the resources.³⁷⁴ The manufacturing industries sealed most of the Acquisitions and Mergers during this period namely petroleum, metal, chemicals, food processing and transportation equipment industries. Some of these products were new in the market and experiencing both low demand and supply in the market. Experts attribute the second period to the increase in investment banks hence embracing a pivotal role to facilitate the corporate control arrangements.³⁷⁵ The major economic downturn of the stock market in 1929 shook the progress made so far in terms of acquisitions and mergers in the global economic arena. The economic woes extended into the 1930s hindering further expansion and consolidation by companies. The introduction of incentives and subsidies such as tax reliefs in the US and England contributed to the provision of inspiration to rejuvenate the new era of corporate control deals.³⁷⁶

³⁷²Romano, Roberta. "Competition for corporate charters and the lesson of takeover statutes." *Fordham L. Rev.* 61 (1992): 843.

³⁷³ Ibid.

³⁷⁴ Ibid 10

³⁷⁵Drew, Donald R., et al. "Gap acceptance in the freeway merging process." *Highway research record* 208 (1967): 1-36.

³⁷⁶ Ibid.

3.2.3 The Third Period of Takeovers (1945-1964)

The third period occurred after the Second World War and continued until 1964 when there was less activity in the takeover market since it did not fall under the merger wave periods.³⁷⁷ From the previous period, various justifications seem to motivate takeovers. These include a search for favourable tax regimes, quest to consolidate operations, past inability to achieve business targets, pursuit for bigger market share, a paradigm shift from the bond markets to stocks markets and attraction of better employee skills. This period of takeover is highly significant to discuss as it includes the management role in the takeover and in this period, the importance of management during the procedure of takeovers was also realised.

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The justification for takeovers during this period further sought to maximise on management skills. Many companies failed to explore cost cuts while maximising sales and revenues. This situation made such firms vulnerable to acquisitions by their competitors or peers, which had leaner management systems in place. In some instances, some firms' managers were sympathetic to implementing tough policies that would again make them profitable. Typically, a firm that is underperforming is usually more attractive for takeovers, because the benchmarks for improvement are certain. This explains why underperforming firms' suit acquisition compared to

377Romano, Roberta. "Competition for corporate charters and the lesson of takeover statutes." *Fordham L. Rev.* 61 (1992): 843.

378 A. Agrawal and J. F. Jaffe. Do Takover Targets Underperform? Evidence from Operating and Stock Returns. *Journal of Financial and Quantitative Analysis*. Vol. 38, No. 4, (1988). pp. 721-726.

their counterparts.³⁷⁹ Even economists support this position with a general view that the takeovers in the third period catalysed by stakeholders' quest for discipline and effectiveness in overall operations. Hence, after the shift to stock oriented business models was to maximise stock returns.³⁸⁰ Therefore, maximising return on investment for the shareholder.

3.2.4 The Fourth Period of Takeovers (1965-1980)

The fourth phase of takeover occurred between 1965 and 1980 when the world had recovered from the adverse effects of the Second World War.³⁸¹ This period was greatly characterised by mergers, acquisitions and takeovers that were largely practised by dominant corporations, which had large resources, market capitalisation and dominance.³⁸² Experts stated that the corporate control deals were primarily inspired by the high rises in stock prices, stringent enforcement of the antitrust laws that were adopted throughout England and the US and the progressive increment of interest rates. In this period (1965-1980), companies with large resources had the opportunity to expand their business by taking over the small companies and this process helped them to grow in the market.

The small entities that overcame the period of corporate control became subject of takeover targets by bigger corporations as it became more profitable to invest in their stocks in financial markets. The corporate financial deals were financed appropriately from equity and not

³⁷⁹ R. A. Brealey and S. C. Myers. *Principles of Corporate Finance*, 4th ed. New York, NY: McGraw Hill (1991).

³⁸⁰ *Ibid* 7

³⁸¹ Pound, John. "Raiders, targets, and politics: The history and future of American corporate control." *Journal of Applied Corporate Finance* 5.3 (1992): 6-18.

³⁸² This is the period of growth of conglomerate corporations.

by investment banks that had dominated the other phases of the takeovers.³⁸³ The investment banks earned large financial sums by acting as advisors to one the parties. The Attorney General of the US announced the government's plans to split the large transnational corporations by the end of 1968.³⁸⁴ This development and other regulatory measures were precipitated by the fact that corporations that actively participated in takeovers had poor performance registered in the stock markets despite taking part in a takeover of the small companies.³⁸⁵ Most of the modern corporate control deals of contemporary time trace their roots in the 1970s. The most notable corporate deal associated with this period is the famous United Technologies, the merger between INCO and ESB as well as the merger between Garlock Industries and Colt Industries to form OTIS Elevator.³⁸⁶

The concept of leveraged buyouts is rapidly becoming an issue of the past in the current business environment. Trehan has indicated that leveraged buyouts paved the way for the application of contemporary takeovers during that particular period. Financial corporations to represent the corporate control deals that would later be changed to mergers, acquisitions and takeovers by the existing market environment and legal jurisdictions used the leveraged buyouts.³⁸⁷ The effects of LBOs became so rampant in the 1960s even though it is a concept that

³⁸³ Ibid 10

³⁸⁴ Ibid 4

³⁸⁵D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁸⁶D. Selmer. Hostile Corporate Takeovers: History and Overview. *Northern Illinois University Law Review*, Vol. 203, No. 3, (1988). pp. 33 - 56.

³⁸⁷Y. Amihud. *Leveraged Management Buyouts: Causes and Consequences*. Dow Jones/ Irwin, Homewood, Illinois, (1989). pp. 14 - 27.

began earlier in the history of takeovers.³⁸⁸ The LBOs of the later period of 1960s were known as “bootstrap” corporate transactions as attributed to the takeover trends of steel companies by Sharon Steel Company that was owned at that time by Victor Posner.³⁸⁹

This approach of studying the history of takeover has been followed by a number of corporate experts and researchers. Legal experts have justified the sudden rise LBOs in the 1980s to the converging regulatory and economic factors prevailing in the US; the effective government policies on antitrust and securities laws that led to the approval of mergers that would previously have been challenged. The other aspect is the deregulation of several industries that provided opportunities for mergers, acquisition and corporate restructuring.³⁹⁰ This ensured that profitable companies consolidated and experienced further growth and controlled competitive forces of the market through forceful takeovers otherwise known as buyouts at the time.³⁹¹

The LBO experts have stated that the later periods of 1980s experienced a high increase in LBO deals that mainly involved buyouts of small and medium sized companies.³⁹² The small and medium sized deals did not feature mostly in the headlines like the mega multimillion deals that involved very large corporations. It is significant to mention that the LBOs at that time only

³⁸⁸R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. (2006). 4 December 2006,

³⁸⁹R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. (2006). 4 December 2006,

³⁹⁰R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. (2006). 4 December 2006,

³⁹¹LBO-Advisers. The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory, (2011).

³⁹² Ibid,

made less than 10% of the overall transactions that took place over the globe since the mode of acquiring and merging transformed into the modern practice.³⁹³

The other feature attributed to the LBOs in the 1980s is the infamous incident where numerous, highly prominent corporate buyouts resulted in bankruptcies of the target companies. The companies were worth less than the amounts they owed to other businesses.³⁹⁴ According to Trehan, the aftermath is associated and accrued to the fact that leverage ratio was nearly 100% and the interest payments were very high hence many companies' operating cash flows were not able to meet the requirements of the contract.³⁹⁵ The other vital feature of the corporate control market during this period when LBOs dominated the takeover arrangements was the fact that the market was initially created, sustained and developed by large businesses of the 1960s and 1970s.

The reports from the Washington Post in the year 2005 indicated that Kravis Kohlberg Roberts and Co. had acquired Merrill Lynch for an amount of over US \$ 33 billion.³⁹⁶ According to the Harvard Business School records of record-making businesses, Kravis Kohlberg Roberts and Co. is famed to have been the pioneer modern day leveraged buyout-type of takeovers in the world business history after they took over Orkin Exterminating Company during the 1960s

³⁹³ Ibid.

³⁹⁴R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. (2006). 4 December 2006

³⁹⁵R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. (2006). 4 December 2006.

³⁹⁶M. Levinson. *The Box, How the Shipping Container Made the World Smaller and the World Economy Bigger*. Princeton University Press, Princeton, (2006). pp. 44 - 47.

decade.³⁹⁷ However, according to Trehan, the first ever LBO that was most similar to contemporary takeover transactions was conducted during the spring season of 1955, when McLean Industries acquired Waterman Steamship Corp with a US\$ 42 million borrowed capital and a further US\$ 7 million rose through several issues of their preferred stock. Upon execution of the takeover deal, McLean Industries sold US\$ 20 million worth assets previously belonging to Waterman Steamship Corp as well as the liquid cash circulating at Waterman at the time the deal was closed. They would be under pressure from the banks financing the deal to reduce the level of borrowing by asset sales.³⁹⁸

Levinson who argues that seconds Trehan's contention, *"The first leveraged buyout that was most alike to modern takeovers may have been the purchase of Waterman Steamship Company by McLean Industries, Inc. in 1955. McLean Industries, Inc. was then owned by Pan-Atlantic Steamship Company"*.³⁹⁹

The only difference that prevented this particular deal from being a typical takeover deal was the fact that McLean borrowed over US\$ 42 million of the acquisition capital and raised a further US\$ 7 million by issuing preferred stocks. Had the company used its capital base to finance the deal rather than borrow, this would have marked the pioneer version of contemporary takeover deals.⁴⁰⁰

³⁹⁷LBO-Advisers. (2011). The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory.

³⁹⁸ Ibid 16

³⁹⁹LBO-Advisers. The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory. (2011).

⁴⁰⁰M. Levinson. *The Box, How the Shipping Container Made the World Smaller and the World Economy Bigger*. Princeton University Press, Princeton, (2011). pp. 44 - 47.

The LBO at the time was still regarded as a business acquisition meant for both private and public companies. The acquisition was predominantly financed by debts given the condition of a basic minimum investment on sound equity of the target company. The rapid increase in LBO transactions at the close of 1980s decade was associated with an equivalent buyout during the early 1990s hence eliminating the availability of loan financing. This forced many corporations to finance their takeovers or acquisitions with the shareholders 'capital and investments. This point of view led to the current system of takeovers experienced in the corporate environment as business sought to expand their operations and extend beyond their borders to tap the markets.⁴⁰¹ This meant that the acquiring company did not have to use the assets of the target as securities or collateral of their debts as required by the secured creditors in the LBOs. Where they had previously guaranteed that interests and principal amount obligations of an LBO could be met with cash flows and assets belonging to the target company posed for refinancing, most LBO initiators found themselves opting to finance the deals themselves hence changing the LBOs into takeover transactions.⁴⁰² The emerging trend in the corporate expansion strategies was further impacted in the 1980s by a rapid development of high-yielding debt portfolios otherwise known as "junk bonds" that provided the prospective LBO initiators with adequate capital required enhancing the financing of the takeover exploits without the need of loans.⁴⁰³ During this period the perception of takeovers changed in that the US companies

⁴⁰¹LBO-Advisers. The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory. (2011).

⁴⁰²J. Porter and H. Singh. An Empirical Analysis of the Motivation Underlying Takeovers in Australia. *Social Science Research Network Working Paper*, (2007).p. 2

⁴⁰³Ibid, pp. 2 - 3.

became interested in extending their arms to include takeovers in the financial market. The concept of leveraged buyouts originated, but no particular legislation was enacted to regulate them, presumably in the belief that the existing legislation would be sufficient to regulate this new market.

England seems to have taken the initiative during this period, but not on the scale that the US did. In England, the takeover issue is usually governed by company legislation and by case law. The protection of minority shareholders in the takeover process was not a new phenomenon in England. The protection of minority shareholders in takeovers is best reflected in the case of *Foss v Harbottle*.⁴⁰⁴ After the *Foss v Harbottle* case it was allowed that a minority shareholders could put forward a claim or allegation on behalf of the organisation. This rule in the *Foss v Harbottle* marked the beginning for solutions by minority shareholders. Mr. Starkie Turton and Mr. Foss were minority shareholders in a company called “Victoria Park Company”. The company had been established in 1835 to purchase land to the tune of 180 acres in Manchester, England, which later on grew to be Victoria Park. An Act of Parliament incorporated the company. The petitioners claimed that the company’s property had been wasted and misapplied and that several mortgages were inappropriately taken out secured by the company’s assets. They requested that a receiver be appointed and those who were guilty be held liable to the company. The court threw the case out stating that when its directors wrong a company it is only the company that has standing to sue.⁴⁰⁵

⁴⁰⁴*Foss v Harbottle* (1843) 67 ER 189

⁴⁰⁵ *Ibid* 41

The takeover issues were also considered by the Takeover Panel, which was set up in 1968 in London, England, as a regulatory body.⁴⁰⁶ Compared to the US system, the English system of takeovers seem to have been more organised in that it always paid attention to protecting the minority shareholders and judicial measures, the propriety of takeover and mergers used to be considered by the Takeover Panel.

During this period, the Sherman Antitrust Act was still in place in the US for the regulation of the mergers and takeovers⁴⁰⁷. However, the enforcement was lenient during the Johnson administration years of 1964-1967 because of the sluggish economic growth during that period. Together with the Celler-Kefauver Act of 1950 in force, many merged firms were prevented from unfair competition.⁴⁰⁸

3.2.5 The Fifth Takeover Period (1981-1989)

From the foregoing section, it is evident that the pioneer corporate deals like the LBOs were transformed over time into the current conventional takeover transactions experienced in the business world⁴⁰⁹. The immense volume of concentrated market takeover activities of modern times is typical of the takeover boom recorded in the 1980s decade (with takeover deals having recently been transformed from the predominant LBOs of previous decades).

⁴⁰⁶ The Takeover Panel - <http://www.thetakeoverPanel.org.uk/structure>, accessed 18 April 2016

⁴⁰⁷ Ibid 45

⁴⁰⁸Ibid The Sherman Antitrust Act of 1890.

⁴⁰⁹Davis, Gerald F., and Suzanne K. Stout. "Organization theory and the market for corporate control: A dynamic analysis of the characteristics of large takeover targets, 1980-1990." *Administrative Science Quarterly* (1992): 605-633.

The period of the 1980s is said to have opened the way for extensive research on the activities around the globe to determine the importance and best way of carry out the activity.⁴¹⁰ The three studies that were highly endorsed by the experts at the time was conducted by Walter in 1984, Bishop, Dodd in 1987, and finally by McDougall and Round in 1986.⁴¹¹ The insightful studies revealed that the rapidly increasing lucrative wealth outcomes generated by the takeover transactions and the impressive performance posted by the firms that successfully took part in takeover arrangements hence increasing the need for takeovers for the large corporations during that period.⁴¹²

The period of the 1980s is marked as the period in the history of takeovers to record the highest number of takeovers as denoted by the immensity of the transactions executed, the volume of all transactions and by the size of corporations engaging in takeover bids, and that some of the modern takeover transactions are typical of that particular period.⁴¹³

This period of evolution in a takeover in the business scene is characterised by breaking up of large corporations into small units called corporate breakup or conglomerate demergers. This was because the sum of the parts was now less than the breakup value.⁴¹⁴ The medium-sized

⁴¹⁰ B. Stanley. The biggest takeover bid in history: US\$ 128 billion offered for German firm. *The Spectator*. 20 November 1999, Hamilton, Ontario, (1999). pp. 7 - 11.

⁴¹¹J. Porter and H. Singh. An Empirical Analysis of the Motivation Underlying Takeovers in Australia. *Social Science Research Network Working Paper*, (2007). p. 2

⁴¹²I. Erel, R. Liao and M. Weisbach. World Markets For Merger and Acquisitions. *Working Paper Series*. National Bureau of Economic Research, Inc., Institute for Financial Research, (2009). pp. 4 – 7.

⁴¹³R. Rajan and R. Hattari. The Global Financial Crisis and Cross-border in Developing Asia. *Institute of South Asian Studies Brief*. National University of Singapore, (2009). pp. 2 - 5.

⁴¹⁴Karpoff, Jonathan M., and Paul H. Malatesta. "State takeover legislation and share values: The wealth effects of Pennsylvania's Act 36." *Journal of Corporate Finance* 1.3-4 (1995): 367-382.

firms experienced growth resulting from favourable market conditions. Most of the takeover targets launched growth initiatives in new markets outside their original markets and core business. The companies that needed easy access to the new markets horizons preferred taking over the innovative and less capitalised firms, then merging their business operations.⁴¹⁵

The major beneficiaries of the corporate control during this period of evolution include pharmaceutical industries, oil and gas companies, banking firms and the players in the airline industry across the business world.⁴¹⁶ During this period of evolution, the foreign takeovers became more predominant, where the domestic firms initiated cross-border takeovers to tap the new potential in overseas markets for further growth. The increased corporate control deals specifically unsolicited takeovers fuelled an increased volume of previously profitable, but relatively small enterprises in order to survive being forced to adopt new management structures.⁴¹⁷

3.2.6 The Sixth period - Takeovers in Modern Times (2000 – 2016)

It is important to note that the takeover arrangements undertaken in the current business world are generally taken by entities as expansion strategies and a bid to control a large market for increased profitability. In fact, Porter and Singh in their research have associated the contemporary time mergers, acquisitions and takeovers to the corporate finance field of the

⁴¹⁵Björn, Ismo. "Takeover: the environmental history of the coniferous forest." *Scandinavian journal of history* 25.4 (2000): 281-296.

⁴¹⁶Travlos, Nickolaos G. "Corporate takeover bids, methods of payment, and bidding firms' stock returns." *The Journal of Finance* 42.4 (1987): 943-963.

⁴¹⁷Ibid.

decades.⁴¹⁸ The arrangements have contributed to the current reallocation of resources in the global economy.⁴¹⁹ From an investment point of view, takeovers accounts for over 70% of the US foreign investment every year.⁴²⁰ This fact makes the takeovers, the single most dominant form of foreign investment in the US and the entire business world. The arrangements (takeovers,) are collectively referred to as the corporate control market.⁴²¹ The corporate control market has rapidly gained popularity and has been by many firms over the last two decades. The deals are said to have involved very substantial amounts of money to the tune of billions of US dollars per year globally.⁴²²

According to Rajan and Hattari, in 1970 the global outward foreign direct investment stocks stood at only US\$ 14 billion, but it has increased by more than 140 times over by the year 2007 to about US\$ 2,000 billion.⁴²³ Rajan and Hattari maintained that the most important point to note in regard to the fact that the FDI upsurge has largely been triggered by a dramatic increase in the corporate control market transactions (in both frequency and capital volume) of most existing entities and not because new corporate entities are being created.⁴²⁴

⁴¹⁸ Ibid 14

⁴¹⁹C. Moschieri and J. Campa. The European Industry: A Market in the Process of Construction. *Academy of Management Perspectives*, (2009). Vol. 23, No. 4, pp. 71 – 87.

⁴²⁰R. Rajan and R. Hattari. The Global Financial Crisis and Cross-border in Developing Asia. *Institute of South Asian Studies Brief*. National University of Singapore, (2009). pp. 2 - 5.

⁴²¹ Ibid, p. 1.

⁴²² R. Rajan and R. Hattari. The Global Financial Crisis and Cross-border in Developing Asia. *Institute of South Asian Studies Brief*. National University of Singapore, (2009). p. 1.

⁴²³Routley, Richard, and Valerie Routley. "The fight for the forests: the takeover of Australian forests for pines, wood chips, and intensive forestry-3." (1975).

⁴²⁴ Ibid, pp. 1 - 2.

The trade and development conference hosted by the UN further stated that the number and volume of the global corporate control market arrangements witnessed in the year 2006 netted a value of over \$880 US dollars.⁴²⁵ The value reached a maximum of US\$1200 in the millennium, which was the record for the period.⁴²⁶ This can be compared to a negligible volume of pre-1980 and the modest US\$ 150 billion worth of recorded at the beginning of the 1990s.⁴²⁷ As a result, is considered to be a vital platform for growth, diversification of operations, strategic international expansion and technological gain meant for developed, upcoming and the developing economies.⁴²⁸

As justification for current mergers and takeovers, the corporate control market is currently becoming the business strategy of firms that are intending to expand and expand their control of a particular market. In fact, the trend has further enhanced competition among the firms in various industries, as they battle to maximise their revenues for continued operations. The modern corporations are said to be involved in rewriting the traditional rules of.⁴²⁹ Modern takeovers are closely associated with the adverse effects of the economic crises that hit the financial markets recently in the year 2007.⁴³⁰ The global economic crisis period that started

⁴²⁵ C. Moschieri and J. Campa. The European Industry: A Market in the Process of Construction. *Academy of Management Perspectives*, (2009). Vol. 23, No. 4, pp. 71 – 87.

⁴²⁶ N. Kumar. “How Emerging Giants Are Rewriting the Rules of ”. *Harvard Business Review*, (2009). Vol. 87, No. 5, pp. 115 – 121.

⁴²⁷ C. Moschieri and J. Campa. The European Industry: A Market in the Process of Construction. *Academy of Management Perspectives*, (2009). Vol. 23, No. 4, pp. 71 – 87.

⁴²⁸ Ibid.

⁴²⁹I. Erel, R. Liao and M. Weisbach. World Markets For Merger and Acquisitions. *Working Paper Series*. National Bureau of Economic Research, Inc., Institute for Financial Research, (2009). pp. 4 – 7.

⁴³⁰ Ibid 22

around the summer of 2007 and lasted up until the beginning of 2010 revealed, that transactions in the corporate control market have become a strategic tool for growth and a key tool for strategic management in the 21st Century.⁴³¹ In the process, the dynamics of the corporate control market transactions have evolved to become the modern-day all-around business strategy for strategic growth and or company survival especially in the times of economic recession.⁴³²

3.3 Some Salient Trends of Takeover Transactions in England

It is evident that in England, the process of takeovers and mergers are governed by the City Codes on Takeovers and Mergers otherwise commonly known as the Takeover Codes.⁴³³ The City Codes as will be studied in Chapter 5 is a collection of rules that are written and overseen by the Takeover Panel. The Panel is made of people derived from the business and legal fraternity who have both insightful and professional knowledge about the issues of takeovers and mergers. The Panel in England is charged with regulating, formation and implementation of the City Codes in the relevant takeover events. Through its two main organs (code and hearing committee), the independent regulatory body has the capability of resolving various conflicts arising in the corporate world as a result of takeovers deals. The Panel is further attributed to a flexible and well-informed fashion to dispute resolutions in the required time. The parliament has

⁴³¹C. Moschieri and J. Campa. The European Industry: A Market in the Process of Construction. *Academy of Management Perspectives*, (2009). Vol. 23, No. 4, pp. 71 – 87.

⁴³²K. Ravichandran. Effect of Financial Crisis over in GCC Countries. *Working Paper Series G34*, (2009), pp. 45 - 59.

⁴³³J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 1.

conferred upon the body statutory powers to enforce the codes in the corporate scene without the interference of the court during such a crucial process. It follows that the court is not allowed to introduce the judicial procedure during the actual process of the takeovers and only allowed to intervene after the process has been completed.⁴³⁴

The Panel on takeovers and mergers in England is competitive in providing resolution to disputes hence appeal to the courts are rare after the Panel has reached a decision. It enjoys the advantages of non-interference from the judicial system of the government hence performs its duties independently to enhance the procedures in the takeovers.⁴³⁵ The takeover Panel is considered an effective mechanism to be applied in situations where quick, well informed and flexible response to disputes arising during the takeover processes is required. According to the experts, the takeover Panel governs and administers the resolutions of disputes in real time to enhance the quick process of transition in the takeovers.⁴³⁶

Of significance is the fact that the City Code was formerly a non- statutory body of professional rules adopted primarily to govern city institutions in the corporate control transactions on a relatively voluntary basis.⁴³⁷ The City Code became statutory in the year 2006 and before then the provisions in it were enforced as an ethical mechanism that firms voluntarily

⁴³⁴C. Moschieri and J. Campa. The European Industry: A Market in the Process of Construction. *Academy of Management Perspectives*, Vol. 23, No. 4, (2009). pp. 71 – 87.

⁴³⁵ R. Finbow and N. Parr. *UK Merger Control: Law and Practice*. Sweet and Maxwell, London, (1995). pp. 29 - 45.

⁴³⁶J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 1.

⁴³⁷Mitchell, Mark L., and J. Harold Mulherin. "The impact of industry shocks on takeover and restructuring activity." *Journal of financial economics* 41.2 (1996): 193-229.

embraced for purposes of good publicity and corporate image. A breach or contravention of the Code during corporate control deals mean that the involved firm suffered immense reputational damage with real market costs. Poor reputation results in loss of clients and highly compromised market position.⁴³⁸ The companies that go against the provisions risked being excluded from the city services predominantly run by prime institutions subsequently not enjoying the benefits accrued by other firms. The role played by the City Code in the business society enhanced its transformation into statutory status by the parliament providing enforcement powers against all the existing institutions in England.⁴³⁹

The fully-fledged implementation and the regulatory arm of the “Panel on Takeovers and Mergers” also forced many companies that could otherwise default on the Code to think twice prior any defiant actions since the Panel is not bound by statutory bureaucracy interests.⁴⁴⁰ It is argued that the success achieved by the implementation, administration and regulation by the City Code is that enhance its adoption into England statutes in 2006.⁴⁴¹ On adoption by the government in 2006, the parliament conferred upon it the statutory powers to function effectively hence became a component part of England compliance with the European Takeover Directive 2004/25/EC.

The Takeover Code has made England takeover practices to be strongly weighted towards the protection of the shareholder’s interests more than it does guarantee the directors’

⁴³⁸Jensen, Michael C. "Takeovers: Folklore and science." (1984).

⁴³⁹Ibid, p. 17.

⁴⁴⁰Ibid, p. 18.

⁴⁴¹Ibid, p. 24

right of decision making or the interests of other stakeholders to the firms involved in the takeover interests.⁴⁴² This issue of the takeover will be further elaborated and given more weight in other chapters of the research. It is vital to mention that the Takeover Code is by large geared towards the protection of shareholder interests, making England's takeover transactions very dissimilar in the case of the US corporate control market which is greatly scaled towards upholding the liberty of a firm's management board during the decision making processes following a takeover bid.⁴⁴³

The takeover Codes further emphasise the importance of equally treating the firms involved in a takeover struggle without the favour of considering the market dominance of either firms or corporate clout commanded by either the offeror or target company.⁴⁴⁴ The Codes critically emphasise the requirement of soliciting for shareholders' consent to takeovers or to the adoption of the takeover defences. All the shareholders of a company, in law, must be treated equally or with relative equality as emphasised in the company's incorporation charter, whichever of the two provides the most protection for the shareholders.⁴⁴⁵ These two equality requirements (for firms and shareholders) are captured with similar emphasis in the Directive Article 3 (1) A, saying "all holders of the securities of an offeree company of the same class

⁴⁴²United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 8/19.

⁴⁴³Hopt, K Comparative Company Law, ECGI - Law Working Paper Series, Paper No. 77/2006, 1 December 2006, in M Reimann and R Zimmermann eds., *The Oxford Handbook of Comparative Law*, Oxford University Press, Oxford, 2006, pp. 1161-1191.

⁴⁴⁴J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, 2006, p. 1.

⁴⁴⁵R. Finbow and N. Parr. *UK Merger Control: Law and Practice*. Sweet and Maxwell, London, (1995). pp. 29 - 47.

Must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected".⁴⁴⁶

The Codes have been attributed to excessively offering protective measures for firms against hostile bids, such as having numerous mandatory requirements before any prospective acquirer can present a takeover bid interests.⁴⁴⁷ The measures are said to have barred many potential acquirers from making their takeover bids to the target companies but instead enhanced the pursuit of mutually agreeable bid. The codes are strict to the extent of ensuring that unless the shareholder's consent is granted, the Code strictly prohibits a firm's management from employing any defensive tactics that would have the effect of frustrating an actual or anticipated bid.⁴⁴⁸

In resonance with the Code, the EU Directive on Takeovers and Mergers Article 3 (1) C, directs that "the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bids".⁴⁴⁹ This scenario as shall emerge in a later discussion contrasts with the US corporate control market, where a firm's board of directors have a flexible mandate to engage in any takeover defensive tactics without seeking the shareholder's consent first, as long as the

⁴⁴⁶United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication (1992). 2268, Vol. 4, p. 8/19.

⁴⁴⁷European Commission. 2004. Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids. *EC Official Journal, L 142*. Published 30 April 2004, pp. 0012 – 0023.

⁴⁴⁸United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 8/19.

⁴⁴⁹Bebchuk, Lucian Arye, and Allen Ferrell. "Federalism and corporate law: the race to protect managers from takeovers." *Colum. L. Rev.* 99 (1999): 1168.

defensive tactics can aptly be justified in complete accordance with the legally recognised fiduciary duties of corporate directors.⁴⁵⁰ England context is however different in many ways, primarily as a consequence of the unique feature of the Code interests.⁴⁵¹

The takeover Code clearly regulates the type of information that companies should or should not release to the general public with regard to a potential takeover bid. It is a requirement of the Code that any information relating to a tabled or prospective takeover bid must not be released to the public except when and only when such announcements are regulated as such by the Code. In this regard, the Code uses a timetable to schedule every aspect of takeover bid interests.⁴⁵²

The compulsory minimum incorporation period after a bid's declaration is also similarly captured and emphasised by the Directive Article 3 (1) B, directing that

“the holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation

⁴⁵⁰J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006) pp. 1 -2.

⁴⁵¹European Commission. 2004. Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids. *EOfficial Journal*, L 142. Published 30 April 2004, pp. 0012 – 0023.

⁴⁵²United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 9/19.

of the bid on employment, conditions of employment and the locations of the company's places of business”.⁴⁵³

The schedules are stipulated in timetables of the Codes allowing the shareholders time to meet and deliberate on the bid, give or deny consent to the board of directors on whether to agree to or react defensively to a given takeover bid interests.⁴⁵⁴

According to Kraakman et al. (2004)

“a final general aspect of information rules in takeover bids is the acceptance of the view that information disclosure is ineffective unless shareholders are given enough time to absorb the information (or other people’s analyses of the information) before they have to act on it”.⁴⁵⁵

From this perspective, it can be argued that when the Code regulates bid response timings, it is to offer all concerned parties a required minimum time for informed decision makings, such as 20 days after the initial bid (adequate for the shareholders to convene according

⁴⁵³United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 9/19.

⁴⁵⁴R. Kraakman, P. Davis, H. Hansmann, G. Hertig, K. Hopt, H. Kanda and E. Rock. *The anatomy of corporate law: A comparative and functional approach*. Oxford University Press, New York, (2004). p. 176.

⁴⁵⁵United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 9/19.

to the United States International Trade Commission)⁴⁵⁶ or a relatively shorter period after a revised bid.⁴⁵⁷ The scholars are however quick to point out that,

“The main counter-argument against very generous absorption periods is the need to minimise the period during which the target’s future is uncertain and, in particular, during which the normal functioning of the centralise management of the target is disrupted”.⁴⁵⁸

Again, the more the mandatory minimum offer period are, the more chances there are that a White Knight will appear ultimately making it a more costly bid.⁴⁵⁹ The Code’s imposition of lengthy mandatory minimum offer period is seen by some experts as delimiting the success of takeovers in England at the expense of potential and actual bidders.⁴⁶⁰

In England, takeover bidders have a set minimum bid level to observe as set out in the Code, which in most cases follows from the previous purchase of the firm’s shares.⁴⁶¹ For instance, it is the requirement of the Code that the offer made by an actual or potential bidder must never be of less value than any of the prices that the bidder paid to acquire shares within the three months prior to making the big announcement. According to the Code, when a firm

⁴⁵⁶ S. Kenyon-Slade. *Mergers and Takeovers in the US and UK: Law and Practice*, Oxford University Press, Oxford, (2004). pp. 67 - 83.

⁴⁵⁷United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 9/19.

⁴⁵⁸R. Kraakman, P. Davis, H. Hansmann, G. Hertig, K. Hopt, H. Kanda and E. Rock. *The anatomy of corporate law: A comparative and functional approach*. Oxford University Press, New York, (2004). p. 176.

⁴⁵⁹ Ibid.

⁴⁶⁰S. Kenyon-Slade. *Mergers and Takeovers in the US and UK: Law and Practice*, Oxford University Press, Oxford, (2004). pp. 67 - 83.

⁴⁶¹J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review*, (2000). Vol. 19, No. 1, pp. 29 - 32.

announces its intention to present a takeover offer, it must always be prepared to match or raise the price it has been willing to pay in its acquisition initiative three months prior to such an announcement.⁴⁶²

Again in accordance with the bid minimum levels, the Code requires that if the target company's shares are acquired during the deal's offer period and they are bought at a higher price than the offer price, then the firm or entity making the takeover offer must increase that offer price to match or exceed the value of the target firm's shares during the deal's offer period.⁴⁶³

The Code also greatly reduces the opportunities of a shareholder to initiate a creeping tender offer as a takeover strategy.⁴⁶⁴ A creeping tender offer is the third available takeover mechanism besides more common friendly takeovers and the less common outrightly hostile takeover bids.⁴⁶⁵ The creeping tender offer is so-called creeping because it involves a potential acquirer gradually.⁴⁶⁶ In this takeover mechanism, once the potential acquirer accumulates stock volume that commands an adequate voting power, he or she surprises the target company with a tender offer. If the presiding management declines the tender offer, the potential acquirer can

⁴⁶²J. Borer and J. Hohn. Hostile takeovers. *International Financial Law Review*, (2000). Vol. 19, No. 1, pp. 29 -32.

⁴⁶³Hopt, K *Comparative Company Law*, ECGI - Law Working Paper Series, Paper No. 77/2006, 1 December 2006, in M Reimann and R Zimmermann eds., *The Oxford Handbook of Comparative Law*, Oxford University Press, Oxford, pp. 1161-1191.

⁴⁶⁴S. Kenyon-Slade. *Mergers and Takeovers in the US and UK: Law and Practice*, Oxford University Press, Oxford, (2004). pp. 67 – 83

⁴⁶⁵A. Jones and B. Sufirin. *EC competition law: Text, cases, and materials*. Oxford University Press. Oxford, (2007). pp. 1016 – 1018

⁴⁶⁶R. Finbow and N. Parr. *UK Merger Control: Law and Practice*. Sweet and Maxwell, London, (1995) pp. 29 - 47.

effect a favourable change in the target company's management through a vote and in so doing get the tender offer accepted.⁴⁶⁷

The Code however requires that every shareholder who accumulates stock gradually must make the takeover offer known to the target company when his/her/its shareholding volume, including the stock volume held by other parties by then acting in a concert (what is legally termed as a concert party because they only acquire stock in an identity complementing that of the interested shareholder,⁴⁶⁸ reaches the 30% scale of the target's total share volume. This has been seen as totally defeating the creeping tender offer advantage in English takeover practices.⁴⁶⁹

Again, the Code seeks to reduce malicious schemes between competitors via the use of takeover threats that are known to happen in many highly competitive industries. On this accord, the Code requires that if there are rumours in circulation or speculations are being made to the effect that a certain firm is seeking to take over another, any actual or prospective bidder in the rumoured or speculated takeover must necessarily make an announcement to clarify its position in regards to that rumour or speculation, if that rumour or speculation has in any way affected the

⁴⁶⁷ S. Kenyon-Slade. *Mergers and Takeovers in the US and UK: Law and Practice*, Oxford University Press, Oxford, (2004). pp. 43 – 91

⁴⁶⁸Hopt, K Comparative Company Law, ECGI - Law Working Paper Series, Paper No. 77/2006, 1 December 2006, in M Reimann and R Zimmermann eds., *The Oxford Handbook of Comparative Law*, Oxford University Press, Oxford, pp. 1161-1191.

⁴⁶⁹J. Armour and D. Skeel. *Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation*. Working Paper, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 1.

target company's share trading patterns and prices.⁴⁷⁰ The Code ensures that companies that are in competition do not start such rumours and speculations to negatively impact on their competitors when they have no intention of making a takeover bid, a potentially lethal strategy if left unregulated.⁴⁷¹

It should be noted that in England, takeovers are also regulated in accordance with stipulations of the European Commission market competition law⁴⁷² a good example of such scenarios is when a takeover transaction threatens the competitive markets envisioned by the commission within member states. There are instances that takeovers can be blocked especially when such takeovers have the potential to yield uncompetitive conditions in the EU market such as is exemplified by Jones and Sufrin where

“The EC prohibited Schneider’s takeover of Legrand on the basis that the concentration would lead to the creation or strengthening of a dominant position on a number of identified electrical equipment markets”.⁴⁷³

The discussion featured above has focused only on providing a succinct highlight of the most salient trends in English takeovers and takeover transactions based on the most prominent statutory and practice regulatory mechanisms, the City Code of Takeovers and Mergers and the

⁴⁷⁰J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). pp. 1 - 3.

⁴⁷¹ Ibid 77

⁴⁷²Ibid, p. 2.

⁴⁷³J. Armour and D. Skeel. *Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation.* *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 2.

EU Directive of Takeovers as overseen by the Panel on Takeovers and Mergers⁴⁷⁴. The regulatory mechanisms have numerous provisions and requirements some of which will be reviewed in a later section of this research in contrast to the US corporate control market trends.

At this juncture, however, it is vital to highlight that in some instances prior to the widespread acceptance and binding observance of the Code, and more importantly, prior to the statutory adoption of the Code in 2006, English takeovers were legally regulated by the Companies Act 1985⁴⁷⁵. The Act featured the famous Rules Governing the Substantial Acquisition of Shares, a set of rules that sought to legally control how takeovers were initiated, conducted and finalised. When the Code sufficed from the professional circles of the corporate control market, the Rules Governing the Substantial Acquisition of Shares were then implemented and overseen as an accompaniment to the Code. At this time, the Code mainly regulated and defined when and how the announcement of pertinent shareholdings levels was made at the onset of a takeover bid. With the improvement of the Code, its acceptance, successful adoption and subsequent statutory incorporation into England and by extension EU takeover law the Rules Governing the Substantial Acquisition of Shares have been abolished.⁴⁷⁶

⁴⁷⁴Scholes, Myron S., and Mark A. Wolfson. *The effects of changes in tax laws on corporate reorganization activity*. No. w3095. National Bureau of Economic Research, 1989.

⁴⁷⁵Jensen, Michael C. "Takeovers: Their causes and consequences." *The Journal of Economic Perspectives* 2.1 (1988): 21-48.

⁴⁷⁶ S. Kenyon-Slade. *Mergers and Takeovers in the US and UK: Law and Practice*, Oxford University Press, Oxford, (2004). pp. 43 - 91.

Similar provisions as were apparent in the Rules Governing the Substantial Acquisition of Shares are still in existence within England Companies Act 1985.⁴⁷⁷

3.4 Some Salient Trends of Takeovers in the US

Any analysis of the US takeover context in contemporary times is always cognisant of the fact that, “the content of takeover regulation differs just as markedly on the two sides of the Atlantic (the US and England)”.⁴⁷⁸ Indeed, one of the most dominant agreement points among corporate experts is that the US corporate control environment contrasts greatly with that of England, more so in the regulation and execution of takeovers.⁴⁷⁹

In most US jurisdictions, takeovers are governed under precedents set by Delaware courts, mainly because these particular State laws were the pioneer to give American corporations ‘a great room to manoeuvre, perhaps explaining why even up to today, more corporations are registered in Delaware than in all other American states combined.’⁴⁸⁰

Armour and Skeel (2006) traced many of the presiding disparities between English and the United States takeover regulation frameworks to their origination. Their discussion highlighted several significant insights to the characterisation of the contemporary US takeover

⁴⁷⁷United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992). Vol. 4, p. 8/19.

⁴⁷⁸J. Armour and D. Skeel. *Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation*. Working Paper, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006) p. 6.

⁴⁷⁹A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995) p. 7.

⁴⁸⁰*Ibid*, p. 8 - 9.

environment. As was noted in the foregoing section, the contemporary regulatory environment of England was largely initiated by the private interests of corporate professionals and institutional investors (who originated the City Code on Takeovers and Mergers). The resultant self-regulation and governance of English takeover transactions would later be rubber-stamped and adopted in ‘as is basis’ by the region’s new legal frameworks.⁴⁸¹ As noted by Armour and Skeel, “The self-regulation of takeovers in England has led to a regime largely driven by the interests of official stockholders.”⁴⁸²

It is therefore easy to see why the origin of takeover regulation in England has influenced the region’s dominant insistence on shareholder’s rights during takeovers (since the originators were shareholding institutional investors) than on the rights accorded to firms’ managers.

This contrasts in a major way with the US takeover context where the origination of takeover regulation was not with the shareholders but with corporate managers. Armour and Skeel put it even better in their opinionated statement that,

“The dynamics of judicial law-making in the US have benefited managers by making it relatively difficult for shareholders to influence the rules.”⁴⁸³ While the City of London (UK) found it easy to privatise takeover deals, Wall Street (US) found it extremely hard to follow the same privatisation route in regulating corporate takeovers because US federal regulation in the 1930s both pre-empted self-regulation and restricted the ability of institutional investors to coordinate.”⁴⁸⁴ This

⁴⁸¹A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995) p. 7.

⁴⁸²Ibid, p. 2.

⁴⁸³A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995) p. 3.

⁴⁸⁴Ibid, p. 3 - 4.

explains why up to today, the US takeover regulatory mechanisms have accorded corporate directors immense powers to preside over takeover bids, either as offerees or as recipients of such bids, without the obligation to seek for shareholder consent prior to making vital decisions”.⁴⁸⁵

Armour and Skeel point out that:

“in the United States, Easterbrook and Fischer’s shareholder-oriented approach has been far more successful in theoretical debates than as an influence on actual practice (mainly because Delaware courts have dismissed the shareholder choice perspective in several important takeover decisions, emphasising instead that the company is managed by or under the control of its directors”.⁴⁸⁶

To exemplify this phenomenon and the immense powers that US takeover regulation grants to corporate directors, the 1998 case of *Kahn v. MSB Bancorp, Inc.* is a replica of many similar court decisions.⁴⁸⁷ MSB Bancorp, Inc. had been the target of a takeover by Kahn. At the beginning of the bid process, MSB received an unsolicited offer proposing a merger with Kahn, Khan being the bidder.⁴⁸⁸ This first letter did not propose the price offer for the takeover but

⁴⁸⁵A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995) p. 3.

⁴⁸⁶United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992) Vol. 4, p. 89/19.

⁴⁸⁷ *Kahn v MSB Bancorp, Inc.*, 734A.2d 158 (Delaware 1999)

⁴⁸⁸J. Coates. Takeover defences in the shadow of the pill: A critique of the scientific evidence. *Texas Law Review*, No. 79, No. 2, (2000). pp. 271-382.

simply made Kahn's intention known and invited MSB to enter into negotiations.⁴⁸⁹ Soon after, MSB received a second letter, this one having a suggested offer price for their stock should the bid be accepted. Notably, the second letter also did not specify on the terms of the proposed takeover although it gave a bid offer.⁴⁹⁰

After a brief consideration and consultation with their investment banker in regards to the offer, MSB board of directors rejected the bid.⁴⁹¹ It was at this point that Khan sued MSB, for having made a board decision that breached their fiduciary duties of loyalty and care. According to Khan's suit, MSB's board rejected the offer before disclosing it to their shareholders and were thus in violation of fiduciary duties.⁴⁹² After hearing the case the Delaware Chancery Court found that the plaintiffs were not guilty of violating their directors' 'fiduciary duties of loyalty and care in the rejection of Khan's takeover bid, since they

“Merely voted not to negotiate the merger offer, “and no superior benchmark of statutory review is applicable to that verdict, because “there was no defensive action by the target’s board of directors”.⁴⁹³

⁴⁸⁹United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, (1992).Vol. 4, p. 9/17.

⁴⁹⁰J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, Cambridge, University Of Cambridge, (2006). p. 7.

⁴⁹¹Ibid, pp. 7 - 8.

⁴⁹²J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, Cambridge, University Of Cambridge, (2006). p. 2.

⁴⁹³Ibid, pp. 2 - 3.

This decision would later be confirmed in 1998 by the Delaware Supreme Court.⁴⁹⁴ As can be seen from the foregoing explanation, most states as well as the federal corporate control market regulating authority

s only require directors to satisfy their obligations to the best interest of the company and its shareholders as provided for in corporate charters and the basic company law⁴⁹⁵. Once this obligation is fulfilled or can be proved as having been fulfilled, directors can proceed to make takeover decisions oblivious to shareholder inclinations⁴⁹⁶. This can be gleaned from Fleischer and Susaman's research as they emphasised on the fact that,

*“During takeovers, directors ‘responsibilities in Delaware and most jurisdictions are measured primarily by the business judgment rule, a principle that essentially defers to the decision-making process of the directors themselves and that, absent special circumstances such as personal gain, presumes the propriety of the directors’ actions’.”*⁴⁹⁷

The scholars further note that “in cases against directors arising out of completed actions involving operational issues, the business judgment rule shields directors from personal liability if, upon review, the court concludes the directors’ decision can be attributed to any rational

⁴⁹⁴ C. Mayer. Corporate Cultures and Governance: Ownership, Control and Governance of European and US Corporations, Transatlantic Perspectives on US-EU Economic Relations: Convergence, Cooperation and Conflict. Conference Draft presented on 31 March 2002, Said Business School, Oxford, University of Oxford, Oxford, (2002). p. 6.

⁴⁹⁵ Ibid 121

⁴⁹⁶Deakin, Simon, and Giles Slinger. "Hostile takeovers, corporate law, and the theory of the firm." *Journal of Law and Society* 24.1 (1997): 124-151.

⁴⁹⁷C. Mayer. Corporate Cultures and Governance: Ownership, Control and Governance of European and US Corporations, Transatlantic Perspectives on US-EU Economic Relations: Convergence, Cooperation and Conflict. Conference Draft presented on 31 March 2002, Said Business School, Oxford, University of Oxford, (2002). p. 6.

business purpose”.⁴⁹⁸ This means that, for any shareholder in a US company to challenge decisions of the directors during a takeover bid, the said shareholder will have to rebut the primary assumption of the business judgment rule for it is upheld by many courts particularly those in Delaware.

In Fleischer and Susaman’s words, “a shareholder plaintiff must effectively provide evidence that the “board of directors, in reaching its challenged decision, breached any one of it’s ‘triad of fiduciary duties, loyalty, good faith and due care’”.⁴⁹⁹ Examples of precedent rulings that set out these conditions include the *Unitrin, Inc. v. American General Corp.*⁵⁰⁰ also delivered in Delaware in 1995, *Sinclair Oil Corp. vs. Levien.*⁵⁰¹ As was distributed in the Delaware Supreme Court in 1971, the *Cinerama, Inc. v. Technicolor, Inc.*⁵⁰² delivered in Delaware in 1995, the *McMullin v. Beran*,⁵⁰³ delivered in Delaware in 2000, the *Partners v. Berlin*⁵⁰⁴ delivered in Delaware in 1999, as well as the *Tri-Star Pictures, Inc.*⁵⁰⁵ delivered in Delaware in 1993.

In effect, contemporary US takeovers are quicker and more flexible since the legal framework underscoring takeover transactions have been greatly simplified and liberated in the

⁴⁹⁸ Ibid.

⁴⁹⁹ A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995). p. 4.

⁵⁰⁰ *Unitrin, Inc. v. American General Corp.* (651 A. 2d 1361, 1373)

⁵⁰¹ *Sinclair Oil Corp. vs. Levien* (280 A. 2d 717, 720)

⁵⁰² *The Cinerama, Inc. v. Technicolor, Inc.* (663 A. 2d 1156, 1162-63)

⁵⁰³ *The McMullin v. Beran* (765 A. 2d 910, 917)

⁵⁰⁴ *The Partners v. Berlin* (726 A. 2d 1215, 1221)

⁵⁰⁵ *Tri-Star Pictures, Inc.* (634 A. 2d 319, 333)

last three decades. The US context nevertheless tends to overly lend the ex-post flavour to dominate takeover dispute resolution; something that makes the much more expedient UK Panel on Takeovers and Mergers preferable at least in this regard.⁵⁰⁶ This overly simplified perspective fails to capture why hostile takeovers are more common and often more successful in the US than in most European countries with the exception of England where a considerable but still lesser hostile takeovers are executed as compared to the US. The perspective also fails to illustrate on the fact that why U.S mergers, acquisitions and takeovers are by far more than any recorded in any country across the globe, including England.⁵⁰⁷ According to the United States International Trade Commission,

*“Takeovers have not been as common in Europe as they have been in the United States, and more importantly, hostile takeovers have been fairly rare in Europe.”*⁵⁰⁸

The Commission further states that,

*“...only in the United Kingdom is the hostile takeover a common occurrence.”*⁵⁰⁹

An ideal explanation to these two questions is perhaps the one offered by Armour and Skeel in arguing that,

⁵⁰⁶A. Fleischer and A. Sussman. *Takeover Defence*. Fifth Edition. Aspen Law and Business, Englewood Cliffs, NJ, (1995). p. 4.

⁵⁰⁷Ibid, p. 3.

⁵⁰⁸ Ibid.

⁵⁰⁹J. Coates. Takeover defences in the shadow of the pill: A critique of the scientific evidence. *Texas Law Review*, No. 79, No. 2, (2000). pp. 271-382.

“While US regulation of tender offer bidders is relatively shareholder-friendly, the treatment of target managers ‘responsibilities in the face of an unwanted takeover bid is anything but’.”⁵¹⁰

This means that for those seeking to takeovers other companies, US regulations accord shareholders the right to participate in the decision making process, such as of which company to acquire, when and at what cost. However, the scenario changes when it comes to the shareholders of a target company since in this instance, the directors are given an almost sole prerogative to make decisions on whether to accept or decline takeover bids.

As Armour and Skeel further argued that
 *“managers of a target company are permitted to use a wide variety of defences to keep takeover bids at bay, ...the most remarkable of the defences is the poison pill or shareholder rights plan, ...designed to dilute a hostile bidder’s stake massively if the bidder acquires more than a specified percentage of target stock—usually 10 or 15%”*.

The poison pills work miracles for US target companies in averting a takeover bid. An example of such a poison pill defence strategy is when the target managers invite all their shareholders with the exception of the hostile bidder to buy additional shares at a highly reduced price, thus giving managers the absolute ability to defend their interests against hostile bidders.⁵¹¹

To make the manager’s power even more absolute US corporate managers can have both the poison pill strategies at their disposal as well as staggered boards,

⁵¹⁰United States International Trade Commission. *The Effects of greater economic integration within the European Community on the United States: First follow-up report*. United States International Trade Commission Publication 2268, Vol. 4, (1992). p. 9/17.

Auerbach, Alan J., ed. *Corporate takeovers: Causes and consequences*. University of Chicago Press, 2013.

⁵¹¹M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives*, Vol. 2, No. 1, (1988). p. 23.

“Giving them a nearly total discretion to refuse to accept a takeover bid that is not wanted”.

The scholars go on to point out that

*“In addition to poison pills and staggered boards, US targets are also permitted other defences, such as breakup fees and other “lockup “provisions that are designed to cement a deal with a favoured bidder while keeping hostile bidders at bay”.*⁵¹²

As this ensues, it also emerges that US corporate shareholders are among the most suppressed in regards to voting power allocation as compared to England and Europe at large. In a study that accessed the concentrations of voting power among firms across Europe and the US, Mayer points out that shareholders in Germany and Austria have clear voting bunching ranging within the 75%, 50% and 25% margin of voting blocks. According to the scholar, these two countries⁵¹³ have a voting regulation that corresponds significantly to the trends of blocking minority voting and supporting majority and more so super-majority blocks of shareholder voting. On the other hand, firms in Italy and Belgium usually concentrate their voting blocks to slightly more 50% of the shareholders ‘voting power. This can be compared with England, where firm’s exhibit few voting blocks that are slightly above 30% since it is required by takeover regulation to declare subsequent voting power accumulation above the 30% shareholding potential.⁵¹⁴

As Mayer points out this restriction imposed on English shareholders

⁵¹²M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives*, Vol. 2, No. 1, (1988). p. 23.

⁵¹³Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

⁵¹⁴M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives*, Vol. 2, No. 1, (1988). p. 27.

*“Corresponds to the level at which mandatory bids have to be made for all the shares of a target company ... since takeover rules have therefore discouraged the accumulation of share blocks in excess of 30% in England”. The one jurisdiction in which shareholders ability to challenge managers through their voting power is highly limited is the US where, “shareholdings in excess of 10% and 20% ..have regulatory control implications (in terms of disposal of shares and liabilities for federal law violations)”.*⁵¹⁵

According to Meyer,

*“this is consistent with the concentrations of ownership of US firms below 10% and 20% and the small number of shareholdings in excess of 20%”.*⁵¹⁶

What emerges so far from a closer examination of the US corporate control market is that shareholders of a target company (the company of interest to this study since it is the one that invokes takeover defences when such defences are deemed most appropriate), have very limited options and that US companies are more or less takeover proof at the discretion of their board of directors⁵¹⁷. There is the business judgment rule to contend with, which favours the directors of a target firm those target company’s shareholders. There is the availability and ease of use of numerous takeover defence strategies if managers feel a hostile takeover bid is not to their best interest. Finally, there is the dismal regulatory allowance for shareholder voting power that makes a takeover bid almost impossible and which does not give shareholders a lot of clout in

⁵¹⁵ Ibid, p. 22.

⁵¹⁶ Ibid, p. 22.

⁵¹⁷Coate, Malcolm B., Richard S. Higgins, and Fred S. Mc Chesney. "Bureaucracy and politics in FTC merger challenges." *The Journal of Law and Economics* 33.2 (1990): 463-482.

challenging manager's actions during takeover bids. All these difficulties are heaped upon the shareholders and their interests⁵¹⁸.

Nonetheless, it is noteworthy that despite the limitations personified by the business judgment rule, most US jurisdictions including Delaware have modified the traditional concept of the business judgment rule to apply it contextually in solving any dispute arising from the defensive takeover actions taken by a target company's board so as to resist unsolicited takeover bids.⁵¹⁹ Whenever there is shareholder contention on a board decision during the sale of a company's control, American courts have begun to accept shareholders to present grievances that would otherwise have been barred by the business judgment rule in previous contexts.⁵²⁰ Fleischer and Sussman argue that on the fact that,

“Because of the nature of contested takeovers and mergers and the very substantial financial stakes involved, target board actions in those contexts are frequently challenged in the courts ... (and) thus, numerous cases have adjudicated the nature of a board's fiduciary responsibilities in evaluating and reacting to an unsolicited offer and in entering into a merger or sale of control and a sizeable body of law has developed”.⁵²¹

It thus emerges that, the reputed liberation and flexibility of the US takeover market has emerged as a product of many legal battles and policy transformations and adaptations. This exemplary development is quite understandable given that the US corporate market has been

⁵¹⁸ Ibid 44

⁵¹⁹ Ibid, pp. 172.

⁵²⁰Ibid. pp. 170

⁵²¹M. Jensen. Takeovers: Their Causes and Consequences. *Journal of Economic Perspectives*, (1988). Vol. 2, No. 1, pp. 22.

more proactive in history, than that of any other developed nation.⁵²² Several crucial elements of the US takeover legal framework have seen dramatic changes in the last three decades most notably the role played by industry regulation, the role of directors in takeover bids in both target and acquiring firms as well as the requisite procedural aspects of a takeover process. According to Jensen, the US takeover market has been dodged with the controversy of liberating the corporate players to engage in corporate control deals with minimal legal inhibitions and often delimiting mandatory requirements, or whether corporate control transactions should be closely regulated as a measure of safeguarding against corporate malpractices⁵²³.

Most of the scholars and practitioners who take either of the two sides in the legislative restrictions ‘controversy agree at least on the basic realisation that,

“The US market for corporate control has created large benefits for shareholders and for the economy as a whole by loosening control over vast amounts of resources and enabling them to move more quickly to their highest-valued use”.⁵²⁴

According to Jensen and other scholars and practitioners in this school of thought, the high and frequent number of completed and attempted takeover transactions in the US corporate control market presents an advantage and not a disadvantage as some liberalists claim. The school of thought holds that the future of the US corporate control market is in even more liberalisation and flexibility and not in the outdated stiff regulatory practices of the past decades. In his words, Jensen states that

⁵²² Ibid. p.120

⁵²³ Ibid 110

⁵²⁴ Ibid, pp.123.

*“This is a healthy market in operation, on both the takeover side and the divestiture side, and it is playing an important role in helping the American economy adjust to major changes in competition and regulation of the past decade”.*⁵²⁵

It has, however, been contested that the highly liberated corporate control market and the removal of many regulatory framework previously governing the sector as well as in consideration of the bad and good experiences of other developed economies across the world, the US government should initiate some form of stringent control on modern-day takeovers. Jensen notes that,

*“The controversy has been accompanied by strong pressure on regulators and legislatures to enact restrictions that would curb activity in the market for corporate control”.*⁵²⁶

Consequently, there have been tens of congressional bills proposed for adoption by the US Congress in the last 20 years or so, most of them proposing new restrictions on corporate takeovers, but as Jensen notes, none of these has passed as yet.⁵²⁷

Most notable among the proponents of increased legislative regulation of takeovers has been the so-called Business Roundtable.⁵²⁸ The Business Roundtable is a lobby group comprising of 200 chief executive officers representing as many of the largest US

⁵²⁵R. Trehan. The History of Leverage Buyout. *Research Papers for Hoteliers*. 4 December 2006.

⁵²⁶ Ibid.

⁵²⁷LBO-Advisers. The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory; (2011). p.3.

⁵²⁸ Ibid.

corporations.⁵²⁹ The lobby group has in the last 10 years persistently and passionately advocated for more restrictive legislation on the corporate control market especially with regards to takeover transactions.⁵³⁰ These concerted efforts have been seen to bear fruits with the state legislatures of Ohio, New Jersey, Indiana, New York, Pennsylvania, Maryland, Connecticut, Kentucky, Illinois, Michigan and Minnesota have passed some relatively restrictive antitakeover laws within the last few years.⁵³¹

Among the most notable legal frameworks that have so far governed takeovers in the US was the initiative of the US Federal Reserve Board to implemented new debt-financed takeover restrictions at the beginning of the 1987 fiscal year, as a bid to limit the failures of the prominent LBOs of the decade.⁵³² As discussed earlier, the 1980s decade recorded one of the most dramatic LBO booms in the US corporate control market, only to end up with numerous negative economic impacts as many of these LBO deals ultimately led to failure and losses in previously profitable enterprises.⁵³³

⁵²⁹LBO-Advisers. The History of the Leveraged Buy-Out. LBO-Advisers Website - A Venture capital and private equity directory. (2011). p.3.

⁵³⁰J. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 1.

⁵³¹. Armour and D. Skeel. Who writes the rules for hostile takeovers, and why? The peculiar divergence of US and UK takeover regulation. *Working Paper*, No. 331. September 2006. Centre for Business Research, University Of Cambridge, Cambridge, (2006). p. 3.

⁵³² E. Penrose. *The theory of the growth of the firm*. Oxford University Press. Oxford, (1959). pp. 23 - 78.

⁵³³ A. Seth, K. Song and R. Pettit. (2000). Synergy, Managerialism or Hubris? An Empirical Examination of Motives for Foreign Acquisitions of U.S. Firms. *Journal of International Business Studies*, Vol. 31, No. 3, p. 388.

3.5 Conclusion

Evolution of the merger and acquisition activities has been discussed in this chapter. The history of takeovers was analysed in two perspectives namely; the evolution path perspective and the timeline perspective. In addition, the issues of takeovers in the contemporary corporate world were examined.

The evolution path approach of analysing the history of takeovers particularly looked into the issues surrounding it in a chronological manner. It was identified to contain to five phases: First to fifth eras. The first era notes the takeover as having begun in 1870 and 1904 with the reshaping of the large business activities. Small firms initially got engaged in mergers, acquisitions and buy-outs with a major aim of benefiting from large-scale transactions. It was noted in between 1916 and 1929, the second era was associated with the “oligopolistic” firms, which entered into the takeovers with major’s aims of exploiting new and existing markets fully, takeovers in the 1870s, the boom of 1980s decade, takeovers in the modern times. Finally, the contemporary issues considered were the salient trends of takeovers both in the U.K and the U.S.

In the initial phase of Acquisitions and Mergers of cooperation, almost no defence tactics existed. Apparently, the concept of defence tactics became evident in England and US in a concrete form in the 1960s. In the process of Acquisitions and Mergers apparently until the 1960s minority shareholders’ position was mostly disregarded, although in England *Foss v Harbottle* was the first case to highlight this issue and the development of defence tactics and all forms of it received attention in Chapter 3 of this research.

CHAPTER 4: Types of common takeover defence tactics in England and the US

4.1 Introduction

This particular chapter of the research study presents comprehensive illustration on identifying and discussing the most prominent types of takeover defence tactics practised within the US and England. As discussed earlier, “takeover defence tactics are techniques that are applied to deter acquisition or merging of the target company with the acquirer”.⁵³⁴ These techniques can be pre-takeover or post-takeover defence tactics suggesting that they can either be implemented before or after a takeover bid. The defence strategies are in most situations implemented against hostile takeovers as compared to more friendly takeovers.⁵³⁵

A hostile takeover refers to a situation in which merging or acquiring a target company by the acquirer is executed through strategic, legal or the management of the target company rights to retain their independence due to a fear of losing their positions or considering that the company is being under-valued. The other types of takeovers consist of friendly takeovers, reversed takeovers and backflip takeovers.⁵³⁶ Various techniques may be used against the hostile take-overs and other strategies. However, tactics discussed in this chapter are charter amendments, control over the register and control over the debts, cross-shareholding, litigation,

⁵³⁴ Ibid pp. 40

⁵³⁵ Powell, Ronan G., and Andrew W. Stark. "Does operating performance increase post-takeover for UK takeovers? A comparison of performance measures and benchmarks." *Journal of Corporate Finance* 11.1 (2005): 293-317.

⁵³⁶ Kleiman, R. Takeovers, *Encyclopedia of Business: Reference for Business*, Second Edition <<http://www.referenceforbusiness.com/encyclopedia/Str-The/Takeovers.html>> accessed on 12 March 2016

self-tender, people pills, poison pills, the crown jewel, golden parachute, greenmail and white knight.⁵³⁷

These defence strategies are protected and regulated by the Federal Act, the Williams Act passed in 1968 that relates to acquisitions and tender offers.⁵³⁸ The formation of this Act was initiated by a large number of takeovers that initiated in the era of 1960s unexpectedly.⁵³⁹ The Act was created to identify the difficulties managers and stockholders had in making crucial decisions with very little information and preparation.

According to the Act,

“The bidders must have all the details of the tender offers filed with the Securities and Exchange Commission (SEC) and the target company. Their files must contain the terms, cash resources and their intended plans for the company thereafter, among others”.⁵⁴⁰

There was also a stipulation about the minimum period, the offer would remain open and as well the number of days the shareholders would have to consider and make up their minds, after the offering.⁵⁴¹

⁵³⁷ Bellak, Christian, Michael Pfaffermayr, and Michael Wild. "Firm performance after ownership change: A matching estimator approach." *Applied Economics Quarterly* (formerly: *Konjunkturpolitik*) 52.1 (2006): 29-54.

⁵³⁸ The Williams Act 1968

⁵³⁹ Bellak, Christian, Michael Pfaffermayr, and Michael Wild. "Firm performance after ownership change: A matching estimator approach." *Applied Economics Quarterly* (formerly: *Konjunkturpolitik*) 52.1 (2006): 29-54.

⁵⁴⁰ *Ibid* 5

⁵⁴¹ The Williams Act 1968

Controversially, those defence strategies deployed prior to takeovers have been seen to be more effective, than the post-takeover defences.⁵⁴² In this discussion, the following tactics have been identified as the preventive defences against hostile takeovers; control over the register, control over the debts, cross-shareholding, golden parachute and changes of control clauses which are also referred to as charter amendment.⁵⁴³In addition to that, the post defences identified include; litigation, self-tender, Pac man defence, White Knight and people pill. These defence strategies are compared through their process in which they are executed in the US and England.⁵⁴⁴

It is also worth noting that new types of takeover defence tactics are also emerging which will also be highlighted in this chapter. The primary purpose of discussing these new defence tactics is to validate the fact that there is no ‘one size fit all’ strategy to counter the takeovers, which are continually evolving in the corporate world.

4.2 Pre-Take-over defence tactics – “Preventive Measures”

The pre-bid defence tactics are an essential and pivotal strategy of stalling the attempts by the dominant company to take over the target company.⁵⁴⁵Furthermore, it can also be considered as a vital step towards taking prior action of protecting the target company and other stakeholders

⁵⁴² Berkovitch, Elazar, and Naveen Khanna. "How Target Shareholders Benefit from Value-Reducing Defensive Strategies in Takeovers." *The Journal of Finance* 45.1 (1990): 137-156.

⁵⁴³ Shivdasani, Anil. "Board composition, ownership structure, and hostile takeovers." *Journal of accounting and economics* 16.1 (1993): 167-198.

⁵⁴⁴ Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

⁵⁴⁵ Gilson, Ronald J., and Reinier Kraakman. "Takeovers in the Boardroom: Burke versus Schumpeter." *Bus. Law* 60 (2004): 1419.

against suffering adverse effects of an unfair takeover by a potential bidder. The pre-bid defence tactics involve the strategic mechanism undertaken by the board of the target company in anticipation of a larger company presenting a takeover bid.⁵⁴⁶ Another aspect is analysing that the share price remains high, thus making them more expensive to acquire.

Fighting off an unwanted takeover by the target company often paralyses the normal operation of the target firm. The minority shareholders are worried as to their position as the various events unfold.⁵⁴⁷ Stakeholders such as the employees and the management may feel insecure in their jobs. Whenever possible, the company's management should consider putting in place preventive measures rather than wait to adopt "reactive strategies" which are much complex to implement.⁵⁴⁸ Some of the pre-takeover defence strategies that can be implemented are: control over the register, control over the debts, cross-shareholding, golden parachutes and charter amendments and ensuring that the share price remains high.⁵⁴⁹

Executing effective preventative measures may be costly and time-consuming. Therefore, the company's board and management may be pre-occupied with identification and dealing with such factors that may potentially lead to a takeover.⁵⁵⁰ There are seven major warning signals

⁵⁴⁶J. Porter and H. Singh. An Empirical Analysis of the Motivation Underlying Takeovers in Australia. *Social Science Research Network Working Paper*, (2007).p. 2.

⁵⁴⁷Kurp, Melissa M. "Corporate Takeover Defenses After QVC: Can Target Boards Prevent Hostile Tender Offers Without Breaching Their Fiduciary Duties." *Loy. U. Chi. LJ* 26 (1994): 29.

⁵⁴⁸Gilson, Ronald J. "The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment." *Fordham L. Rev.* 61 (1992): 161.

⁵⁴⁹ Ibid

⁵⁵⁰Gorzala, Jeannette. *The art of hostile takeover defence*. Igel Verlag, 2010.

identified that may indicate the possibility of a take-over in the near future of a company.⁵⁵¹ The earlier the company notices these factors, the less vulnerable it may be.

These factors could be listed as:

- High notification of unsolicited offers to sell their firm's share in the recent months.
- When the minority shareholders conduct lawsuits to have their rights protected within the firms in the case of a takeover.⁵⁵²
- The company and its board's reputation are compromised.
- A swift interest in the company's business by the minority shareholders who keep requesting for various copies of documents.
- The company is regularly inspected the government authorities that intend to review the company's register of shareholders, information on the company's assets, the lists of creditors and clients of the company.⁵⁵³
- Increase in the magnitude of small stock exchange transactions of the shares of the company.
- When most of the company's in the same industry have been absorbed. However, this might give rise to anti-trust/monopoly issues should the company be a target.

⁵⁵¹Stein, Jeremy C. "Takeover threats and managerial myopia." *Journal of Political Economy* 96.1 (1988): 61-80.

⁵⁵² Ibid pp 38

⁵⁵³Dodonova, Anna, and Yuri Khoroshilov. "Jump bidding in takeover auctions." *Economics Letters* 92.3 (2006): 339-341.

4.2.1 Golden Parachutes

This defence technique involves altering the compensation packages of the management and executive that would be dismissed in an event of a takeover that they qualify for substantial compensation packages.⁵⁵⁴ These benefits are normally substantial and are aimed at warding off impending hostile takeovers as it will substantially increase the acquisition costs. The key genesis of such inclusions in the clauses of the corporate charter is the anticipated change of control over the company followed by the dismissal of the executive.⁵⁵⁵ This is usually effective when the dismissal is out of the control of the target company's executives highlighting a reduction in the workforce or dismissal of the board of directors. The decisions may be arrived at a general meeting of the shareholders of the acquirer and in accordance with the provisions of the prevailing corporate law.⁵⁵⁶

The substantial financial packages contained in the executive's contracts usually included benefits such as bonuses, share options and hefty severance pays among others.⁵⁵⁷ The costs may be considered unnecessarily too high for the potential hostile acquirers to continue with the

⁵⁵⁴Singh, Harbir, and Farid Harianto. "Management-board relationships, takeover risk, and the adoption of golden parachutes." *Academy of Management Journal* 32.1 (1989): 7-24.

⁵⁵⁵Machlin, Judith C., Hyuk Choe, and James A. Miles. "The effects of golden parachutes on takeover activity." *The Journal of Law and economics* 36.2 (1993): 861-876.

⁵⁵⁶Singh, Harbir, and Farid Harianto. "Top management tenure, corporate ownership structure and the magnitude of golden parachutes." *Strategic Management Journal* 10.S1 (1989): 143-156.

⁵⁵⁷ Davidson, Wallace N., Theodore Pilger, and Andrew Szakmary. "Golden parachutes, board and committee composition, and shareholder wealth." *Financial Review* 33.4 (1998): 17-32.

prospect of acquiring the target. The acquirer may not want to retain the targets current management and dismiss them with the substantial financial severance package.⁵⁵⁸

‘Golden parachute’ is a takeover defence measure adopted mainly in the US system. It can be a simple effective strategy that drives away eventually several potential bidders. Its intention is to put off unwanted hostile takeovers through the extension of lucrative financial benefit packages to the management and employees by making the cost of the acquisition substantially more.⁵⁵⁹Hence, defence mechanism ensures that the management arranges employment contracts for themselves and the company’s employees in a bid to increase their post-employment compensation in an event the company is taken over. The creation of the golden parachutes for the management and employees ensures that the target company becomes less attractive to the bidder due to the substantially increased financial costs of the acquisition of these arrangements.⁵⁶⁰

The motive of the management in advancing a golden parachute does not only lie in the fact of protecting the all the stakeholders but also in the fact that they fear to lose their positions when the company is taken over.⁵⁶¹ The fears that trigger the use of golden parachute clauses include the anticipation that there will be “change of control over the company and subsequent dismissal of the executive by an acquirer provided that this dismissal is outside the executive’s

⁵⁵⁸Choi, Albert. "Golden parachute as a compensation-shifting mechanism." *Journal of Law, Economics, and Organization* 20.1 (2004): 170-191.

⁵⁵⁹Hall, Pamela L., and Dwight C. Anderson. "The effect of golden parachutes on shareholder wealth and takeover probabilities." *Journal of Business Finance & Accounting* 24.3 (1997): 445-463.

⁵⁶⁰ Evans, Jocelyn D., and Frank Hefner. "Business ethics and the decision to adopt golden parachute contracts: Empirical evidence of concern for all stakeholders." *Journal of Business Ethics* 86.1 (2009): 65-79.

⁵⁶¹Lambrecht, Bart M., and Stewart C. Myers. "A theory of takeovers and disinvestment." *The Journal of finance* 62.2 (2007): 809-845.

control. For instance, reduction in workforce or dismissal of the Chairman of the Board of Directors due to the decision of the general meeting of the bidder's shareholders provided such additional ground for dismissal is stated in the labour contract.⁵⁶²

In the history of takeovers in the US, "golden parachute" has been extensively used as a tactic having increased to 81% in 2001 from 35% in 1987 according to a survey by Executive Compensation Advisory Service (ECAS).⁵⁶³ A case in point is the ex-Martel CEO Jill Barad's US \$ 50 million send-off package which resulted in the Obama administration in US imposing a limit on the use of golden parachute with the aim of reining in the compensation of the management at companies that have been bailed out by the US government.⁵⁶⁴

*"Companies receiving federal aid are going to have to disclose publicly all the perks and luxuries bestowed upon senior executives, and provide an explanation to the taxpayers and to shareholders as to why these expenses are justified. And we're putting a stop to these kinds of massive severance packages we've all read about with disgust; we're taking the air out of golden parachutes."*⁵⁶⁵

In a study involving more than 850 acquisitions announced in the US between 1997 and 2007, the importance of the golden parachutes to CEOs when their entire post-acquisition

⁵⁶² Ibid pp. 34

⁵⁶³ Baber, William R., Patricia L. Daniel, and Andrea A. Roberts. "Compensation to managers of charitable organizations: An empirical study of the role of accounting measures of program activities." *The accounting review* 77.3 (2002): 679-693.

⁵⁶⁴ Murphy, Kevin J., and Tatiana Sandino. "Executive pay and "independent" compensation consultants." *Journal of Accounting and Economics* 49.3 (2010): 247-262.

⁵⁶⁵ "President Barack Obama's remarks on executive pay", February 4, 2009, The New York Times newspaper, <<http://www.nytimes.com/2009/02/04/us/politics/04text-obama.html>> accessed on 11 March 2016

compensation package, including potential loss.⁵⁶⁶ In England, the golden parachute schemes have been under attack for some time. This follows a condemnation on the directors for being egocentric. Directors “*forget their wider duties when a fat check is laid before them*”, the business secretary, Vince Cable reproved the directors and promised to review manner in which the pay incentives for top managers are drawn up.⁵⁶⁷ It is also worth noting that the Chief Executive Officers, CEOs have been found to settle for lower acquisition premiums when they are promised and are eager to receive their ‘golden parachute’.⁵⁶⁸

A study by Dran Tran from Cass Business School⁵⁶⁹ and, Professor Eliezer Fich and Ralph, Le Bow College of Business has proved this fact and established that it is a likely behaviour by CEOs in most takeover scenarios.⁵⁷⁰ These CEOs are basically letting their firms sell at \$249 million, equivalent of £158 million below the value. The study revealed that a 5% fall in acquisition premium was attributed to a 10% increase in the relevance of the golden parachutes relative to the takeover send-off package.⁵⁷¹ This described the \$249 million shortfalls in deal value of the average transactions. The research also affirmed that larger parachutes push some executives to compromise the interests of shareholders.

⁵⁶⁶Mullin, George L., Joseph C. Mullin, and Wallace P. Mullin. "The competitive effects of mergers: stock market evidence from the US Steel dissolution suit." *The Rand journal of economics* (1995): 314-330.

⁵⁶⁷“Golden parachutes: as their importance to CEOs increases, shareholders lose out in takeovers” <<http://www.next-finance.net/Golden-parachutes-as-their>> accessed 12 March 2016

⁵⁶⁸Hirsch, Paul M. "From ambushes to golden parachutes: Corporate takeovers as an instance of cultural framing and institutional integration." *American journal of Sociology* 91.4 (1986): 800-837.

⁵⁶⁹ Cass Business School, London, UK.

⁵⁷⁰LeBow College of Business, Philadelphia, USA.

⁵⁷¹ Ibid pp 46

"Our results show that as CEOs become more insulated from personal losses due to relatively larger parachutes, shareholders obtain less favourable acquisition terms. This suggests that overly important parachutes encourage some self-serving CEOs to sacrifice premium for personal gain".⁵⁷²

According to Richard Lambert and David Larcker, golden parachutes had a positive impact on senior directors actions towards the management companies and also has positive influence on the price of target company's shares.⁵⁷³

However, on the other hand, there are others stating that golden parachutes are not a fair defence tactic for a target company. Because they allow too much protection for directors even though they were incompetent or took an incorrect decision.⁵⁷⁴

4.2.2 Shark Repellents

Shark repellent is a defence mechanism adopted by corporations in their bid to defend the target company from a forceful takeover.⁵⁷⁵ This mechanism is predominantly practised in the US legal arena on takeovers and mergers. The term shark repellent literally means a defensive

⁵⁷² Fich, M, Tran, L. and Walking, A. *Importance of golden parachutes*. (2011),

⁵⁷³ Richard Lambert and David Larcker, 'Golden Parachutes, Executive Decision Making and Shareholder Wealth' (1985) 7 *Journal of Accounting and Economics* 179, 201

⁵⁷⁴ Randy Myers, 'Minimise Parachute Penalties' (*Journal of Accountancy*, October 2001)
<<http://www.journalofaccountancy.com/Issues/2001/Oct/MinimizeParachutePenalties.htm>> accessed 25 October 2016

⁵⁷⁵ Knoeber, Charles R. "Golden parachutes, shark repellents, and hostile tender offers." *The American Economic Review* 76.1 (1986): 155-167.

method adopted by an individual or anybody in a bid to protect oneself from unexpected attacks by the sharks hence keeping the predator away.⁵⁷⁶

In the current business scenario, majority of the organisations have taken the initiative to develop on their own fate in the competitive environment through the application of shark repellent that sends off the hostile bidders to look for other less feisty targets.⁵⁷⁷ The management of the target company normally brings this defence mechanism forth by making amendments or policies that only take effect when a takeover attempt is announced or advanced to the shareholders with the sole objective of making the takeover less attractive or profitable to the potential bidder.⁵⁷⁸

However, the defence tactic is not preferred by several shareholders since the move is most likely to tarnish the company's financial position and further interfere with the sole objective of the management of focus on business operations.⁵⁷⁹ Generally, shark repellent is considered to discourage the bidders from taking over a company through a number of methods already discussed in this section. As per the analysis of the legal experts and professionals, primary reason of executing shark repellent to serve the purpose of reinforcing the ability of the company's board of directors to retain overall control by ensuring that it is difficult to gain

⁵⁷⁶ Ibid pp. 21

⁵⁷⁷Friedenberg, Ellen S. "Jaws III: The Impropriety of Shark-Repellent Amendments as a Takeover Defense." *Del. j. Corp. L.* 7 (1982): 32.

⁵⁷⁸Pound, John. "The effects of antitakeover amendments on takeover activity: Some direct evidence." *The Journal of Law and Economics* 30.2 (1987): 353-367.

⁵⁷⁹Mahoney, James M., and Joseph T. Mahoney. "An empirical investigation of the effect of corporate charter antitakeover amendments on stockholder wealth." *Strategic Management Journal* 14.1 (1993): 17-31.

control of the board through either a fight or at an annual general meeting.⁵⁸⁰ Delaware registered corporations have essentially made shark repellent a necessary provision in their incorporation documents. Shark repellents are varied in nature; some adopted to strengthen the board's defence while others are meant to limit the actions that can be taken by the shareholders. The shark repellent tactics include, but not limited to anti-greenmail provisions, golden parachutes, fair price provisions, etc.⁵⁸¹

Linn and McConnell's view on shark repellents is that the adoption of this defence tactic would not have any negative impact on shareholders or stocks. It cannot also negatively "lead to any misallocation of real corporate assets".⁵⁸²

Other scholars mentioned that the implementation of shark repellents may not have any significant impact on takeover activity and consequently the shareholders do not take any responsibility on consequences if there was any delay in the takeover process and give the board of directors sufficient time to look for a white knight or demand a higher price for shareholders.⁵⁸³

⁵⁸⁰ Gilson, Ronald J. "The case against shark repellent amendments: Structural limitations on the enabling concept." *Stanford Law Review* (1982): 775-836.

⁵⁸¹ Chakraborty, Atreya. "Golden parachutes and shark repellents and shareholders' interests: Some new evidence." *Global Finance Journal* 18.3 (2008): 373-384.

⁵⁸² Scott C. Linn and John J. McConnell, 'An Empirical Investigation of the Impact of 'Antitakeover' Amendments On Common Stock Price' (1983) 11 *Journal of Financial Economics* 361,398.

⁵⁸³ Mark S. Johnson and Ramesh P. Rao, 'The Impact of Anti-takeover Charter Amendments on Expectations of Future Earnings and Takeover Activity' (1999) 20 *Managerial and Decision Economics* 75,86.

4.2.3 Strengthening a Board's defence

The application of a staggered board as a means of defence is one important mechanism under the shark repellent.⁵⁸⁴ It fundamentally ensures that there is a delay in the hostile takeover while at the same time increasing the board's control over the corporate voting mechanism, and facilitated through the division of the board into various classes. The actual working mechanism of this defence tactic depends on each of the three classes of directors elected or removed only one every set number of years.⁵⁸⁵ Viewing it fewer than 141 (d) of the Delaware Company Law,⁵⁸⁶ the ultimate aftermath of this type of arrangement is that it may succeed in dissolving a proxy competition by the insurgent shareholders seeking to overhaul the existing directors, hence ensuring the board retains the control measures.⁵⁸⁷

The defence tactics ensure that the target company is protected from the hostile bidder since it ensures that despite acquiring a large proportion of the shares of the target company, the bidder does not have the power to appoint the majority of the board until the successful election of the board has occurred.⁵⁸⁸ This lies in the fact that only one-third of the board may be removed annually during the elections. The board, in this case, retains two-thirds of the seats on the board

⁵⁸⁴Stiles, Philip. "The impact of the board on strategy: An empirical examination." *Journal of Management Studies* 38.5 (2001): 627-650.

⁵⁸⁵Hillman, Amy J., Albert A. Cannella, and Ramona L. Paetzold. "The resource dependence role of corporate directors: Strategic adaptation of board composition in response to environmental change." *Journal of Management studies* 37.2 (2000): 235-256.

⁵⁸⁶The Delaware General Company Law, Title 8, Chapter 1 of the Delaware Code,

⁵⁸⁷ Ibid pp. 49

⁵⁸⁸Hanly, Ken. "Hostile takeovers and methods of defence: A stakeholder analysis." *Journal of Business Ethics* 11.12 (1992): 895-913.

despite the majority acquisition of shares by the bidding company.⁵⁸⁹ Under the Delaware Company Law, a company that applies “staggered boards” may have its directors removed only by cause unless its charter indicates the reverse. Any action leading to the removal of any director as a result of ‘cause’ must be addressed with a reason in a prior notice to allow appropriate time for adequate response.⁵⁹⁰ Legal experts in the takeover arena have attributed the use of staggered boards when combined with poison pills to be effective since the bidder would be unable to remove the pill without winning two successive elections and thus raised the odds of a target company being independent of 34% to 61%.⁵⁹¹

The staggered boards are not beneficial to the shareholders in any way.⁵⁹² Studies have indicated that the staggered boards tend to reduce the returns for the shareholders as compared to then on-staggered board in the event of a potential takeover.⁵⁹³ However, the staggered board still offers continuity of leadership in the company and should not cause any reason for alarm provided the company is moving in the right direction.⁵⁹⁴

⁵⁸⁹Brennan, Niamh M., Caroline A. Daly, and Claire S. Harrington. "Rhetoric, argument and impression management in hostile takeover defence documents." *The British Accounting Review* 42.4 (2010): 253-268.

⁵⁹⁰Henry, Darren. "Directors' recommendations in takeovers: An agency and governance analysis." *Journal of business finance & accounting* 32.1-2 (2005): 129-159.

⁵⁹¹D'Aveni, Richard A., and Idalene F. Kesner. "Top managerial prestige, power and tender offer response: A study of elite social networks and target firm cooperation during takeovers." *Organization science* 4.2 (1993): 123-151.

⁵⁹²Yarrow, George K. "Shareholder protection, compulsory acquisition and the efficiency of the takeover process." *The Journal of Industrial Economics* (1985): 3-16.

⁵⁹³ Pontiff, Jeffrey, Andrei Shleifer, and Michael S. Weisbach. "Reversions of excess pension assets after takeovers." *The RAND Journal of Economics* (1990): 600-613.

⁵⁹⁴Bainbridge, Stephen M. "In defense of the shareholder wealth maximization norm: A reply to Professor Green." *Wash. & Lee L. Rev.* 50 (1993): 1423.

4.2.4 Limiting shareholders' action

In this defence tactics, it is worth noting that the super majority provisions rules especially when the bidder more than specified shares in the target company hence limiting its ability to avoid the influence of the minority shareholders.⁵⁹⁵ It requires the approval of any business combination that involves the target company and the offeror, who have more shares than a specified threshold, hence approved by a supermajority vote of all the target's shares. Consequently, the holders of the majority shares use the power of their voting threshold. Hence, setting up a level higher than that used for mergers.⁵⁹⁶ The supermajority provisions have a portion referred to as 'majority of minority' that provides minority shareholders higher powers to eliminate mergers, given that the approval by outstanding voting shares.⁵⁹⁷

4.2.5 Charter amendments

A Charter refers to a document incorporating an institution and specifying its rights, which also include the Articles of Incorporation and the Certificates of Incorporation. It is normally filed with the particular jurisdictional government authority by the founding members of the company, its objectives, nature of its operations and ownership styles adopted (identities

⁵⁹⁵Parch, M. Megan. "The creation of a class of limited voting common stock and shareholder wealth." *Journal of Financial Economics* 18.2 (1987): 313-339.

⁵⁹⁶ Ibid pp. 52

⁵⁹⁷Bainbridge, Stephen M. "Director primacy in corporate takeovers: preliminary reflections." *Stanford Law Review* (2002): 791-818.

and share allocation).⁵⁹⁸ The charters are identified as ‘Certificate of Incorporation’ or ‘Article of Organisation/ Incorporation’ in the US and ‘Article of Association’ in England.⁵⁹⁹

More debatably, charter amendments denote the changes imposed on the initial corporate charter document in order to increase the value of the takeover bids, make the bids more demanding and defining the role of managers in the execution of takeovers defence mechanisms.⁶⁰⁰ This was noticed in the 1980s boom of corporate takeovers and was based on shareholder’s agreement and empowerment of managers to achieve the ultimate objectives of the company. ‘Anti-takeover amendments’ have been used in the past to refer to the charter amendments implying the intentions of the company’s resistance by amending the articles of incorporation.⁶⁰¹

A company may include in its clauses loan agreements or contracts that bind the acquirer on a takeover to accelerate the debts so that all debts immediately become repayable.⁶⁰² The effect of this is that it makes the takeover more expensive for the acquirer as they also have to replace the debt finance. Failure upon which the bidder is expected to terminate the contract is the harsh side of the alterations of the clauses. In circumstances like this, the bidder is unsure

⁵⁹⁸ Madura, J “Introduction to business”, Fourth edition, 2007, pp164-167

⁵⁹⁹Matthiessen, Peter, et al. "Attempts to assess the environmental hazard posed by complex mixtures of organic chemicals in UK estuaries." *Marine pollution bulletin* 26.2 (1993): 90-95.

⁶⁰⁰ Damodaran, A “Acquisitions and Takeovers”, in F Fabozzi, John and Wiley, Handbook of Finance, New York, pp55-57

⁶⁰¹ Gamble, Andrew, and Gavin Kelly. "Shareholder value and the stakeholder debate in the UK." *Corporate Governance: An International Review* 9.2 (2001): 110-117.

⁶⁰² Ibid pp. 84

whether it is going to benefit or not from the process.⁶⁰³ This tends to discourage away unwanted suitors. In some instances, a firm will make special amendments to its bylaws, simply the charters that are considered active only in the event that a takeover attempt is announced or offered to the shareholders. These alterations are designed to make the takeover less attractive or profitable to the offer.⁶⁰⁴

The idea of the charter amendment, also known as a "porcupine provision" is not necessarily a noble measure, as not all the shark repellent measures are in the best interest of the shareholders.⁶⁰⁵ This is a result of the damage that may be caused by the firm's financial positions and even the destruction of the management's focus on vital strategic business objectives.

4.2.6 Control over the register.

A company's register contains very vital information regarding the company and should be guarded against unauthorised personnel to avoid sabotage.⁶⁰⁶ In aggressive take-overs, the acquirer seeks to identify the target company's shareholders, the quantity of their shares and eventually persuade them to sell their shares to them. In joint stock companies, such information is contained in the register. The register clearly reveals a lot about the company; the names of the

⁶⁰³Franks, Julian R., Kjell G. Nyborg, and Walter N. Torous. "A comparison of US, UK, and German insolvency codes." *Financial Management* (1996): 86-101.

⁶⁰⁴ Hirshleifer, David, and Anjan V. Thakor. "Managerial performance, boards of directors and takeover bidding." *Journal of Corporate Finance* 1.1 (1994): 63-90.

⁶⁰⁵Machlin, Judith C., Hyuk Choe, and James A. Miles. "The effects of golden parachutes on takeover activity." *The Journal of Law and economics* 36.2 (1993): 861-876.

⁶⁰⁶Travlos, Nickolaos G. "Corporate takeover bids, methods of payment, and bidding firms' stock returns." *The Journal of Finance* 42.4 (1987): 943-963.

shareholders, the quantity of shares owned by each, nominal value of the shares and the type of shares owned.⁶⁰⁷

- Ways in which such unauthorised access can be avoided are: The choice of a highly reputable registrar to register the company's shares.
- Verify the registrar's history concerning any participation in the hostile takeovers.
- Check for the controllers of the registrar's company.

4.2.7 Control over the debts

The raiders often take advantage of the company's credit indebtedness, during a hostile take-over.⁶⁰⁸ In other words, the acquirer uses the "bankruptcy contract" in order to get the assets of the target company. Thus the following measures can be undertaken to prevent hostile attack in regard to the company's debts;

- Careful monitoring and evaluation of the company's creditors
- All the debts and risks of the company should be accrued towards a special purpose vehicle that does not contain any significant assets of the firm.⁶⁰⁹
- Avoid overdue debts.
- A company should fight to eliminate anticipated bankruptcy procedures, by paying overdue debts.

⁶⁰⁷Jackson, Gregory, and Martin Hoepner. "An emerging market for corporate control? The Mannesmann takeover and German corporate governance." (2001).

⁶⁰⁸Nathan, Charles M., and Marilyn Sobel. "Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids." *The business lawyer* (1980): 1545-1566.

⁶⁰⁹Atanassov, Julian. "Do hostile takeovers stifle innovation? Evidence from antitakeover legislation and corporate patenting." *The Journal of Finance* 68.3 (2013): 1097-1131.

4.2.8 Cross-shareholding

In this technique, a parent company needs to identify at least three subsidiary companies in which they own 100% of the share capital of each.⁶¹⁰ In contributing to the share capital, the parent company may transfer part of its most valuable assets to the subsidiaries. Consequently, the subsidiary issues more shares, which should not be less than four times the initial share capital.⁶¹¹ The outcome of such a scheme is that the parent company gets to own less than 25% of the share capital of each of the subsidiaries. In particular, the parent company lacks a blocking shareholding. In this way, the goals and ambitions of the hostile acquirer are thwarted. However, when implementing such techniques, the parent company should be obliged to ensure the subsidiaries are loyal to them.⁶¹²

4.2.9 Crown jewel

The term 'crown jewel' symbolises or rather refers to the valuable assets that a company holds. Precisely, it is the most valuable component of a company and is defined by such features as profitability, asset value and future prospects.⁶¹³ In circumstances of hostile takeovers, the

⁶¹⁰Gokhale, Jagadeesh, Erica L. Groshen, and David Neumark. *Do hostile takeovers reduce extramarginal wage payments?*. No. w4346. National Bureau of Economic Research, 1993.

⁶¹¹Dietzenbacher, Erik, and Umed Temurshoev. "Ownership relations in the presence of cross-shareholding." *Journal of Economics* 95.3 (2008): 189-212.

⁶¹²Kuroki, Fumiaki. "The relationship of companies and banks as cross-shareholdings unwind: fiscal 2002 cross-shareholding survey." *Financial Research Group, NLI Research* (2003).

⁶¹³Kaye, Judith S. "Safeguarding a Crown Jewel: Judicial Independence and Lawyer Criticism of Courts." *Hofstra L. Rev.* 25 (1996): 703.

management in a bid to secure their financial benefit and those of the shareholder use the crown jewel defence by creating anti-take-over clauses which compel the sale of their crown jewels.⁶¹⁴

4.3 Post –Takeover Defence Strategies

The preventive measures may fail to work at times or may be compromised for example by negative publicity.⁶¹⁵ The target management may be ambushed by the predator. In this situation, the company through its board and advice of its investment bankers may be forced to identify and implement an effective defence technique. Investment bankers earn substantial fees advising either the predator or the target on either their acquisition or defence strategies.⁶¹⁶ The post-take defence strategies that have been proved to work are; litigation, self-tender, Pac man defence, white knight and people's pill. In the United States, the majority of the firms adopt a minimum of one anti-takeover defence.⁶¹⁷ The poison pill and the staggered board are the two most common defence strategies widely practised in the US. The staggered board is adopted by about 60% of the large firms in order to prevent an acquirer from causing an alteration in the total board composition.⁶¹⁸ On the other side, around 50% of the important firms take up poison pill and this raises the cost of the firm high enough to prohibit its sale. As the takeover scenario

⁶¹⁴Zhang, Haijun, et al. "Crown Jewel catalyst: How neighbouring atoms affect the catalytic activity of top Au atoms?." *Journal of catalysis* 305 (2013): 7-18.

⁶¹⁵Field, Laura Casares, and Jonathan M. Karpoff. "Takeover defences of IPO firms." *The Journal of Finance* 57.5 (2002): 1857-1889.

⁶¹⁶Coates IV, John C. "Takeover defences in the shadow of the pill: A critique of the scientific evidence." *Tex. L. Rev.* 79 (2000): 271.

⁶¹⁷Hirshleifer, David, and Sheridan Titman. "Share tendering strategies and the success of hostile takeover bids." *Journal of Political Economy* 98.2 (1990): 295-324.

⁶¹⁸Rasolofoa, Yves, David Hawking, and Jacques Savoy. "Result merging strategies for a current news metasearcher." *Information Processing & Management* 39.4 (2003): 581-609.

progresses, the release of information into the financial press is critical and it tightly controlled by both parties.⁶¹⁹

4.3.1 Poison pills

As much as the defence tactics have the desired effect of preventing takeovers, there are often those schemes that are detrimental to shareholder value. These tactics are referred to as poison pills and are related to ‘shark repellent’ tactics are now becoming uncommon in the US.⁶²⁰ This gradual decline in popularity is associated with a number of factors, such as the increased activism by institutional investors such as hedge funds and other investors.⁶²¹ Alternatively, shareholders desire for an acquisition and transition to block boards from adding defensive plans and the elapse of such clauses over time. A Poison pill refers to a technique or rather simply, “a shareholder’s rights” contract that is designed to put off the acquirers from taking over the target company by making the price to be paid for the target less attractive for the acquirer in the event of a takeover. This stock is redeemable at the boards’ decision.⁶²²

⁶¹⁹Reynders, Edwin, et al. "Merging strategies for multi-setup operational modal analysis: application to the Luiz I steel arch bridge." *Proceedings of IMAC 27, the International Modal Analysis Conference*. Vol. 400. 2009.

⁶²⁰Pound, John. "The effects of antitakeover amendments on takeover activity: Some direct evidence." *The Journal of Law and Economics* 30.2 (1987): 353-367.

⁶²¹Jensen, Michael C. "Agency costs of free cash flow, corporate finance, and takeovers." *The American economic review* 76.2 (1986): 323-329.

⁶²²Painter and Kirchner supra.n.11.

The acquisitions and mergers lawyer Martin Lipton of Wachtell is known for his invention of the poison pill alongside Katz, Rosen & Lipton in 1982, which was responding, to tender based hostile takeovers.⁶²³

In the early 1980s poison pills gained in popularity as there were numerous takeovers by corporate raiders like Carl Icahn.⁶²⁴ The term poison pill originated to the actual poison pill that is carried by spies where they would take the pill after being discovered in order to kill them rather than face interrogation by the enemy.

Shareholders, since the early 2000s, have been expected to act against the authorisation of poison pills, because they are made for the resistance of takeovers. On the other side, takeovers can be perceived as financially advantageous to the shareholders.⁶²⁵

There are arguments that poison pills can destroy the interests of the shareholders because they prolong the present management.⁶²⁶ One example is where Microsoft made a non-invited bid for Yahoo! Before subsequently dropping it since the CEO of Yahoo! Jerry Yang counter-argued that the company was worth substantially more and unless Microsoft was willing to raise the price to USD 37 per share.⁶²⁷ A Microsoft executive had views that Yahoo! would go all the way to burn

⁶²³"Poison pill defence" <<http://www.money-zine.com/investing/stocks/poison-pill-defence/>> accessed 13 April 2016

⁶²⁴Dong, Ming, et al. "Does investor misvaluation drive the takeover market?." *The Journal of Finance* 61.2 (2006): 725-762.

⁶²⁵Leeth, John D., and J. Rody Borg. "The impact of takeovers on shareholder wealth during the 1920s merger wave." *Journal of Financial and Quantitative Analysis* 35.2 (2000): 217-238.

⁶²⁶Curwen, Peter. "Microsoft Googles Yahoo!." *info* 10.4 (2008).

⁶²⁷Smith, Greg, et al. "FacetMap: A scalable search and browse visualization." *IEEE Transactions on visualization and computer graphics* 12.5 (2006).

the furniture and harm the place in case they went hostile. Ever since the events of 2001, Yahoo! is known to possess a working shareholders rights plan. With respect to the financial analysts, raising the price to USD 33 per share was too expensive and that Yahoo! was not negotiating in good faith, which subsequently initiated a number of shareholder lawsuits. There also followed a proxy fight by the corporate raider Carl Icahn. The stock price of Yahoo! plunged after withdrawal of the bid by Microsoft, which led to Jerry Yang facing a negative reaction from the stakeholders leading ultimately to his resignation.⁶²⁸

There are two kinds of poison pills namely the “call” plan and the “put” plan. The “call plan” comes into play when a company issues a “call option” which depicts the form of a dividend and is associated with every outstanding share of the company. The call poison pills are further categorised into “flip in” poison pill or “flip over” poison pill.⁶²⁹ The flip in a poison pill, with the exception of the acquirer, allows all other shareholders to purchase the shares of the company at a discounted cost.⁶³⁰ Consequently, more shares are purchased, thereby diluting the shares held by the acquirer and making it more difficult for the target to be acquired by the bidder. The investors obtain substantial profits as a result when the shares are sold. On the other hand, a flip over poison pills allows the stockholders to purchase the shares of the acquirer at a discounted price after the merger or acquisition. An example of flip over poison pill is when the

⁶²⁸ Steve Lohr “ Microsoft’s failed Yahoo bid risks online growth”, <http://www.nytimes.com/2008/05/05/technology/05soft.html?_r=5&hp&oref=slogin&oref=slogin&oref=slogin&oref=slogin> accessed 10 January 2015

⁶²⁹ Ibid 17

⁶³⁰ Ibid 39

stockholders of the target company are granted the right to purchase the acquirer's stock on a two for one basis after the subsequent merging of the two companies.⁶³¹

In the US companies, the use of poison pill anti-takeover techniques has reduced significantly over the past decade.⁶³² This is due to pressure from proxy advisory firms and investors. In contrast, English companies have been banned from implementing the poison pill defence by the corresponding takeover Panels. This particular defence strategy can impede hostile takeovers especially those by foreign bidders. A current example is the attempt to take over Autonomy, in UK by the US buyer, Hewlett Packard in 2011.⁶³³ The Autonomy's board in a bid to prevent the process and disinterest the bidder recommended a £7 billion, a price equivalent to an \$ 11.5 billion takeover by the Hewlett Packard as a more realistic price.⁶³⁴

In other words, poison pills are considered to be a shareholders' rights plan that requires the bidding company to involve consultative talk with the board of the target company. This is prior to seeking to acquire a certain percentage of the target company's stock.⁶³⁵ A failure to comply with the condition is likely to cause substantial economic harm to the acquirer as the

⁶³¹ Ryngaert, Michael. "The effect of poison pill securities on shareholder wealth." *Journal of Financial Economics* 20 (1988): 377-417.

⁶³² Ryngaert, Michael. "The effect of poison pill securities on shareholder wealth." *Journal of Financial Economics* 20 (1988): 377-417.

⁶³³ Brudney, Victor, and Marvin A. Chirelstein. "Fair shares in corporate mergers and takeovers." *Harv. L. Rev.* 88 (1974): 297.

⁶³⁴ Arik Hesseldahl "HP's \$5 Billion Fraud Lawsuit Against Former Autonomy Executives Is Now Public", MAY 5, 2015 <http://www.recode.net/2015/5/5/11562326/hps-5-billion-fraud-lawsuit-against-former-autonomy-executives-is-now> accessed 10 March 2016

⁶³⁵Malatesta, Paul H., and Ralph A. Walkling. "Poison pill securities: Stockholder wealth, profitability, and ownership structure." *Journal of Financial Economics* 20 (1988): 347-376.

rights held by it become void and other shareholders are granted the opportunity to buy shares of the target company at half the quoted price.⁶³⁶

The rights plan can be undertaken by the directors without the approval of the shareholders.⁶³⁷ They can also authorise the rights to be distributed as a dividend to the shareholders of the company. The board of directors have the power to redeem or exercise the right; the preferred stock might be convertible into ordinary shares at an advantageous price.⁶³⁸ If this right is exercised it substantially raises the cost of the takeover. This type of poison pills is commonly known as flip-over. It allows shareholders of the target company to buy the shares of the new company resulting from the combination of the bidder's and target companies once the takeover is effected at a predefined substantial discount.⁶³⁹ This discount usually averages at a 50% discount on the market price of the shares. The flip over is the only course of action left when the bidder has already acquired almost all the target company's shares. Thereby exercising considerable control over the target company. The bidder finds itself in a position where it necessary to sell off the already acquired shares of the target company at a substantially discounted market price to the former shareholders.⁶⁴⁰

⁶³⁶Lipton, Martin. "Merger Waves in the 19th, 20th and 21st Centuries." *The Davies Lecture, Osgoode Hall Law School, York University* 14 (2006).

⁶³⁷Haleblian, Jerayr, and Sydney Finkelstein. "The influence of organizational acquisition experience on acquisition performance: A behavioral learning perspective." *Administrative Science Quarterly* 44.1 (1999): 29-56.

⁶³⁸ Ibid pp 37

⁶³⁹ Ibid pp 36

⁶⁴⁰ Gregory, Alan. "An examination of the long run performance of UK acquiring firms." *Journal of Business Finance & Accounting* 24.7-8 (1997): 971-1002.

On the other hand, the rights can be purchased by at a higher price over the issue price, with the large shareholder left out from the repurchase of the share (flip-ins).⁶⁴¹ Additionally, it is worth to note that this pill allows the target shareholders to buy additional shares and to increase their holdings over that of the bidder who controls a given percentage stock of the target company. Flip in poison pill allows a target company's board or right holders with a high stake to buy new shares in the company (target company) before a takeover is affected. Hence, increasing their control over that of the bidder's control. Further, the additional shares acquired may be bought at a discounted market price, to ensure that right holder can always create additional stock to overcome a takeover bid.⁶⁴²

This defence approaches to takeovers ensure that any potential hostile takeover attempt is very expensive since the bidder either has to buy very expensive shares in comparison to the cheaper additional shares bought by the shareholders.⁶⁴³ The acquirer will have to fund the discounts that the target company's shareholders are offered once the takeover is influenced. At this point of the transaction, the poison pills are considered to be provisions that are incorporated in the charter of a company giving management and shareholders special rights to act in case of such an eventuality. The poison pills are considered to be a mandatory requirement that is

⁶⁴¹Franks, Julian, Robert Harris, and Sheridan Titman. "The postmerger share-price performance of acquiring firms." *Journal of Financial economics* 29.1 (1991): 81-96.

⁶⁴²Berkovitch, Elazar, and Naveen Khanna. "How Target Shareholders Benefit from Value-Reducing Defensive Strategies in Takeovers." *The Journal of Finance* 45.1 (1990): 137-156.

⁶⁴³Fornell, Claes, and Birger Wernerfelt. "Defensive marketing strategy by customer complaint management: a theoretical analysis." *Journal of Marketing research* (1987): 337-346.

negatively impacting on the takeover bid. They set conditions for hostile bidders to satisfy prior to taking over of the company.⁶⁴⁴

4.3.2 The effects of poison pills on companies

Several companies have failed to maintain their independence after adopting the poison pill strategy. As much as the poison pills are effective at warding off the unsolicited offers, they reveal to the financial community that the companies using them have some financial or structural weakness and vulnerable to takeovers.⁶⁴⁵

The antagonists of this technique and advocates of many shareholders are concerned with the negative impact of poison pills; many have sponsored proposals that would require shareholder approval prior their incorporation into the corporate charter. Their logic is based on the fact that rather than safeguard the independence of the firms, poison pills have the tendency to foster inefficiencies and poor management, that lead to poor productivity and weak competitiveness that eventually results in lower share value.⁶⁴⁶

On the same note, there is another particular type of poison pill, "dead-hand" which has greatly exasperated the shareholder activists. The serving board of directors can only withdraw the Dead-hand poison pills.⁶⁴⁷ These kinds of schemes are put in place to keep the existing board and current management in place, going as far as ignoring the interest of existing shareholders or

⁶⁴⁴ Ibid 29

⁶⁴⁵Johnson, Dana J., and Nancy L. Meade. "Shareholder wealth effects of poison pills in the presence of anti-takeover amendments." *Journal of Applied Business Research* 12.4 (1996): 10.

⁶⁴⁶Sundaramurthy, Chamu. "Corporate governance within the context of antitakeover provisions." *Strategic Management Journal*(1996): 377-394.

⁶⁴⁷Feinberg, Phyllis. "'Deadhand' Pills a Major Proxy Issue." *Pensions and Investments*, 19 October 1998, 3.

in conflict with the majority of the shareholders. It actually alienates the shareholders' ability to act by written consent. Another variation is the no-hand poison pill, which by its definition cannot be altered by anyone for at least a period of one year or otherwise as specified.⁶⁴⁸

The Chief Executive Officers (CEOs) and Boards of Directors have often condemned the poison pill for the negative impact it has on the share value. Poison pills are brutally effective bargaining tools that are suitable for extracting just the most constructive financial terms from a bid.⁶⁴⁹ The CEOs have also taken it as an opportunity to gain some control over the company in the future. Especially when the stock market drop sharply and opportunistic raiders began their antics of the undervalued firms.⁶⁵⁰

Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd⁶⁵¹ represents the cases that involved implementation of a poison pill. The Committee of the Imperial Tobacco Pension Trust wanted the court to allow for a varying of the content of rule 64A with respect to the pension scheme with the management's verification. This action would result in a 5% per annum increase in the benefits of the members or the Retail Price Index.⁶⁵² This provision was influenced by the amendment under rule 36 that allowed the committee to make an amendment under the consent

⁶⁴⁸Read more: Poison Pills<<http://www.referenceforbusiness.com/encyclopedia/Per-Pro/Poison-Pills.html#ixzz1kYxdPxCU>> accessed on 23 February 2016.

⁶⁴⁹Malmendier, Ulrike, and Geoffrey Tate. "Who makes acquisitions? CEO overconfidence and the market's reaction." *Journal of financial Economics* 89.1 (2008): 20-43.

⁶⁵⁰Holmstrom, Bengt, and Steven N. Kaplan. *Corporate Governance and Merger Activity in the US: Making Sense of the 1980s and 1990s*. No. w8220. National bureau of economic research, 2001.

⁶⁵¹ *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589.

⁶⁵²Wulf, Julie. "Do CEOs in mergers trade power for premium? Evidence from "mergers of equals"." *Journal of Law, Economics, and Organization* 20.1 (2004): 60-101.

of the company management. Hanson Trust Plc had taken over Imperial Tobacco. The introduction of the rule was not that favourable since previously the pensions of the employees were only incremented for a particular purpose and mostly at the rate of inflation.⁶⁵³ Thereafter, the existing scheme was closed to new entrants. However, in 1986, the takeover became effective. This time was marked by inflation increasing above 5% hence the committee required the management to update pensions by over 5%. The new management declined and countered with an alternative idea of the lesser of 15% pa or RPI update.⁶⁵⁴ Employees that had dealt with the old scheme had the capacity to take their share if they transferred (at this time there was approximately £130m).⁶⁵⁵ The new scheme however required any surplus to be received by the company and not the employees individually. The trust claimed that if the committee was obliged to have the consent of management for the update of deals that would counter inflation, then the offer provided was neglecting the duty of good faith since it forced the employees to ignore their acquired rights.⁶⁵⁶

With respect to Sir Nicolas Browne Wilkinson VC, the rule 64A could not be made so as to allow the committee to approve increases, without the consent of the management.⁶⁵⁷ Sir Nicolas Browne-Wilkinson VC upheld on the fact that the concept of subsection 64A could not

⁶⁵³ Ibid p21

⁶⁵⁴ Ibid pp 25

⁶⁵⁵ Empson, Laura. "Fear of exploitation and fear of contamination: Impediments to knowledge transfer in mergers between professional service firms." *Human relations* 54.7 (2001): 839-862.

⁶⁵⁶ Compte, Olivier, Frederic Jenny, and Patrick Rey. "Capacity constraints, mergers and collusion." *European Economic Review* 46.1 (2002): 1-29.

⁶⁵⁷ Browne-Wilkinson, Nicholas. "Territorial Jurisdiction and the New Technologies." *Isr. L. Rev.* 25 (1991): 145.

be constructed without the acceptance of management of the company. However, the company management could not use its discretion to withhold its consent in a way that undermined good faith, and mutual trust and confidence. As per the judgement of the case following comments were registered:

“In my judgment, it is not necessary to found such a claim in contract alone. Construed against the background of the contract of employment, in my judgment the pension trust deed and rules themselves are to be taken as being impliedly subject to the limitation that the rights and powers of the company can only be exercised in accordance with the implied obligation of good faith”.⁶⁵⁸

On the other hand, the management would not utilise its discretion to consent as such it was undermining confidence, mutual trust and good faith. In this case, the company was perceived not to be exercising fiduciary power, this means it could take account of its own interests and financial burdens; however, there was a need to use its own powers for the right purpose. The idea of forcing members to ignore their rights so the company could benefit from the surplus was not acting in good faith.⁶⁵⁹

Criterion Properties Plc v Stratford UK Properties LLC⁶⁶⁰ is an English case which deals with takeover defences that may be employed by a board of directors to hinder the buying

⁶⁵⁸ Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd [1991] 1 WLR 589.

⁶⁵⁹ Criterion Properties Plc v Stratford UK Properties LLC [1991] 1 WLR 589, 597-598

⁶⁶⁰ Criterion Properties Plc v. Stratford UK Properties LLC & Ors [2004] UKHL 28. Available on <http://www.bailii.org/uk/cases/UKHL/2004/28.html> accessed on 5 December 2015

of shares without the consent of the board. Initiating a poison pill so as to counter a takeover bid was perceived as an improper use of the directors' powers.⁶⁶¹

Rule 21 of the City Code on Takeovers and Mergers sets aside the case for public companies, which do not entertain any ruling that counters a takeover bid. Aubrey Glasner who was the previous Managing Director of Stratford UK had joined the company based on a poison pill contract.⁶⁶² In case the Managing Director was to leave office in the event of a takeover happening, the company would owe Criterion Properties an outstanding payment in the form of a "put option". Oaktree and Criterion formed a joint venture. Glasner was dismissed once the board learned about the poison pill. Hart J never hesitated to turn down the pill in the initial instance. With respect to the judgment in *Cayne v Global Natural Resources Plc*, he claimed that ignoring such reasons should not be entertained and the board should have the capability to counter the constitutional rights when considering the threat.⁶⁶³ There is a major suggestion that a company should be capable of acting in the face of its 'impotence and beggary'. Carnwath LJ and Brooke LJ were in line with the judge's conclusion that the directors have exercised their powers in the wrong way claiming that he should never have considered the existing director's knowledge.⁶⁶⁴

⁶⁶¹ Johnson, Jennifer J., and Mary Siegel. "Corporate Mergers: Redefining the Role of Target Directors." *University of Pennsylvania Law Review* 136.2 (1987): 315-416.

⁶⁶²Yarrow, George K. "Shareholder protection, compulsory acquisition and the efficiency of the takeover process." *The Journal of Industrial Economics* (1985): 3-16.

⁶⁶³Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

⁶⁶⁴ *Cayne v Global Natural Resources Plc* [1984] 1 All ER 225

According to Lord Nicholls, ‘knowing receipt’ was not necessary. An agreement could be forgone following misapplication of the company’s assets regardless of whether B has any issues on the assets.⁶⁶⁵ A is in a position to hold a personal claim for “unjust enrichment” against B which follows a defence of change of position. If there were proof of fault on B then personal accountability, would be required of B, which is then viewed strictly.

According to Lord Scott, the agreement had the capacity to counter any form of takeover. With this, the case is viewed as a discussion or ostensible, apparent, actual or authority.⁶⁶⁶

In the High Court’s Judgement of *Criterion Properties Plc v Stratford UK Properties LLC*, quoting from Megarry VC's judgment in *Cayne v Global Natural Resources Plc*, he criticised on the fact that the non-acceptance in not considering such facts should not be taken that far. Further, the board needs to have the authority to interfere with these rights related to the constitution where the threat is big enough. In the Court of Appeal Brooke LJ and Carnwath LJ emphasised on the fact that “judge's conclusion that the directors' had improperly exercised their powers was correct and should not have gone on to consider the actual knowledge of the director”.⁶⁶⁷

Hogg v Cramphorn Ltd⁶⁶⁸ involves an English company law case that involved the question of director of liability. The court ruled that the dilution of the stock value by the

⁶⁶⁵Nicholls, Lord. "Knowing Receipt: The Need for a New Landmark." *Restitution: Past, Present and Future* (1998).

⁶⁶⁶Nahavandi, Afsaneh, and Ali R. Malekzadeh. "Acculturation in mergers and acquisitions." *Academy of management review* 13.1 (1988): 79-90.

⁶⁶⁷ *Criterion Properties Plc v. Stratford UK Properties LLC & Ors* [2004] UKHL 28. Available on <http://www.bailii.org/uk/cases/UKHL/2004/28.html> accessed on 5 December 2015

⁶⁶⁸*Hogg v Cramphorn Ltd* [1967] Ch 254

corporate directors for the prevention of a hostile takeover was a breach of their fiduciary duty to the entity.⁶⁶⁹

Mr. Baxter approached Cramphorn Ltd's Board of Directors with a takeover deal for the entity. The directors however viewed that the takeover was not favourable to the company. This led to the issuing of 5,707 shares each with ten votes to the trustees, belonging to the welfare scheme of the employees. With this, they could outvote the bid by Baxter for majority control of the company.⁶⁷⁰ This led to one of the shareholders suing Mr Hogg with the claims that the issuing of the shares was ultra vires. Cramphorn supported that the actions of the directors were in good faith. There was the fear that Mr Baxter would fire most of the workers.

Buckley J who wrote on behalf of the court claimed that the new shares given by the directors were not valid. By issuing the shares with the intent of barring the takeover, the directors had neglected their duties as directors. A fiduciary duty is created by the power to issue shares and hence these powers should only be utilised for the purpose of raising capital and not for other purposes such as a takeover.⁶⁷¹ There was no proof that the directors had acted honestly and that their intentions were in the best interest of the entity. The only way giving of shares would be acceptable would be if the decision was made by the shareholders in a general meeting,

⁶⁶⁹ Ibid p. 32

⁶⁷⁰Baxter, Michael St Patrick. "The Fiduciary Obligations of Directors of a Target Company in Resisting an Unsolicited Takeover Bid." *Ottawa L. Rev.* 20 (1988): 63.

⁶⁷¹ Ibid p. 37

wherein the case under consideration there no votes in general meeting on the newly issued shares.⁶⁷²

In the final judgment Buckley J stated that the directors could not misuse their powers to distribute the shares of the company for the purpose of takeover. However, they can issue the shares only to enhance the capital of the company. On the judgement of this case Buckley J quoted Piercy and said:

“With those observations I respectfully agree. Unless a majority in a company is acting oppressively towards the minority, this court should not and will not itself interfere with the exercise by the majority of its constitutional rights or embark upon an inquiry into the respective merits of the views held or policies favoured by the majority and the minority. Nor will this court permit directors to exercise powers, which have been delegated to them by the company in circumstances which put the directors in a fiduciary position when exercising those powers, in such a way as to interfere with the exercise by the majority of its constitutional rights; and in a case of this kind also, in my judgment, the court should not investigate the rival merits of the views or policies of the parties . . . It is not, in my judgment, open to the directors in such a case to say, ‘We genuinely believe that what we seek to prevent the majority from doing will harm the company and therefore our act in arming ourselves or our party with sufficient shares to outvote the majority is a conscientious exercise of our powers under the articles, which should not be interfered with’.”⁶⁷³

⁶⁷² Mandelker, Gershon. "Risk and return: The case of merging firms." *Journal of Financial Economics* 1.4 (1974): 303-335.

⁶⁷³ *Hogg v Cramphorn Ltd* [1967] Ch 254

Moran v. Household International, Inc.⁶⁷⁴ represents the standings of the Delaware Supreme Court that viewed that the shareholder rights plan also referred to as a poison pill as a legal exercise for the board of directors of the Household International was the basis of a business judgment. This case also represents an instance where the Court of Chancery viewed the poison pill as a legal exercise based on the Household's business judgment. *Moran v Household International* agreed and verified the judgment as stated.⁶⁷⁵ *Moran* is critically the initial case where the U.S state acknowledged a shareholder rights plan. Household International Inc. represents an expanded company consisting of subsidiaries in the merchandising, transportation and financial services. Vons Grocery and Car Rental were included in its wholly owned entities. The Court of Chancery detailed with respect to the Household that poison pills were acceptable as a business judgment.⁶⁷⁶ In August 1984, the board of Household International voted for the adoption of a shareholder rights plan. The plan was executed when the board was not facing the threat of takeover, which highlights a substantial distinction with other takeover defence cases such as Unocal. The board was focusing on the rising instances of 'break up' takeovers which involved the breaking up of large industrial entities into smaller companies and the Household International was considered likely by such takeovers.⁶⁷⁷

John Moran was a member of the Household International board and did not support the implementation of the shareholder rights plan. At the time he was the Chairman of the largest

⁶⁷⁴ *Moran v. Household International, Inc* 500 A.2d at 1348

⁶⁷⁵ L. Bebchuk and A. Ferrell, Symposium: Federalism and Corporate Law: The Race to Protect Managers from Takeovers, 99 Colum. L. Rev. 1168 (1999) at 1179.

⁶⁷⁶ *Moran v. Household International, Inc* 500 A.2d at 1349

⁶⁷⁷ Hunt, John W. "Changing pattern of acquisition behaviour in takeovers and the consequences for acquisition processes." *Strategic Management Journal* 11.1 (1990): 69-77.

shareholder of Household International, Dyson-Kissner-Moran Company. D-K-M was planning a leveraged buyout targeting the Household International, which was never implemented.⁶⁷⁸

According to the trial Court, the adoption of the shareholder rights plan by the Household International was a legitimate business judgment. The Delaware Supreme Court upheld the ruling of the lower court.⁶⁷⁹

4.3.3 Pac man

The Pac man defence is a technique that target company uses to secure itself from a hostile takeover by making an attempt to acquire it would be a buyer. The term “Pac man” is coined from a popular video game, “Pac man”. In the game, the Pac man is pursued by four ghosts in maze of dots. When he identifies and eats a ‘powerful pill’ or dot, he gains the strength to turn against his enemies and goes in pursuit of them.⁶⁸⁰ Far from that in the corporate history, the term is accredited to buyout guru Bruce Wassertein, Chairman of Wassertain and Co.

In an event that the target company is faced with an unwelcome unsolicited and belligerent bid by the acquirer. In an attempt to send away the acquirer, the target company may implement any method in an attempt to successfully see off the acquirer. It might go as far as dipping its hands into its war chest for the funds to accumulate the acquirer’s stock in order to acquire over half of the company’s stock.

⁶⁷⁸ Schweizer, Lars. "Organizational integration of acquired biotechnology companies into pharmaceutical companies: The need for a hybrid approach." *Academy of Management Journal* 48.6 (2005): 1051-1074.

⁶⁷⁹ Lipton, Martin, and Andrew R. Brownstein. "Takeover Responses and Directors' Responsibilities—An Update." *The Business Lawyer* (1985): 1403-1430.

⁶⁸⁰ Pearce, John A., and Richard B. Robinson. "Hostile takeover defenses that maximize shareholder wealth." *Business Horizons* 47.5 (2004): 15-24.

An internationally recognised instance of Pac man defence is that of Volkswagen surviving the Porche's hostile takeover attempt. Porche actually, slowly acquired a stake in the much larger counterpart, consequently to the point where it owned more than half of the company in 2009.⁶⁸¹ In the announcement that came later that year, the Volkswagen Group emerged to be the surviving entity.

In the US corporate history, Bendix is known as a company that narrowly and cunningly escaping an attempted hostile takeover by the Martin Marietta Company in 1982.⁶⁸² Initially, Martin Marrieta bought shares in Bendix with the intention of assuming control over the entire company. The Bendix Company then persuaded Allied Corporations to act as a "White Knight", eventually yielding to its purchase by the Allied Company the same year. This strategy in retrospection was labelled as 'Pac man defence'.

There are some scholars that raised their voice on the dangers of the Pac-Mac defence. Deborah A de Mott stated that the Pac man defence could end up in a cross holding structure between the target and the bidder company as the purchased shares could have voting rights. Particularly this could be more complicated in the US if the companies are based in separate states where they have different legislation on voting rights. As a result this could have impact on efficient of the corporate law.⁶⁸³

Another scholar, Gregory Corcoran sees this as a high risk measure to tackle against the hostile bidder. Moreover, if the decision right will be the directors responsibility, they will have to make sure that they are behaving in the shareholders interests rather than on their own

⁶⁸¹Gorzala, Jeannette. *The art of hostile takeover defence*. Igel Verlag, 2010.

⁶⁸² Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

⁶⁸³ De Mott A Deborah, 'Pac-Man Tender Offers' (1983) 32 Duke Law Journal 116,117, 130

interests. In the US, the SEC considered to abolish the Pac man defence but they also accepted that there were some benefits for the shareholders if it was used correctly although there was a cause for concern.⁶⁸⁴

4.3.4 Green-mail

A company may denounce the take-over by the acquirer and purchase back the recently acquired stock. This defence tactic is commonly known as greenmail and was most popular during one of the trends in 1980's.⁶⁸⁵ It comes in handy with a requirement that the raiders company should not make any further attempts of take-over. This is coupled with the fact that the shares have to be bought at a premium over the takeover price.

The term greenmail is used to refer to the practice of buying the stock of a target company by the company itself at a substantial premium so that the shareholders gain a significant increase in their stock value as compared to the presiding market charge for similar stock.⁶⁸⁶ This type of premium is provided in exchange for the stockholders' mutual agreement to accept or allow the target company's board to reject a takeover bid. The premium offer is negotiated when a bidder attempts to gain control of the target company and hence used as a defence tactic.

The targeted share repurchase knew as greenmail simply represents the buyback of shares owned by a particular shareholder of the target company who has made his intentions known of

⁶⁸⁴ Corcoran Gregory, 'The Dangers of the Pac-Man Defence' (The Wall Street Journal, 2007) <<https://blogs.wsj.com/deals/2007/11/15/the-dangers-of-the-pac-man-defense/>> accessed 29 October 2017

⁶⁸⁵Arbel, Avner, and Robert H. Woods. "Shark repellent: Anti-takeover measures for the hospitality industry." *The Cornell Hotel and Restaurant Administration Quarterly* 29.3 (1988): 28-39.

⁶⁸⁶ Ibid pp. 31

taking over the company by presenting a bid.⁶⁸⁷ The greenmail consideration is essentially at a premium above the prevailing market price. At a certain point, a considerable amount of shares are held by a hostile bidder, which forces the target company to repurchase the stock at a substantial premium to prevent any further attempts of the takeover. However, experts have argued that management uses greenmail in their own interest of perpetuating its ability to exploit the target company.⁶⁸⁸

Greenmail was popular in the US in the 1980s and the legal system has since been upgraded to curtail this mechanism. This is due to the fact that some transactions involving takeover are carried out with a view of making extraordinary profits by selling back the acquired shares to the target company at a higher premium than the initial price with no real initial intention of taking over the company.⁶⁸⁹ The greenmail mechanism is predominantly adopted by the management who fear the loss of their jobs in the company. The ultimate losers in the process are the shareholders who lose their money to the bidding company in form of profits. The practised has since received criticism especially in the US where it originated.⁶⁹⁰

Unocal v Mesa Petroleum Co⁶⁹¹ represents landmark decisions with respect to the Delaware Supreme Court on defensive mechanisms on takeover bids.

⁶⁸⁷Karpoff, Jonathan M., Paul H. Malatesta, and Ralph A. Walkling. "Corporate governance and shareholder initiatives: Empirical evidence." *Journal of Financial Economics* 42.3 (1996): 365-395.

⁶⁸⁸Morck, Randall, and Lloyd Steier. "The global history of corporate governance: An introduction." *A history of corporate governance around the world: Family business groups to professional managers*. University of Chicago Press, 2005. 1-64.

⁶⁸⁹Jackson, Gregory, and Martin Hoepner. "An emerging market for corporate control? The Mannesmann takeover and German corporate governance." (2001).

⁶⁹⁰Roe, Mark J. "A political theory of American corporate finance." *Columbia Law Review* 91.1 (1991): 10-67.

⁶⁹¹ *Unocal v Mesa Petroleum Co* 493 A.2d 946 (Del. 1985)

The business judgment rule was being applied by the Delaware Court until the Unocal decision in 1985 with respect to sales, mergers and takeover defences.⁶⁹² The Unocal, board of directors could not prevent a takeover unless there was proof it was “a threat to the corporate culture and the defensive tactic applied should be proportional to the threat”. This need was later identified as the Unocal test for the board of directors.

However, in *Unitrin v American General Corp*, it was considered and slightly switched to mean where force was required to be used before Court intercession.⁶⁹³

Mesa Petroleum had made a deal involving a front-end loader that was two-tiered for Unocal Corporations where \$54 in cash was given for the front end in addition to \$54 in junk bonds as the finishing of the deal.⁶⁹⁴ Most shareholders usually want to transact in cash rather than bonds, with it was expected that they would tender the present shares and close the deal although \$54 never seemed like a fair price. If the shareholders did not accept to tender they risked paying \$54 in risky debts instruments as opposed to cash.

Unocal created a self-tender offer for \$72 excluding Mesa share as a response to the tender offer from Mesa. There were attempts by the Unocal board to start a tender offer to counter the uninvited offer by Mesa Petroleum. Adoption of a tender offer is because Mesa had acquired 64 million shares of Unocal. This would translate to Unocal have to purchase back 49%

⁶⁹²Gilson, Ronald J., and Mark J. Roe. "Understanding the Japanese keiretsu: Overlaps between corporate governance and industrial organization." *Yale Law Journal* (1993): 871-906.

⁶⁹³ *Unitrin v American General Corp* 651 A.2d 1361 (Del. 1995)

⁶⁹⁴Jensen, Michael C. "The takeover controversy." (1988).

of their shares where the shares which would have been brought back would never have been held by Mesa.⁶⁹⁵

The court held that this form of selective exchange offer could not be legally applicable and ordered the stoppage of the use of self-tender offer defences.

However, the Delaware Supreme Court had a different view of the trial court. The Court perceived the Unocal Board of Directors possessed logical reasons for their belief of the existence of a danger to effectiveness or corporate culture.⁶⁹⁶ The response was also viewed as proportional to the threat. This logical relation analysis triggered a review of the timing, the nature and the price of the offer in addition to the effect on the employees, the community, the customers, the creditors and the shareholders.

The Court considered Revlon and MacAndrews where it is allowed to look at other constituencies other than the stakeholders.⁶⁹⁷ Although in Cheff v Mathes wanted the raider payment or greenmail to disappear the Unocal Court prohibited the payment to the shareholders with exception of the raider.⁶⁹⁸

The Court's opinion was substantial because the conflict of interest meant that takeover defences would not be favourable for the shareholders. In the Unocal case, the Court was careful that the board had the capacity of using takeover defences to protect the corporation's culture was in a manner that is not acceptable, in addition to control of the entity by the board. The

⁶⁹⁵Schubert, David J. "Unocal Corp. v. Mesa Petroleum Co.: A New Era of Fiduciary Duty." *Baylor L. Rev.* 38 (1986): 687.

⁶⁹⁶ Ibid pp 39

⁶⁹⁷ Revlon Inc. v MacAndrews & Forbes Holdings, Inc, 506 A.2d 173 (Del. 1986)

⁶⁹⁸ Cheff v Mathes, 199 A.2d 548 (Del. 1964)

inclusion of an enhanced duty on the board to direct their decisions for improving the wellbeing of the entity and its stakeholders. The board is required to prove that its response is a real threat to the corporate culture; this is in addition to proving that their actions were logical as per the present threat, so as to be assigned to the security of the business judgment rule.⁶⁹⁹

In the Judgement of *Unocal v Mesa Petroleum Co*, it was analysed that the Unocal's board of directors had the valid reasons for emphasising that a danger to incorporate efficiency for existing and that the response was reasonable in relation to the threat posed.⁷⁰⁰

Stephen Kenyon-Slade stated that it has never been any requirement in law that the shares can be bought at an “equal term or in equal amounts for all shareholders” and the share premiums may not be considered as a part of the company's assets where stakeholders could have equally.⁷⁰¹

Mr. Espen Eckbo argued that if the company's share price drops down which could result to greenmail, and prohibiting this tactic could increase shareholders wealth.⁷⁰²

Shleifer and Vishnu challenged the traditional approach on greenmail's negative effect on the share price and they concluded that the share price always drops down as a result of greenmail even though the managers improve the value of the target company. Consequently, the

⁶⁹⁹ Ibid pp 42

⁷⁰⁰ *Unocal v Mesa Petroleum Co* 493 A.2d 946 (Del. 1985)

⁷⁰¹ Stephen Kenyon-Slade, *Mergers and Takeovers in the US and UK : Law and Practice* (OUP 2004) 408

⁷⁰² B. Espen Eckbo, 'Valuation Effects of Greenmail Prohibitions' (1990) 25 *The Journal of Financial and Quantitative Analysis* 491, 504

share prices performance should not be considered the effectiveness of greenmail as a takeover defence measure.⁷⁰³

4.3.5 White knight

This defence tactic is goodwill by the acquirer to protect the company on a bid from hostile take-over.

As defined by Kokot “ a white knight is a company (the ‘good guy’) the gallops to rescue the company that is facing a hostile takeover from another company (a “Black knight”) by making a friendly after the purchase the shares of the target company”.⁷⁰⁴

Individual shareholders in the US rarely vote against incumbent management, making it hard to replace the directors even if they under-perform.⁷⁰⁵ This also explains why greenmail (this is a situation in which a large block of stocks are held by an unfriendly company. This forces the target company to repurchase the stock at a substantial premium to prevent a takeover) has been a successful tactic, except when restrained by regulation.

Takeover defences could also be divided into those, which are made when a bid was not even expected, so-called pre-bid defences, which are usually carried out. The takeover defence tactics should preserve the interests of the company as a whole. The importance of the

⁷⁰³ Andrei Shleifer and Robert W. Vishny, ‘Greenmail, White Knights, and Shareholders' Interest’ (1986) 17 The RAND Journal of Economics 293, 294

⁷⁰⁴ Kokot, K “The art of takeover defence”, Journal of Business Law, Val.14, No2, 2006, p 20.

⁷⁰⁵Donaldson, Lex, and James H. Davis. "Stewardship theory or agency theory: CEO governance and shareholder returns." *Australian Journal of management* 16.1 (1991): 49-64.

defence tactics is to protect the target company from an unfair takeover bid which could undermine the interests of the target company.⁷⁰⁶

The application of the “white knight” as a defence mechanism involves the management of a target company approaching a friendly company to purchase its majority shares so as to assist it to repel a potential attempt by the hostile bidder to take over the target company.⁷⁰⁷ White knights in this situation are taken to be the target company the preferred acquirer or rescuer despite controlling the voting department of the company. Strategically, the white knight is not considered to be a takeover mechanism or defence since, at the end of the transaction, the company is taken over by an alternative bidder though, being more acceptable and approved by the management. The target company, therefore, has to make a choice between takeover transactions by the hostile bidder or instigate a takeover by a friendly alternative bidder.⁷⁰⁸

Obviously, white knight transactions are considered beneficial to the incumbent management and the shareholders as well. The shareholders enjoy the raised bid offer arising from the alternative takeover by the white knight, while the incumbent management may remain in the same positions or obtain a better one in the newly merged firms. The takeover regulation allows the entry of a white knight into a takeover deal initially undertaken by the initial hostile bidder. The condition of such an entry is by offering a higher price for the stock than the unfriendly bidder, to avert the takeover bid. The higher bid will ultimately render the interest of

⁷⁰⁶Giacomazzi, Franco, et al. "Information systems integration in mergers and acquisitions: A normative model." *Information & management* 32.6 (1997): 289-302.

⁷⁰⁷Smiley, Robert H., and Scott D. Stewart. "White knights and takeover bids." *Financial Analysts Journal* 41.1 (1985): 19-26.

⁷⁰⁸ Ibid pp. 45

the hostile bidder useless unless they persist in fighting on further.⁷⁰⁹ Hence, fulfilling the objective of protecting the target company from the raid. White knight as post bid defence is not easy to come by in the current economic climate due to the economic recession. Hence it difficult to get the alternative bidder that is ready to sacrifice their investment to surpass that of a hostile bidder. It is important to note in the context of this study that the earlier mentioned advantages of white knight to the management is not guaranteed and that the actual reason for adopting this type of mechanism is to protect the company from unfriendly takeover and that may result in infringement of rights of the shareholders of the target company.

Kraft's hostile takeover bid for Cadbury best exemplifies case law in this type of takeover defence.⁷¹⁰

In 2009, Kraft Foods made a hostile bid for Cadbury, the UK-listed chocolate maker, following which, in August 2011, it became apparent that Cadbury's purchase would allow Kraft to restructure and split its business model into two companies within a year: into a \$16bn grocery and a \$32bn global snacks business.⁷¹¹

When the initial bid was made, though, Cadbury was not for sale and aggressively battled against this move by Kraft.

The Chairman of Cadbury, Sir Roger Car, launched a robust defence against the bid, stating that the share price offer was "unattractive" and that it "fundamentally undervalued the

⁷⁰⁹Grossman, Sanford J., and Oliver D. Hart. "Takeover bids, the free-rider problem, and the theory of the corporation." *The Bell Journal of Economics* (1980): 42-64.

⁷¹⁰ DePamphilis, D, *Mergers, Acquisitions and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions*, Seventh Edition, Elsevier Academic Press, New York (2014) pp 579-580

⁷¹¹Clarke, Blanaid. "Directors' Duties in a Changing World: Lessons from the Cadbury PLC Takeover." *Eur. Company L. 7* (2010): 204.

company”. He even went as far to say that he would rather another confectionery company, such as Hershey, Ferrero or Nestlé, takeover the running of Cadbury. The British government’s business secretary, Lord Mandelson, who said that the government would oppose any buyer who failed to “respect” Cadbury’s traditions, backed up this stance.⁷¹²

Cadbury recommended that its perceived idea of what Kraft would do to the Cadbury business was “an unappealing prospect that sharply contrasts with the Cadbury strategy of a pure-play confectionery company”, though this would eventually be proven wrong by Kraft running Cadbury as a separate entity, therefore creating more value for its shareholders.⁷¹³

In November 2009, Hershey, Ferrero and Nestlé actually showed interest in making a bid, thus giving Cadbury more potential options. Roger Carr said that he would prefer to merge with Hershey rather than Kraft because this would generate higher earnings per share. It was also reported that the directors of Cadbury secretly contacted Hershey's directors to encourage them to tender a counter-offer, in order to compete with Kraft. This “white knight” strategy aimed at offsetting some of the pressure associated with hostile takeover bids and to defend the target company.⁷¹⁴

However, Hershey did not have the financial clout to make a bid without Ferrero's assistance, and Nestlé would have been open to anti-trust proceedings, so eventually, Kraft merged with Cadbury by offering \$19.5 billion.

⁷¹² “Don't try to make a quick buck from Cadbury, Mandelson tells Kraft”

<http://www.theguardian.com/business/2009/dec/04/cadbury-bidders-will-face-opposition> accessed on 3 September 2015

⁷¹³ Ibid pp. 56

⁷¹⁴ Case study: Kraft’s takeover of Cadbury- <http://www.ft.com/cms/s/0/1cb06d30-332f-11e1-a51e-00144feabdc0.html#axzz3rBDS9K0t> accessed on 5 September 2015

The two companies agreed on a price of 840 pence per share plus a special 10 pence per share dividend, which was approved by 72 percent of Cadbury's shareholders.⁷¹⁵

With Cadbury being such a major UK company, the story was front-page news, in the financial press, for at least four months. Added to the takeover itself was the controversial involvement of the UK government-owned RBS bank acting as Kraft's advisors and financial backer. Nonetheless, as there were no competition issues, UK regulators were not involved, which allowed Cadbury's management team to concentrate on the deal itself and the real decision-makers, namely Cadbury's shareholders.⁷¹⁶

The deal demonstrated that very rational hedge fund managers and other arbitrageurs made up 31 percent of the share-holding cohort, and these were swayed by the offer price and thus enabled the deal to be completed quickly.⁷¹⁷

Revlon Inc. v MacAndrews & Forbes Holdings, Inc.⁷¹⁸ represents a landmark ruling of the Delaware Supreme Court with respect to hostile takeovers. With respect to the declaration of the Court, there are specific situations, which perceive breaking of the entity is unavoidable. This is in addition to a substantial narrowing of the fiduciary obligations involving the directors of a company that is targeted. The only obligation of the board is maximisation of the immediate stockholder value through securing of the highest possible price.⁷¹⁹ The role of the board of

⁷¹⁵ Ibid pp. 56

⁷¹⁶Franks, Julian R., and Robert S. Harris. "Shareholder wealth effects of corporate takeovers: the UK experience 1955–1985." *Journal of financial Economics* 23.2 (1989): 225-249.

⁷¹⁷Higson, Chris, and Jamie Elliott. "Post-takeover returns: The UK evidence." *Journal of Empirical finance* 5.1 (1998): 27-46.

⁷¹⁸Revlon Inc. v MacAndrews & Forbes Holdings, Inc 506 A.2d 173 (Del 1986)

⁷¹⁹Revlon Inc. v MacAndrews & Forbes Holdings, Inc, 506 A.2d at 182

directors shifts from defending the corporate bastion to auctioning for the best price at a sale of the entity for stockholders.⁷²⁰ A different frame of reference is utilised in the evaluation of the actions of the board. There is no possibility of judicial review of the conduct in such a context with respect to the traditional rule of judgment. The logic is scrutinised with respect to the board's obligations.⁷²¹

A corporate takeover frenzy is influenced by the impact of this statement since the directors want to be auctioneers when their company is perceived to be in play, in order to stay faithful to their fiduciary duties.⁷²²

Usually, a company that is Revlon compels the board to auction the firm to the highest bidder with respect to specific Revlon duties.

This was the decision reached by the Court, while verifying issuance by the Court of Chancery that precluded the Revlon, Inc. from taking an intended action with one of the bidders involved, which successfully stopped an active auction for the acquisition of the company.⁷²³

The Revlon Company was approached by Ronald Perelman the CEO of Pantry Pride with the concept of a negotiated transaction or a hostile tender offer that was priced at \$42 - \$45 per share. Revlon's board rejected the negotiated transaction, as there was a suspicion that the junk bonds would finance the acquisition and that would result in dissolution.⁷²⁴

⁷²⁰Powell, Ronan G., and Andrew W. Stark. "Does operating performance increase post-takeover for UK takeovers? A comparison of performance measures and benchmarks." *Journal of Corporate Finance* 11.1 (2005): 293-317.

⁷²¹ Ibid pp. 41

⁷²²Boone, Audra L., and J. Harold Mulherin. "Do auctions induce a winner's curse? New evidence from the corporate takeover market." *Journal of Financial Economics* 89.1 (2008): 1-19.

⁷²³ Ibid pp. 33

⁷²⁴Powell, Ronan, and Alfred Yawson. "Industry aspects of takeovers and divestitures: Evidence from the UK." *Journal of Banking & Finance* 29.12 (2005): 3015-3040.

The Revlon board hence implemented a defensive action so as to prevent the hostile tender offer. This meant the adoption of a "Note Purchase Rights Plan" which is a variation of the conventional poison pill which leads to the issuance of debt instead of equity rights to the existing shareholders.⁷²⁵

Pantry Pride then shortly announced a hostile cash tender offer for the Revlon shares, which they priced at \$47.50 with respect to their capacity for financial security and redemption of the rights offered to the stakeholders.⁷²⁶

Shareholders were however advised by Revlon board to turn down the offer as insufficient as a response and continued on its offer of re-buying a substantial portion of its shares while trading for convertible preferred stock and senior subordinated notes that are valued at \$100 per share.⁷²⁷ The offer was immediately oversubscribed and the company issued notes composed of agreements that barred Revlon from issuing dividends, selling assets and incurring debt in exchange for 10 million.

Completing the Revlon repurchase program successfully stopped the outstanding tender offer from Pantry Pride. Pantry Pride hence issued another one a few weeks later with respect to the offer that had just been completed with its value relatively equal to the initial offer. Revlon

⁷²⁵ Ibid pp. 250

⁷²⁶Coffee, John C. "Shareholders versus managers: The strain in the corporate web." *Michigan Law Review* 85.1 (1986): 1-109.

⁷²⁷ Ibid pp. 52

board also rejected this offer prompting Pantry Pride to revise their offer and a few weeks later raised their price to \$50 and even \$53 per share.⁷²⁸

During this period Forstmann and Revlon board had started a discussion. Some of it was based on the buyout that would be organised by Forstmann as an alternative option to the Pantry Pride bid.⁷²⁹ They immediately came to a deal in principle priced at \$56. A waiver was included in the agreements of the deal, which was based on the restrictive agreement contained in the previous Revlon repurchase. The trading value of the notes decreased steeply after the declaration of the waiver of the covenants, which threatened the company with litigation from the irate noteholders.⁷³⁰

Pantry Pride was forced to raise the offer to \$56.25 per share. They then publicly declared that they were willing to top any bid made by Forstmann even if it's only by a fraction. This led Forstmann to respond by refusing to enter bidding with Revlon without their substantial assurance that they would close the deal. Revlon went as per Forstmann's will. Shortly after Pantry Pride had offered \$56.25, they closed a deal with Forstmann at \$57.25 per share on a condition that Forstmann would purchase at a discount one of Revlon's essential business divisions if there is another entity that would secure more than 40% of Revlon's outstanding stock. This was in addition to a \$25 million termination fee, a restriction of Revlon board from negotiations with rival bidders in exception of slim situations; there was also the removal of the

⁷²⁸Shleifer, Andrei, and Robert W. Vishny. "Large shareholders and corporate control." *Journal of political economy* 94.3, Part 1 (1986): 461-488.

⁷²⁹Grossman, Sanford J., and Oliver D. Hart. "Takeover bids, the free-rider problem, and the theory of the corporation." *The Bell Journal of Economics* (1980): 42-64.

⁷³⁰ Ibid pp. 46

Note Purchase Rights and the waiver involving the restrictive agreement.⁷³¹ On Forssmann's side, there was an agreement he would support the par value of the Notes, which are still decreasing in value in the market. This would be through their exchange with new notes at their first value during the first issuing. This was followed by Pantry Pride raising their offer to \$58 per share. In addition to filing a claim in the Court of Chancery when it sought temporary relief so as to stop the asset alternative, the no-shop, the rights and termination fee. There were also arguments that the board had neglected its fiduciary duty through restricting Revlon stockholders from closing the deal even with a larger cash offer.⁷³²

The relief was granted by the Court of Chancery after realising the directors had created a challenged deal provision in order to stop the Forstmann deal. This was to prevent a potential liability to the shareholders of Revlon. Forstmann however had no issue in restoring the whole value of the notes based on the new deal, which seized their concern. With this, the Court of Chancery declared that the directors of Revlon had neglected their duty of loyalty while acting in their own personal interest rather than in the interests of increasing the sale for the benefit of the stakeholders.⁷³³

The Court alongside the Revlon board's defensive actions reviewed the challenges of Pantry Pride. These issues included the completion of the repurchase program and induction of a poison pill. The Court made its decision based on its previous standings in the Unocal v Mesa Petroleum case where the Court viewed that although the business judgment favoured the

⁷³¹ Ibid pp. 45

⁷³²Roll, Richard. "The hubris hypothesis of corporate takeovers." *Journal of business* (1986): 197-216.

⁷³³Rydqvist, Kristian. "Takeover bids and the relative prices of shares that differ in their voting rights." *Journal of Banking & Finance* 20.8 (1996): 1407-1425.

approval of the board of a proposed merger, it was not required that the board take anti-takeover measure. This is with respect to the omnipresent spectre regarding the board where they would be serving their own interest while they are should have been acting for the benefit of the stakeholders by securing the maximum value.⁷³⁴ The directors were required to take action such as logic investigation in order to show good faith, to prove a need to take defensive actions. In addition to proving that the actions taken were worth the threat posed.

On applying these criteria, the Court found the actions of Revlon board to have been relatively logical which was the adoption of the poison pill during the period that they were being offered \$45 per share. This is because it led to a visible improvement in the bargaining power since it redeemed their rights while waiting for a better offer, which eventually came. It also had the same views on the exchange offer.⁷³⁵ When the negotiations that led to the merger with Forstmann were reviewed, there was an application of a distinct legal standard with respect to the fact that there was no other way other than the sale of the company or its breakup and where it ended up being sold to one suitor. With this, it was not being charged with the protection of the company and the shareholders from the potential threats but rather giving them an obligation to increase the entity's monetary value for the benefit of the stakeholders. This was the only violation held against the Revlon directors. This was the agreement in the previous transaction by Forstmann in a manner that successfully stopped the bidding contest between

⁷³⁴McConnell, John J., and Henri Servaes. "Additional evidence on equity ownership and corporate value." *Journal of Financial economics* 27.2 (1990): 595-612.

⁷³⁵Loderer, Claudio, and Kenneth Martin. "Executive stock ownership and performance tracking faint traces." *Journal of Financial Economics* 45.2 (1997): 223-255.

Pantry Pride and Forstmann. Revlon board was viewed to have gone contrary to their principles of pursuing and securing the highest price possible for the stakeholders.⁷³⁶

The Court never considered the fact that the deal with Forstmann influenced a higher price than it was actually achievable in addition to promoting the shareholder' interests preventing the depreciating market for the notes.⁷³⁷

After Revlon board allowed the merger negotiations by the management or the buyout with the third party. This would translate that the entity was meant to be sold. This shows that the duty of the board had shifted from the preservation of the corporate entity to increasing the sale value of the company to maximise the benefits of the stockholders.⁷³⁸ With respect to the Unocal standards, the board's responsibilities were substantially altered.

Threats relating to the effectiveness and corporate policy or to the interests of the stakeholders were no longer there. The issue of defensive measures remained questionable. The role of the directors shifted from being the defenders of the organisation to auctioneers that were required to achieve for the most favourable sale price for the stakeholders. It is logical that Revlon does not need an auction. The only mandate on Revlon is that the shareholders should be free to choose between the two transactions. According to Allen, the most predominant actions are a "change in corporate control" and are they acting in good faith for the maximum price for the stakeholders.⁷³⁹

⁷³⁶Anderson, Ronald C., and David M. Reeb. "Founding-family ownership and firm performance: evidence from the S&P 500." *The journal of finance* 58.3 (2003): 1301-1328.

⁷³⁷ 506 A.2d at 173

⁷³⁸ Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985)

⁷³⁹Revlon, Inc. v MacAndrews & Forbes Holdings, Inc, 506 A.2d at 182.

According to the Revlon board, their actions were in good faith this meant the protection of the shareholders since the considerations of other companies are allowed by Unocal. Usually, it is not appropriate to have such concerns for the interests of the non-stockholders during an ongoing auction with active bidders. The main objective is not protection of the enterprise but acquiring the best price from the highest bidder.

The Court declared that the Revlon board completed the critical bidding contest in an unfavourable manner. This led to the failings of not only the Revlon board but also that of the Unocal. It continued to outline that stopping the bidding process and the directors acting for their own security cannot be the required conduct expelled from directors of Unocal.⁷⁴⁰ This means that duties are created by Revlon, which is also viewed as 'enhanced Unocal duties'.

Justice Andrew G.T. Moore made the following opinion

When an action is being considered as claims for fiduciary duties, it may be handled under three phases. The three levels as declared by the Court in Golden Cycle are the stringent standard of entire fairness, the Revlon or Unocal enhanced scrutiny standard and the deferential business judgment rule.⁷⁴¹

The deferential standard which is the initial one is also the business judgment is frequently applied in the Delaware corporate law in its duty care.⁷⁴² In this case, a legal body

⁷⁴⁰ Craig W. Palm & Mark A. Kearney, A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part II), 42 Vill. L. Rev. 1043, 1066 (1997).

⁷⁴¹ Golden Cycle, LLC v. Allan, No. CIV.A. 16301, 1998 WL 892631, at *11 (Del. Ch. Dec. 10, 1998) (mem.)

⁷⁴² Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247, 299-300 (1999) ("In practice the duty of care is all but eviscerated by a legal doctrine known as the "business judgment rule.")

referred to as the business judgment rule completes the duty of care. Also viewed as the default standard (where the facts are required to show why this level of review should be ignored). With respect to the business judgment, the directors had acted with a view of sufficient information in good faith and were truly concerned that their actions would be for the best interest of the entity. This was also an overview of how the business judgment behaves and the duties of a director under its rule. It can be concluded that the business judgment can be based on more than just the inquiry process.

With respect to the Unocal and Revlon standards, the court inquiry stated that the directors were required to prove they had reasonable grounds for their decisions, in addition to indicating reasonable grounds behind their beliefs.⁷⁴³

The Unocal standard deals with the affirmation of defensive tactics from the target board in addition to logically reviewing an actual corporate proportionality and threat.⁷⁴⁴ By demonstrating their independence, being well informed and their actions based on good faith the board can be perceived as materially advanced. Revlon's duties can be perceived to be influenced by 'change in control' and need to be logical. The logic standard should be based on independence of the board, while being careful that the information being used, during the negotiations should in good faith and the best value for the stakeholders. Finding the best value for the stakeholders do not necessarily require an auction based on the situation.

Fairness may entirely stand where most directors to verify the transaction are interested or where most stockholders agree with an alternative. If directors are present on both sides of the transaction, then they can be assumed to be interested or in case they are expectant of any

⁷⁴³ Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986) and Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)

⁷⁴⁴ Unocal, 493 A.2d at 955

financial benefits with respect to self-dealing rather than benefits encompassing even the company.⁷⁴⁵

The corporate board is required to show total fairness by proving that the transactions are positive for the shareholders in terms of both a fair price and fair dealing. Subsequent cases of **Paramount v QVC and Paramount v Time**⁷⁴⁶ involved the same issue, where the board takes on the duty of the Revlon which is auctioning the company and neglect defensive measures that were appropriate under Unocal. As per the law of Paramount v QVC and Paramount v Time, directors of the company are not allowed or given the authority to present favouritism to the shareholder by providing them profit on a long term corporate plan.⁷⁴⁷

On a wide view of the scrutiny standard of judicial review that has recently been discussed in **Moran v Household International Inc.**⁷⁴⁸ There was a major academic debate that emerged due to the Revlon opinion. This was based on what should be in order to utilise the Revlon. There are still questions on the issue regarding the degree to which the doctrine has been applied in the traditional duty of care. This is in relation to ownership transactions such as mergers and how it relates to the Unocal test that was earlier applied to the defensive action of

⁷⁴⁵ Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); see also Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (explaining the purpose underlying the business judgment rule and discussing a director's duties under the rule)

⁷⁴⁶ Paramount Communications, Inc. v. Time Incorporated Fed Sec L Rep (CCH) 94, 514; affd 571 A.2d 1140 (Del. 1989)

⁷⁴⁷ Ibid 515

⁷⁴⁸ Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985)

the board, in order to clear a hostile acquisition bid. It was applied recently in the dealing of protection devices that are present in the merger covenants.⁷⁴⁹

The Revlon doctrine is still persistent despite the expansion of the Revlon and the fact that it is nearly two decades since it was decided. What was expected is that there was some assurance for the practitioners that change of control and cash mergers after the outcome of the principles declared by Revlon that would enhance closer judicial scrutiny in relation to the vast judicial deference, which was early, perceived as appropriate and typical. It is in this manner that the board verifies the provisions that hinder it from hearing from any lucrative offers that may emerge in the middle of the merger deal in addition to presenting it for shareholder approval. The actions of the board that have not made substantial efforts to obtain the best possible price will be scrutinised by the courts. Recently, Delaware litigation considered the standing of an independent board, which hindered negotiations with another bidder that offered higher terms after the initial deal had been signed.⁷⁵⁰

4.3.6 White Squire

In this defence, it is perceived that the target company offers shares to a friendly party who not only wishes the company to operate independently but also operate with a management that is familiar with him/her. The number of shares issued to the friendly party greatly depends on a number of different circumstances. The actual purpose of the transfer of shares is to prevent the bidder; the issue does not actually represent a higher proportion of the share capital in the

⁷⁴⁹ Sudarsanam, P. S. "The role of defensive strategies and ownership structure of target firms: Evidence from UK hostile takeover bids." *European Financial Management* 1.3 (1995): 223-240.

⁷⁵⁰Loderer, Claudio, and Kenneth Martin. "Executive stock ownership and performance tracking faint traces." *Journal of Financial Economics* 45.2 (1997): 223-255.

target company.⁷⁵¹ It is worth noting that regardless of the intentions of the transactions, the shareholders must approve such an action in order to take effect. It follows that the power conferred upon the directors of the target company to allocate the shares must be pursued for the right purpose and should not serve the self-interest of the directors.⁷⁵²

The friendly investor in this defence tactic does not have any intention of gaining majority control in the target company.⁷⁵³ The aim is to assist the company under threat to evade attempts by potential hostile bidders from taking control of the company. As mentioned earlier in the white knight defence, the white squire also has a similar objective and is conducted in the same way. However, the distinctive factor in the white squire defence is that it purchases a large volume of the minority stock of the target company and does not gain control of the voting power of the company. The transaction is solely meant to help the company overcome the takeover bid by the unfriendly bidders. Both the white knight and white squire share the similar purpose of rescuing the target company from the threat of takeover by hostile bidders. The difference is that the white knight assumes the control of the company to drive off the potential bidder.⁷⁵⁴

⁷⁵¹Zarin, Samim, and Erik Yang. "Mergers & Acquisitions: Hostile takeovers and defense strategies against them." *rapport nr.: Management & Organisation 11*: 85 (2011).

⁷⁵²Seretakis, Alexandros. "Hostile Takeovers and Defensive Mechanisms in the United Kingdom and the United States: A Case Against the United States Regime." *Ohio St. Entrepren. Bus. LJ* 8 (2012): 245.

⁷⁵³Block, Dennis J., Jonathan M. Hoff, and H. Esther Cochran. "Defensive Measures in Anticipation of and in Response to Unsolicited Takeover Proposals." *U. Miami l. Rev.* 51 (1996): 623.

4.3.7 Litigation

This is a common anti-takeover defence which has the target company filing court proceedings against the aggressive acquirers. The target company's board should, therefore, identify any breaches of security laws and regulations. The court proceeding can considerably prolong the period before a takeover and thus the target company can utilise the time to solicit competing bids or alternatively formulate other defences.⁷⁵⁵

Paramount Communications, Inc. v Time Incorporated Fed Sec L Rep⁷⁵⁶ represents a US case that deals with defences against acquisitions and mergers in Delaware.⁷⁵⁷ Warner Communications and Time Inc. intended to merge. Time intended that its HBO channel to get expand its TV operations with the help of Warner Communications. An offer of \$200 per share was made by Paramount to all the shareholders starting from \$175. Time had its shares trading at \$120. This is in addition to many defences such as a staggering board where their deadline for 50 days was hard to have met for any motion and a plan for a poison pill with a 15% enhancer. They, however, went further with the Paramount threat. Other than having it as a stock for stock merger they instead had a leveraged purchase transaction.⁷⁵⁸ There was a requirement by the

⁷⁵⁵Krishnan, C. N. V., et al. "Shareholder litigation in mergers and acquisitions." *Journal of Corporate Finance* 18.5 (2012): 1248-1268.

⁷⁵⁶Paramount Communications, Inc v Time Incorporated Fed Sec L Rep (CCH) 94, 514; affd 571 A.2d 1140 (Del. 1989)

⁷⁵⁷Delaware will appear in many of the cases, because it is known as the "Corporate State of America" because of its legislation a considerable number of holding companies are registered in its jurisdiction.

⁷⁵⁸ Ibid 51

NYSE that any transactions of 20% of the shares would require approval by the shareholders. By changing this structure, it meant that the shareholders would not necessarily be informed.

Shareholders never supported the idea of following through with the merger and would have wished for a continuation of Paramount's cash out an offer.

Chancellor Allen in his judgement stated that, "I note parenthetically that plaintiffs in this suit dismiss this claim of 'culture' as being nothing more than a desire to perpetuate or entrench existing management disguised in a pompous, highfalutin' claim... I am not persuaded that there may not be instances in which the law might recognise as valid a perceived threat to a 'corporate culture' that is shown to be palpable... distinctive and advantageous".⁷⁵⁹

4.3.8 People pill

There are businesses or industries that are unique in the sense that they require hi-tech skills to operate and this limited number of individuals is critical to the success of the company. In such corporations, the management boasts of its input and uses it as a tool in resisting a takeover bid. It happens in such way that the target's entire management unanimously threatens to quit or resign in an event of a hostile take-over. This leaves the impending raider in a very volatile condition; it cannot risk losing the management as these are critical to any post-merger success. The people pill defence is rarely used and is common in hi-tech industries.⁷⁶⁰

⁷⁵⁹ Paramount Communications, Inc v Time Incorporated Fed Sec L Rep (CCH) 94, 514; affd 571 A.2d 1140 (Del. 1989)

⁷⁶⁰Buono, Anthony F., and James L. Bowditch. *The human side of mergers and acquisitions: Managing collisions between people, cultures, and organisations*. Beard Books, 2003.

4.3.9 Jonestown Defence or Suicide Pill

This is unique defence tactics that involve the target firm involving in activities that might eventually destroy the future survival of the firm, instead of warding off the hostile bidder. It can be said to be an extreme kind of poison pill and also referred to as “suicide pill”. The term Jonestown trivially refers to the 1998 Jonestown massacre in Guyana in which Jim Jones influenced the members of a religious cult (People Temple) have a group suicide.⁷⁶¹

The Jonestown Defence is normally the most extreme of the defence strategies that can be considered. Among others are; Crown Jewels strategies (which involve selling off the attractive assets at discounted to other potential buyers except of the bidder), share buybacks (where the prices of the stocks are raised while the public equity is reduced at the expense of cash or debt financing), and any other than in the matching trend of threatening the target itself. The difference between Jonestown strategies and the ordinary strategies is not wide though the fact it is extremely detrimental to the target firm. Companies that have gone for this strategy have found themselves insolvent and thus incapacitated to deter any further.⁷⁶² This is driven by the fact that the target firm lowers the price of the company’s assets such that without remaining intangible assets like a brand name or other intellectual property that might be of need to the bidder, the acquisitions and mergers of such firms are devastating.

4.3.10 A staggered board of directors or classified board

Unlike in firms where all the board of directors are granted one year term, a staggered board of directors’ or ‘classified board’ is an unusual system and commonly implemented in the

⁷⁶¹ Read more: <<http://www.investopedia.com/terms/j/jonestowndefence.asp#ixzz1kgzfaBJw>> accessed 24 March 2015

⁷⁶² More on: <<http://www.investopedia.com/terms/j/jonestowndefense.asp#ixzz1kgzisLz9>> accessed 24 March 2015

United States. It requires that only a section of the board of directors (quite often a third) of a company are elected in every tenure and restructuring the entire board of director. The term classified is attributed to the fact that the board of directors of a firm in the type of strategy is divided into specific groups identified as 'class' and the classes can be 'Class I', 'Class II' and so forth.⁷⁶³

These classify boards have a high tendency of complicating or rendering the of publicly listed companies unachievable. In order that the aggressive acquirer gains control of the target firm in a takeover when a board is staggered, it has to ensure that it wins not less than one proxy fight at consecutive shareholder meetings. In the United States corporations, a duet of the classified board that cannot be restructured and poison pill forms one of the best prospective defence strategies.⁷⁶⁴

In spite of its relevance, anti-classified boards activists, most especially the institutional shareholders have consistently fought against having a staggered board of directors, in other words calling for declassification. According to a report by the Wall Street Journal in January 2007, the year 2006 marked the transition towards declassification or annual votes on the entire board of directors. The metrics revealed that about more than half (55%) of the Standard and Poor's 500 companies had the un-staggered boards of directors exceeding the 47% of the previous year, 2005.⁷⁶⁵

⁷⁶³ Faleye,O., 2007, Classified Boards, Firm value, and Managerial Entrenchment, *Journal of Financial Economics* 83, 501-529.

⁷⁶⁴ Lucian Bebchuk, John C. Coates IV, and Guhan Subramanian, The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy, 54 *Stan. L. Rev.* 887 (2002).

⁷⁶⁵ Jared A. Favole, "Big Firms Increasingly Declassify Boards", *The Wall Street Journal*, Jan. 10, 2007.

In the same manner, the staggered board effect is felt in the election of U.S. Senators, members of the Securities and Exchange Commission (S.E.C) and other public organs. It is in such that control of representative bodies by the represented bodies is limited. This means that the principals (that could be shareholders, voters, and the president) have restricted power over the agents that might be board of directors or the Senate or even the S.E.C among others.

As much as the hostile takeovers are rare, the election of agents (board of directors) continues as usual, especially by the classified system.⁷⁶⁶ Even so, the agents of the staggered board of director are intended to represent and protect the interest of shareholders like the other board, besides deterring hostile takeovers. Consequently, the premiums due for shares as a result of takeovers may reduce as a result of the staggered board of directors and thus the evolution of conflict between the board and the principals (shareholders). Provided the company is operating securely, the staggered board is considered to offer continuity in high achieving leadership.

In a study conducted by professors from Harvard and Wharton, 24 governance systems were evaluated as to how they influenced their shareholders' value. It was established, that those systems that protect and foster the shareholder's rights have a high tendency of increasing share price, while those that favour the management just like the staggered board are associated with the erosion of shareholder's value.⁷⁶⁷

Generally, one can conclude that with pressure from institutional investors, there has been a remarkable down-turn in the percentage of the companies that still cling on staggered board of directors. For instance, in the Standard and Poor's 500, just 34 % have classified boards. In line with the Risk Metrics, 79 of the publicly listed companies have considered declassification in

⁷⁶⁶Maseko, Nelson. "Takeover Defenses and Shareholder Rights Protection."

⁷⁶⁷ Jared A. Favole, "Big Firms Increasingly Declassify Boards", The Wall Street Journal, Jan. 10, 2007.

their 2008 elections. It also worth mentioning that there were 54 companies that sponsored, proposals in 2007 and another 72 in 2006.⁷⁶⁸

4.4 Mushrooming Takeover defence tactics

In every aspect of corporate governance, there are emerging issues that may seem hard to deal with using the apparent resources and tools. Just like in corporate governance, takeovers are evolving into complex game plans that require more and convoluted resolutions to handle them. As much as the available defence tactics, both the pre-takeover and post-takeover defences like litigation, white knight, Pac man, and golden parachutes among others have been proven to work.⁷⁶⁹ The gaps left in the world regarding the takeovers are the rationale for the mushrooming of defence tactics. After a critical analysis of the available defence tactics and the situation in both England and the US, insights of effective and efficient defence systems evolved. They were basically three in which two, 'star defence' and 'intact defence' were pre-takeover defence strategies while the last one; 'No retreat' was a post-takeover defence strategy.⁷⁷⁰

4.4.1 Star defence

In the face of advance corporate governance, it goes without saying that efficient and effective management is the key to success in defeating acquisitions. It calls for leadership styles

⁷⁶⁸McArthur, Jerie. "Mergers and acquisitions: the human factor." *Handbook of Business Strategy* 1.1 (2000): 217-223.

⁷⁶⁹Bradley, Margaret M., et al. "Emotion and motivation I: defensive and appetitive reactions in picture processing." *Emotion* 1.3 (2001): 276.

⁷⁷⁰HERBERT, A. EINHORN. "Takeovers and Freezeouts." (1979): 2021-2028.

that have the desired high output required by the stakeholders. As such, the democratic leadership style and corporate governance should be examined to see what it ultimately realises. Indeed, with effective and efficient management, unwanted misfortunes may be kept at bay, including the risk of takeovers. It is worth recognising the ‘star defence’, which is a pre-takeover defence strategy as one of the best strategies that can be adopted.⁷⁷¹

Nonetheless, prevention is a better cure. Takeovers on the side of offerees are often than not associated with failed management systems; linked to bankruptcy, failed planned investments, credit-worthiness and poor adoption of defence strategies. Although these vices are manageable, they are not easy to avoid without a ‘star’ management system. This forms the rationale behind the star defence system. The rationale is that good management will ultimately ensure by their actions that the share price is maintained at a high level, making the company more expensive and ultimately more difficult for the prospective bidder to take over.⁷⁷²

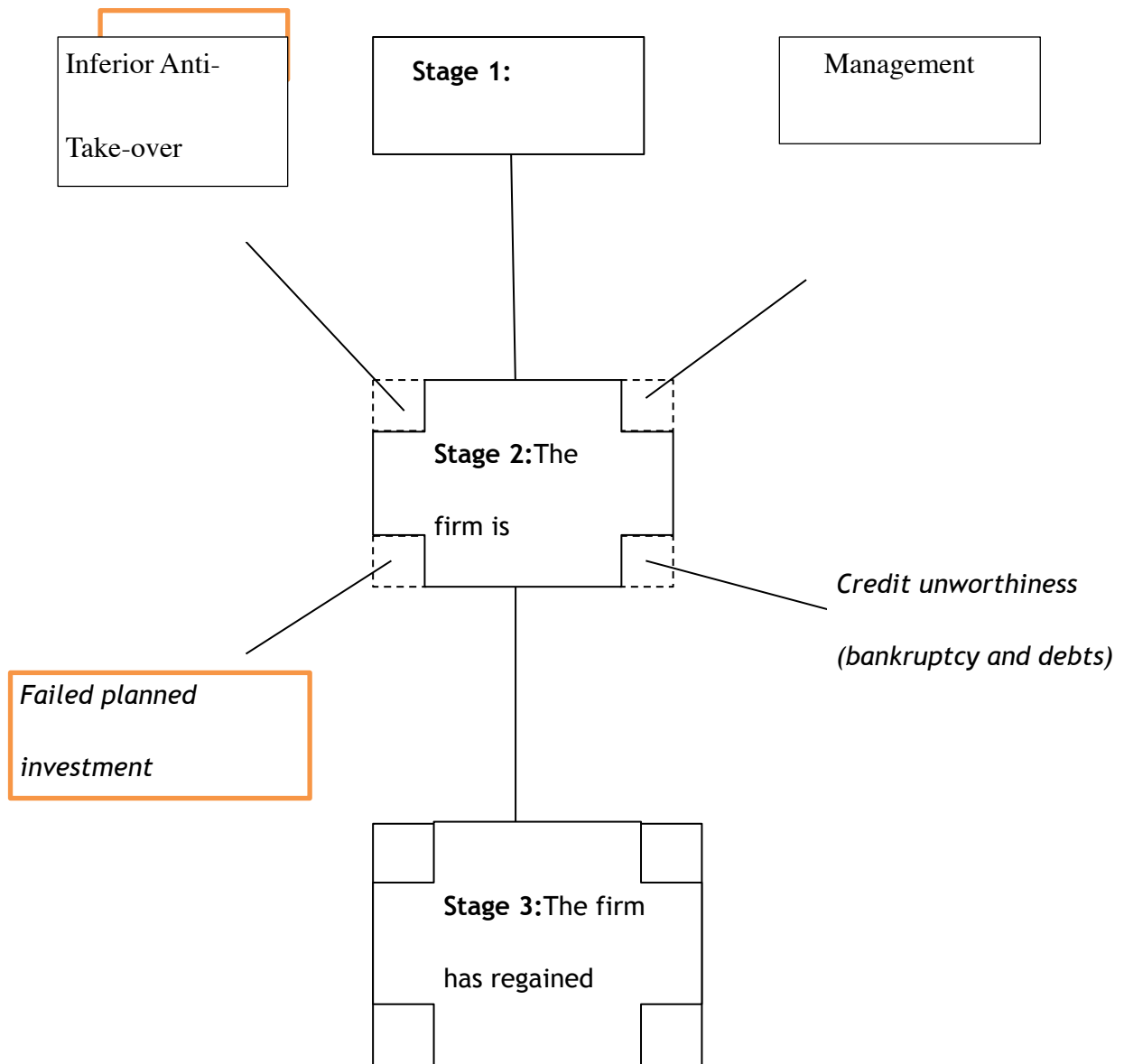
In the absence of an effective management system, the concerned firm is exposed to failures resulting from inferior anti-takeover defence strategies, mismanagement, failed planned investment and credit unworthiness. This is illustrated in the figure below, which describes briefly the stages of a takeover developing.⁷⁷³

Figure: illustration on how a target firm becomes vulnerable to takeovers in the absence of ‘star’ defence

⁷⁷¹Rezzolla, Luciano, et al. "The missing link: merging neutron stars naturally produce jet-like structures and can power short gamma-ray bursts." *The Astrophysical Journal Letters* 732.1 (2011): L6.

⁷⁷²Springel, Volker, Tiziana Di Matteo, and Lars Hernquist. "Modelling feedback from stars and black holes in galaxy mergers." *Monthly Notices of the Royal Astronomical Society* 361.3 (2005): 776-794.

⁷⁷³ Ibid pp. 57



Considering the structure of this defence system, it adopts a multi-strategy approach in which there is some outlined 'star'-splendid rules that have to be adhered to by the operating management.⁷⁷⁴

The strategies are:

- Ensuring a democratic governance of the corporations

⁷⁷⁴Carbonell, Jaime G., and Ralf D. Brown. "Anaphora resolution: a multi-strategy approach." *Proceedings of the 12th conference on Computational linguistics-Volume 1*. Association for Computational Linguistics, 1988.

- Close monitoring and periodic evaluation of the company's credit-worthiness.
- Installing 'golden parachute' techniques into the charter
- Engaging in diversified long-term and beneficial investments

Ensuring democratic governance of the corporations

Despite, the minority's shareholders attitude of disinterest in the company or "laissez faire" kind of role, the agent's ability to enforce democracy in the operation of the company should prevail.⁷⁷⁵ Whether the execution of the board is formed by the major shareholder or not, democracy should be the sense of credibility and integrity upon which the company bases its service to the stakeholders. Research in this area to determine which leadership style is effective, the democratic leadership style has been considered the most effective. In line with preventing take-overs, good leadership styles are capable of ensuring that effective management results in the long-term financial viability of the company.⁷⁷⁶

Even though democracy is practised within the company, it is limited in the sense that some aspects may be ignored. The interests of the minority shareholders are rarely protected. Most of the corporations that have not yet considered this in their charter, and they should make an effort to act. In this way, democracy also helps trim down the conflicts between the agents and the principals of a company. This indeed is a good move towards fostering good corporate governance in all the company's transactions.

⁷⁷⁵Clapp, Jennifer, and Doris A. Fuchs, eds. *Corporate power in global agrifood governance*. MIT Press, 2009.

⁷⁷⁶Jensen, Nathan M. "Democratic governance and multinational corporations: Political regimes and inflows of foreign direct investment." *International organization* 57.3 (2003): 587-616.

Close monitoring and periodic evaluation of the company's credit-worthiness and levels of bad debts.

The way a company runs its business has considerable implications on its credit-worthiness. This is to say that credit-worthiness of a firm is such a vital tool it has, to save it when in crisis.

Beside other roles, the company's management should considerably control the company's cash flow cycle. In simple terms, the firm should always try to settle its differences in cash flows with other corporations. In the long run, this will help improve the company's reputation.⁷⁷⁷

Introducing 'golden parachute' techniques into the charter

Within the company's charter, clauses defining the management redundancy package should be included. In spite of that, they should set high enough that would deter a viable aggressive offeror. One might controversially question the rationale of golden parachute in the context of poor management. Star defence is a democratic takeover defence, there is a low probability of having poor management and therefore the logic of antagonists is beaten.⁷⁷⁸

This mechanism actually entails changing the firm's clauses to contain benefits for the management and executive in the event of a takeover. As much as the benefits are intended to ward off takeovers by making the acquisition cost high. The management and the shareholders should ensure it avoids infringing the takeover laws. One such infringement includes annual reasonably extreme measure to prevent takeovers from materialising. In normal situations, this

⁷⁷⁷Lane, Christel. "Changes in corporate governance of German corporations: convergence to the Anglo-American model?." *Competition & Change* 7.2-3 (2003): 79-100.

⁷⁷⁸Haggerty, Joseph F. "Golden Parachute Agreements: Cushioning Executive Bailouts in the Wake of a Tender Offer." *John's L. Rev.*57 (1982): 516.

mechanism is implemented when a firm is impending a sale. This is not the case in this strategy as it is to implement at the early stages even before any kind of offer is announced. The major difference with its usual application is that the firm would be in a better position and not threatened by a sudden announcement of an unwanted takeover.⁷⁷⁹

Unlike in the real golden parachute defence mechanism where it is implemented to primarily defend the management and the executive from the anticipated change of control and eventual dismissal. In star defence, it is solely meant for the well-being of the firm. Golden parachutes are reportedly common in the U.S system. They have been proved to be better strategies that drive away prospective bidders. The unwanted aggressive takeovers are kept at bay through the extension of lucrative financial and extreme benefits to the management and employees. They ensure that the management initiates employment contracts between the board of directors and the employees so as to raise their post-employment compensation in the event of an unfriendly acquisition. In so doing, the target firm is left attractive to the potential offers owing to the vast pay-outs that may follow the dismissal of the operational management and the employees, which additionally may destabilise the firm.⁷⁸⁰

4.4.2 Harmony with the English regulations

In consensus with the fact that this new defence strategy is designated for England, all measures have to be considered to ensure the yet to be implemented strategy does not violate any of the regulations of the takeover. Being that the City Code oversees English takeovers, the strategy should match with the provisions of the City Code and where it does not match probably file for

⁷⁷⁹Ryan, Patrick J. "Corporate Directors and the Social Costs of Takeovers--Reflections on the Tin Parachute." *Tul. L. Rev.* 64 (1989): 3.

⁷⁸⁰Broughman, Brian. "CEO Side Payments in Mergers and Acquisitions." *BYU L. Rev.* (2017): 67.

an amendment. Similarly, for those publicly listed firms and private firms that operate in the regulated market, it should be considered and therefore indicate that the new defence has also to comply with the European Union Directive 2004/EC.

In summary, the star defence strategy should have six principles of the City Code in itself. First and foremost, in totality, it has to ensure that all the holders of shares or parts of the stock of the same class are given equal treatment. Moreover, when a firm is taken over, the others holders of securities must be protected. Secondly, it spells out that in the case of a merger or acquisition, the individuals possessing securities in a target firm must have adequate time and relevant information to allow them to reach a well-informed decision on the bid. The board of director is held accountable to the shareholders regarding the effects of implementation of the bid on employment, terms of employment and locations of the firm's business places.⁷⁸¹

Thirdly, the board of directors of a target firm are expected to act in the interest of the company as a whole and do not deny the holders of securities the opportunities of influencing a bid especially based on its merits. Fourthly, false markets are not expected in the securities of the target firm and as the bidder or any other concerned firm such that the increase or decrease of the securities turns out to be artificial and thereby interfering with the normal operations of the market. The fifth principle requires the acquirer to announce an offer only when they are sure

Ibid pp. 54

⁷⁸¹ Ibid pp 56

they can meet the full cash consideration together with the implementation of any other consideration.⁷⁸²

Lastly, a target firm must be deterred in its operations for longer that are reasonable by a bid for its securities. Through its formally created timetable, the City Code recognises that making a takeover offer may disrupt the normal business activities of a target. The City Code, therefore, lays down time limits governing the overall period of an offer and the different stages within it. These rules have to be incorporated into the offer document as contractual terms of the offer.

Merits

- (i) It is a multi-strategy approach. Therefore, strong enough to ward off aggressive hostile takeovers
- (ii) The performance of the firm is high throughout
- (iii) The firm has a good reputation hence the need to raise the negotiations during a takeover
- (iv) The management and the executive staff are well taken care of in the corporations charter
- (v) The rights of the minority shareholders are taken care of
- (vi) It is associated with democratic leadership style which is a basis for good management ⁷⁸³

⁷⁸²Harrison, Jeffrey S., Hugh M. O'Neill, and Robert E. Hoskisson. "Acquisition strategy and target resistance: A theory of countervailing effects of pre-merger bidding and post merger integration." *Advances in mergers and acquisitions*. Emerald Group Publishing Limited, 2000. 157-182.

⁷⁸³ Ibid pp 49

Demerits

- (i) It may seem cumbersome to apply it entirety, that is to say, all its constituent strategies

4.4.3 Intact defence

It is obvious that hard work, effective and efficient management will reduce the likelihood of an unwanted takeover, especially where the bidder may have limited financial resources. Challenges may materialise that are difficult to comprehend and thus leading to the company being vulnerable to a takeover. Therefore, to install mechanisms that protect the interests of the principals (the shareholders) and the agents (managers), the board should not hesitate to act. This actually describes the ‘intact defence’, which can be said to post the ‘star defence’ strategy.

The clauses in the corporate charter are modified in such a way that changes in the management are not welcomed. Besides, those that protect the interest of the shareholders are given more weight. In this way, the objectives of the firm are maintained even after the takeover. The firm is precisely meant to benefit its stakeholders and protects its shareholders from unnecessary losses.

This kind of mechanism ensures that even in the event of a takeover, the shareholders and the management benefit from the resulting deal.

When the shareholders are not protected, eventually, the firm collapses and ends up being another firm’s property.⁷⁸⁴

⁷⁸⁴ Ibid 46

Merits

- (i) It is more appropriate for firms with unique products and rare expertise
- (i) There are no major losses incurred by the management and the shareholders.
- (ii) Equal protection of the shareholders both the minority and the majority shareholders

Demerits

- (i) It may paralyse the smooth running of the firm in the future should it takeover go through.

4.4.4 No retreat

It is better to be late than never or rather to have a half a loaf than none. In this post take over technique, the target company's management fights to the last drop of its strength. Loyal, to the shareholders both the minority and the majority, it fights to secure their interest of the stakeholders after an occurrence of a takeover bid.

Demerits

- (i) May face a lot of friction from the government because it likes an attempt to deter a takeover.

4.4.5 Most recent English cases on takeover defence tactics

There are three most used defence tactics, which companies mostly use to fend off any attempts by other companies to place a bid on acquiring them. These include the white squire defence, employment of restructured voting rights and thirdly the use of "poison pills." The white squire defence tactic involves the target company selling out shares to a legal entity referred to as the "white squire" that holds a permanent position in the company and is normally

under the control of the company's Board of Directors. For instance, in the acquisition of OpSec Security Group Plc by Orca Holdings Limited, by allowing Orca to own 99,024,992 shares, which translates to 81.7 %, OpSec could not employ the white squire defence as it had already lost a majority of shares.⁷⁸⁵

The acquisition of John Swann by H7H is another form, thereby allowing the sale of shares; the company did not have any defence tactic that it could use. In this case, John Swan and Sons agreed on a £8.2 million with an alternative of selling shares. In this case, the acquisition was successful since the offerees agreed to take the money.⁷⁸⁶ In the merger between Paddy Power and Betfair, shareholders of the Paddy Power, have acquired 52% of the shares in the company as they would effectively be able to deter any parties that would be interested in placing the bid as they already had a majority.⁷⁸⁷

Restructured voting rights are another defence tactic in which voting rights of the company are sold to hands that are considered to be safe or friendly.⁷⁸⁸ For instance, in the acquiring of Chime Communications plc by Providence Equity Partners, the shares were sold to Providence Equity Partners and WPP. Chime thus considered Providence to be a safe and

⁷⁸⁵<http://www.morningstar.co.uk/uk/news/AN_1443622350653642300/opsec-security-confirms-no-formal-takeover-from-orca-yet.aspx> accessed 27 December 2015

⁷⁸⁶<<http://www.nlsinger.com/john-swan-sons-plc-approves-8-2-million-recommended-cash-acquisition-share-alternative-subject-scale-back-hh-group-plc-hh/>> accessed 27 December 2015

⁷⁸⁷<<http://www.theguardian.com/business/2015/sep/08/paddy-power-and-betfair-merger-agreed>> accessed 27 December 2015

⁷⁸⁸ Zarin, S., & Yang, E. Mergers & Acquisitions: Hostile takeovers and defense strategies against them. rapport nr.: Management & Organisation (2011). 11: 85.

friendly company to take over the business. In this case, Providence Equity parted with consideration of £374 million.⁷⁸⁹

In the proposed acquisition of Darty plc by Groupe Fnac, the board of Darty plc in evaluating the proposal but as a defence tactic, the board wants the company to retain the final dividend of 2.625 cents to be delivered to the shareholders.⁷⁹⁰ In the acquisition of Alkane Energy plc by Barbican Bidci Limited, the company board agreed to the offer since Barbican could be trusted with the share capital of Alkane. By doing this, the company locked out other prospective bidders whom it considered not so trustworthy.⁷⁹¹

BG Group plc has adopted the “poison pill” defence tactic towards the Royal Dutch Shell plc offer of a £47 billion bid. The bid is still being evaluated and if BG considers Royal Dutch Shell bid not enough, it may raise the amount even further to make it unaffordable.⁷⁹²

In a similar case, Mitsui Sumitomo of Japan’s bid to acquire Amlin plc is projected to cost the firm over 500 billion yen. Only a few companies can finance a transaction of this size, which is a good tactic for fending off unwanted bidders.⁷⁹³

⁷⁸⁹<http://www.londonstockexchange.com/exchange/news/alliance-news/detail/1438328269257821800.html>
accessed 5 January 2016

⁷⁹⁰<http://www.euroinvestor.com/news/2015/09/30/groupe-fnac-potential-acquisition-of-darty-plc/13227640> 5
January 2016

⁷⁹¹<http://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/12501704.html> 5
January 2016

⁷⁹²<http://www.wsj.com/articles/eu-approves-shells-takeover-of-bg-group-1441197626> 5 January 2016

⁷⁹³<http://www.bloomberg.com/news/articles/2015-09-07/mitsui-sumitomo-insurance-said-to-be-in-talks-to-acquire-amlin>
accessed 4 November 2015

4.4.6 US Cases on Takeover Defence Tactics

From the early 1990s, there were two critical rulings of the Delaware Supreme Court clarifying roles of a targeted entity management board during a hostile takeover process, and covering probable anti-takeover actions. A significant case during this time was the *Paramount Communications, Inc. v QVC Network, Inc.*⁷⁹⁴ Here, the case was about a proposed merger between Paramount Pictures and Viacom. As a section of the contractual terms of the merger, Paramount consented to various defensive tactics, encompassing a no-shop clause, \$100 million fees for the termination of the agreement and a lock-up choice on nearly 20 % of the plaintiff's ordinary shares (common stock). Nonetheless, the defendant (QVC) intervened with unique terms, ordinarily a more substantial proposal for a merger, factored on cancellation of the defensive tactic. The board of directors at Paramount rejected the situation of conducting an official bidding procedure with QVC, arguing that it was bound to be inconsistent with the former's contractual terms with Viacom. During the ruling, the court indicated that a board of directors must be in a position to justify a negotiated value during the opening of the tender and in case there are a few competing bids, all should be treated with fairness – arm length bargain. Accordingly, the board exercised its capacity to apply anti-takeover tactics such as buyouts or poison pill to frustrate possible contested takeovers, which has been applied within the range of reasonable legal means and not draconian methods.⁷⁹⁵

⁷⁹⁴ *Paramount Communications, Inc. v QVC Network, Inc* 637 A.2d 34 (1994)

⁷⁹⁵ Sneirson, Judd F. "Green is good: sustainability, profitability, and a new paradigm for corporate governance." (2008).

4.5 Conclusion: The Takeover Defence Tactics

The takeover defence tactics or strategies refers to the measures taken by a target firm to either make a deal attractive and affordable to it or ward it off in case it is considered aggressive. The defence measures were categorised into major two categories depending on when they are implemented: the pre-takeover defence measures and the post-takeover defence measures. The pre-takeover defences were defined as those measures deployed prior to the announcement or acceptance of an offer, which involves the mechanism undertaken by the board of the target company in preparation for anticipation by the large company to present a takeover bid.⁷⁹⁶

⁷⁹⁶J. Porter and H. Singh. An Empirical Analysis of the Motivation Underlying Takeovers in Australia. *Social Science Research Network Working Paper*, (2007).p. 2.

CHAPTER 5: Interests And Protection Of Minority Shareholders

5.1 Shareholders in Takeovers

A shareholder by definition refers to someone who owns shares in the company through which it can depend on the size of their shareholding and can influence company decisions. Generally, shareholders can be categorised into two, namely the external and the internal shareholders.⁷⁹⁷

In the daily operations of corporations, the external shareholders are never considered in the decision making processes and often fall victims of any inappropriate decisions made by the firms. During stormy periods, these external shareholders who may have a proportionately small holding are also known as the minority shareholders can be badly affected. Defined by the small proportion of shares they hold in the company, the minority shareholders are normally ignored in the event of takeover negotiations. The majority shareholders (including institutional investors) through their agents will defend their own interests and those of their agents. Eventually, the minority shareholders may be left in a vulnerable position. The minority shareholders may not agree or think that the decision of the directors and majority of shareholders leave them in an inequitable situation.⁷⁹⁸

5.2 Minority Shareholders in Takeovers

It is really perturbing to understand why the minority shareholders have been ill-considered in many instances in both publicly quoted and private companies. In times of

⁷⁹⁷Shleifer, Andrei, and Robert W. Vishny. "Large shareholders and corporate control." *Journal of political economy* 94.3, Part 1 (1986): 461-488.

⁷⁹⁸Firth, Michael. "Takeovers, shareholder returns, and the theory of the firm." *The Quarterly Journal of Economics* 94.2 (1980): 235-260.

financial need, corporations will be expected to acquire more shareholders to raise their capital to boost their operations; they have the responsibility to both the minority shareholders just as much as the major shareholders. Actions of directors and majority shareholders are bound to ignite fear into the minority shareholders regarding the protection of their investments. The minority shareholders are characterised by having no control over the company, illiquid shares and are entitled to residual claims.⁷⁹⁹

5.2.1 Least Control over the Company

As regards this issue of controlling the company, the minority shareholders have least control in narrowly held share situations in private companies.⁸⁰⁰ In contrast, the majority shareholders have a controlling interest in the company and can direct actions.

5.2.2 Illiquid Shares

Owing to the limited market for closed corporate shares of private companies, shares of the minority shareholders are normally regarded illiquid. There may be arrangements in place where the share has to be offered first to existing shareholders. But the question is at what price? This may be very disadvantageous to the minority shareholders.⁸⁰¹ In most of the occasions, the

⁷⁹⁹Cronqvist, Henrik, and Mattias Nilsson. "Agency costs of controlling minority shareholders." *Journal of Financial and Quantitative analysis* 38.4 (2003): 695-719.

⁸⁰⁰Scharfstein, David. "The disciplinary role of takeovers." *The Review of Economic Studies* 55.2 (1988): 185-199.

⁸⁰¹Yarrow, George K. "Shareholder protection, compulsory acquisition and the efficiency of the takeover process." *The Journal of Industrial Economics* (1985): 3-16.

minority shareholders are overlooked or ignored when strategic decisions are made concerning the benefits of the majority shareholders.

5.2.3 Entitlement to Residual Claims

There are no clauses within a company's incorporation documents that may protect the claims of the minority shareholders by defining their benefits. The minority shareholders are without doubts entitled to get their claims in the event of liquidation once all other stakeholders protected by the contract laws, statutes and government legislation are settled. These stakeholders whose rights of claims in the company are protected consist of government tax owed, the executive, the employees, the suppliers, secured and unsecured creditors and debtors/receivables. They do not have to be included in the corporate governance whatsoever to be secure.⁸⁰² As residual risk bearers, the investments of minority shareholders can either appreciate or depreciate or ultimately in the event of liquidation be worth nothing. Though, with correct corporate governance the minority shareholders should always be considered.

Therefore, in order to implement a proper corporate governance system, institutions should be set up to defend the less fortunate shareholders, who have barely any means to defend themselves. This actually forms the basis for this chapter; modes and means should be put in place to protect the interest of the shareholders especially in circumstances such as hostile takeovers as well as the friendly takeovers.⁸⁰³

⁸⁰²Franks, Julian, and Colin Mayer. "Bank control, takeovers and corporate governance in Germany." *Journal of Banking & Finance* 22.10 (1998): 1385-1403.

⁸⁰³Bebchuk, Lucian Arye. "Takeover bids below the expected value of minority shares." *Journal of financial and quantitative analysis* 24.2 (1989): 171-184.

5.3 Interest and protection of minority shareholders in takeovers

This chapter focuses on discussing the interests and protection of minority shareholders in the takeover processes. Takeovers have the effect of adversely affecting a number of stakeholders, the most notable of which is the target and bidder companies, the employees of both the firms, the management and the shareholders (both the major and minor shareholders) in both of the firms. Minority shareholders are in a disadvantaged situation in takeovers as the majority shareholders can easily ignore their rights during takeover process. The majority shareholders can also be eliminated from the company even though they have the rights to oppose the management's decisions on takeover defences and can reject completely.⁸⁰⁴

It therefore important for several corporations most especially the private limited firms with a small number of shareholders to be better prepared for potential and often fatal financial crisis that might arise. It is a necessity that firms should place strategies to prevent losing the support of their shareholders.⁸⁰⁵ They should ensure that the price of shares in a quoted company is as high as possible as this makes the target expensive and more difficult to finance the takeover.

There are several limitations and disadvantages associated with losing shareholders in firms. Among others we have;

- The shareholders left behind might not be financially well-off to purchase the lost shares.

⁸⁰⁴Hart, Oliver. "Corporate governance: some theory and implications." *The economic journal* 105.430 (1995): 678-689.

⁸⁰⁵Hirshleifer, David, and Sheridan Titman. "Share tendering strategies and the success of hostile takeover bids." *Journal of Political Economy* 98.2 (1990): 295-324.

- The shares of deceased shareholders may end up being held by less or inexperienced hands of beneficiaries.
- Some or one of the competitors may end up purchasing the shares.

More often shareholder protection scheme has always provided firms with procedures that have ensured the smooth running of their operations with minimal disruptions. Besides continuity in operation, it has fostered their ability to be in control.⁸⁰⁶ The major benefits associated with shareholder protections are;

- The sale of the firm's shares to the competitor or aggressive parties is avoided.
- It allows for quick access to the funds by the dependents of deceased shareholders or critically ill.
- Fosters stability and continuity of the firm.
- Shareholder protection also allows for quick transfer of shares amongst the remaining shareholders at fair market price and tax efficient.
- It elevates the usage of funds, which are meant for far different activities.
- Each of the firm's shareholders can have the policy to cover their amount of the shares among the ones the company owns.

5.3.1 Cases

The case *Foss v Harbottle*⁸⁰⁷ involved Richard Foss and Edward Starkie Turton, who were the two minority shareholders in Victoria Park. This company was established in 1835 to

⁸⁰⁶Pound, John. "The effects of antitakeover amendments on takeover activity: Some direct evidence." *The Journal of Law and Economics* 30.2 (1987): 353-367.

⁸⁰⁷ *Foss v Harbottle* (1843) 67 ER 189

purchase 180 acres of land near Manchester. After the company was incorporated by an Act of Parliament, the company became Victoria Park, Manchester. Later, the plaintiff indicated that the property of the entity had been misapplied and misappropriated and various mortgages were taken out inappropriately over the property of the company. The complainants asked that the accused parties be held accountable to the entity and that the court orders an appointment of a receiver. The defendants were the five directors of the company and the architect and the solicitor and also H Rotton, E Lloyd, T Peet, J Biggs, and S Brooks, in addition to various assignees of Westhead, Bryoms, and Adshead, who had been declared bankrupts.⁸⁰⁸

The Court dismissed the claim and maintained that when an offence is committed against the company by the directors, it is only the company that has a legal standing to lodge a suit. The court determined two rules. Initially, the court indicated the “proper complainant rule”, which indicates that a wrong committed against a company by only be vindicated by the company. Lastly, the “majority rule principle” that indicates that if the alleged offence can be verified and approved by a simple majority of members in a general meeting, the court has no jurisdiction over the matter.⁸⁰⁹

The judgement of the case *Foss V Harbottle* emphasised on the fact that only the company would be sued if the directors are not implemented any law. In the judgement, Wigram VC highlighted the following aspects:

“The Victoria Park Company is an incorporated body, and the conduct with which the Defendants are charged in this suit is an injury not to the Plaintiffs exclusively; it is an injury to

⁸⁰⁸ Nenova, Tatiana. "The value of corporate voting rights and control: A cross-country analysis." *Journal of Financial Economics* 68.3 (2003): 325-351.

⁸⁰⁹ Ibid.

the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation. And from the case of *The Attorney-General v Wilson* (1840) Cr & Ph 1 (without going further) it may be stated as undoubted law that a bill or information by a corporation will lie to be relieved in respect of injuries which the corporation has suffered at the hands of persons standing in the situation of the directors upon this record”.⁸¹⁰

Another case is **Greenhalgh v Arderne Cinemas Ltd.**⁸¹¹ Here, the facts involve Mr Greenhalgh who was a minority shareholder in Arderne Cinemas and was involved in a long court battle to stop the majority shareholder selling control. The company had two categories of shares: the first class with shares worth 10 shillings and the other with shares worth 2 shillings. The shares worth 10 shillings were sub-divided into two shillings shares and had a single vote. Since, Greenhalgh had the initial two shillings; he lost his control of the company.

According to the Articles of Association under clause 10, article (a),
*“No shares in the company shall be transferred to a person not a member of the company so long as a member of the company may be willing to purchase such shares at a fair value to be ascertained in accordance with sub-clause (b) hereof”.*⁸¹²

The entity altered its Articles through special arrangement at a general meeting that allowed existing shareholders to offer shares to members outside the unit. Thus, the majority shareholders needed to transfer his six-shilling shares each to another Mr Sol Sheckman worth five thousand pounds and his resignation from the board of directors. The judgment on the minority share issue held that rather than the plaintiff finding himself with a controlling stake, he is a position where

⁸¹⁰Foss v Harbottle (1843) 67 ER 189

⁸¹¹ Greenhalgh v Arderne Cinemas Ltd (No 2) [1946] 1 All ER 512; [1951] Ch 286

⁸¹²Ibid.

he has lost control of the company, and his rights are affected commercially. Lord Green MR also indicated that as a matter of law, he is unable to hold that, in view of the nature of the transactions, the rights are altered. Effectively, a right to have a single vote per share with the ordinary shares for the time offered include the new two shilling ordinary shares that result from the sub-division of the 10-shilling shares.⁸¹³

In the judgement Lord Greene MR stated that, “ instead of Greenhalgh finding himself in a position of control, he finds himself in a position where the control has gone, and to that extent the rights... are affected, as a matter of business. As a matter of law, I am quite unable to hold that, as a result of the transaction, the rights are varied; they remain what they always were – a right to have one vote per share *pari passu* with the ordinary shares for the time being issued which include the new 2s ordinary shares resulting from the subdivision”.⁸¹⁴

5.3.2 Interests and protection of minority shareholders in England

Company law provided for very little power over the management of company affairs to minority shareholders. Minority shareholders are protected by shareholder agreements and court actions in the case where their rights are violated. Shareholder agreements include controls on director’s appointment, borrowing, expenditure, profit distribution, and exit mechanisms. Minority shareholders can press for terms that protect them in this agreement.⁸¹⁵ The courts will always give effect to this agreement whenever their rights are infringed. Shareholder right to apply to court in case of a dispute for “unfair prejudice” is covered under Section 994 of the

⁸¹³Ibid.

⁸¹⁴ Greenhalgh v Arderne Cinemas Ltd (No 2) [1946] 1 All ER 512; [1951] Ch 286

⁸¹⁵ Reese, William A., and Michael S. Weisbach. "Protection of minority shareholder interests, cross-listings in the United States, and subsequent equity offerings." *Journal of financial economics*66.1 (2002): 65-104.

Companies Act 2006.⁸¹⁶ If the company affairs are being conducted in a manner that a minority shareholder feels that he/she is unfairly prejudiced, can make an application to court for the correction of the conduct. Unfair prejudice may occur where the company has failed to declare dividends, where majority shareholders collude to purchase the interest of minority shareholders without their consent at an under-value or undertaking any activity, which is not authorised by the Articles of Association. Derivative actions are provided for under Section 260 of the Companies Act 2006.⁸¹⁷ A minority director may approach the court for an order prohibiting any harmful action taken by the directors against the company. Shareholders including minority shareholders may also petition the court under Section 122 of the Insolvency Act 1996 for the winding up of the company if they are aggrieved by any actions taken by the company.⁸¹⁸

5.3.3 Minority shareholders and agency costs

The position of external minority shareholders, their vulnerability is immeasurable. According to William Meckling and Michael Jensen, the costs are regarded as a clash of interest involving the “principal” referring to the stockholder and the “agent” corresponding to the managers.⁸¹⁹ Adolf Berle and Gardner in their 1932 work coined the “separation of ownership

⁸¹⁶ Flourentzou, C. L. N. *Minority Shareholders: Applicability of unfair Prejudice*.

⁸¹⁷ “Companies Act 2006.” *Cabinet Office*. <http://www.legislation.gov.uk/ukpga/2006/46/contents>, accessed 4 (2006): 2013.

⁸¹⁸ *Ibid*.

⁸¹⁹ M. Jensen and W. Meckling, “Theory of the Firm: Managerial behaviour, agency costs and ownership structure”. *Journal of Financial Economics*, Volume 3, Issue 4, October 1976 pp 305-360

and control” in big public companies.⁸²⁰ There arises a crisis in solving the interests of both parties; the agents or rather the managers who are seeking their interests which are delegated by the investors and principals to take control over the company and achieve the company’s objective of profitability (the shareholders’ interests).⁸²¹

More often than not the equity investors in corporations are taken advantage of by the managers. In the recent cases of Tyco and Adelphia, the majority shareholders in the management and control of the company, appropriate for themselves the assets of the company. These conflicting situations of interests have been for long known as ‘control rents’ or simply the ‘private benefits of the control’.⁸²²

Besides the manipulation of the company’s assets and claims, the majority shareholders who comprised of the organisation’s management carried out poorly planned and adopted decisions. Wrong decisions may include wrong investments, which may result in major losses and misuse of the company’s funds. Considering the company’s performance, the firm is ranked amongst the poor performers and reputation. This, in the long run, ends up affecting the stakeholders more than the compensations for the control groups or managers.⁸²³

⁸²⁰ A. Berle and G. Means, *The Modern Company and Private Property* (New York) Harcourt, Brace and World, Inc., 1932).

⁸²¹Dang-lun, L. U. O., and T. A. N. G. Qing-quan. "Pyramid Structure, Ownership and Small Shareholders' Interest Protection—Evidence from Listed Companies in China [J]." *Journal of Finance and Economics* 9 (2008): 132-142.

⁸²² Kristin A. Kennedy "An Analysis of Fraud: Causes, Prevention, and Notable Cases". University of New Hampshire, 2012, pp 15 -20

⁸²³Barak, Aharon. "A Comparative Look at Protection of the Shareholders' Interest: Variations on the Derivative Suit." *International and Comparative Law Quarterly* (1971): 22-57.

It thus becomes an issue of concern that the interests and the benefits of the minority shareholders should be protected. As viewed by Jensen and Meckling, the agency costs are ubiquitous and are recognisable; they can be regulated and balanced through some of the ways listed below:

1. Legal rule which should to a limited degree, define and enact certain shareholder rights
1. Effective incentive compensation
2. Board of directors as shareholders' representative should have the powers and duties specified.
3. The market for corporate control allows for the sale of the company's stock when poorly performing helping eliminate the incompetent management.⁸²⁴

5.3.4 Legal rule

Quite often than not, publicly listed companies are victims of poor performers coupled by the self-entrenchment of the company's board of directors. In the process, both the majority and minority shareholders are the adversely affected. If that is not enough, the minority shareholders are badly placed if that is the case. This is attributed to the fact that unlike the major shareholders, they have the least control in the operations of the firm. Consequently, they are often ignored in the decision making process.⁸²⁵

⁸²⁴M. Jensen and W. Meckling, "Theory of the Firm: Managerial behaviour, agency costs and ownership structure". *Journal of Financial Economics*, Volume 3, Issue 4, October 1976 pp 305-360

⁸²⁵Stapledon, Geof P., and G. P. Stapledon. *Institutional shareholders and corporate governance*. Oxford University Press, 1997.

However, poor performance facilitated by a conflict of interest between the agents and principals. This explains the overwhelming pressure on the minority shareholders owing to their lack of control.

5.3.5 Protection of Shareholders

U.S Legislation regarding conflict of interest

Originating from the common laws of trusts, the fiduciary duty concept has gained its application in corporate governance. It forms the basic legal doctrine aimed at clarifying the position of conflicting interests. The officers and directors of a company are, as fiduciaries, entrusted with certain duties to the company and its shareholders. One of the major duties is the duty of loyalty.⁸²⁶

The duty of loyalty is yet to have a wide range of possible application. As per the moment, it has gained specification in-state company codes and court judgments. As noted in Scott, it is a viewer in the corporate context.

“One can postulate a continuum of situations involving conflicts of interest between controlling managers and owners, with the conflicts becoming less sharp (and perhaps the legal rules less useful). At one extreme would be outright theft, embezzlement, and misappropriation; without effective legal (usually criminal) sanctions in these cases, only the gullible would part with their money. A somewhat less transparent form of achieving the same end is the self-dealing transaction between the manager and his firm. By buying too low or selling too high, the controlling party transfer’s wealth from the firm to himself, but the picture can be confused by intricate transactions in nonstandard assets or subject to varying degrees of price unfairness.

⁸²⁶Moore, Don A., et al. "Conflicts of interest and the case of auditor independence: Moral seduction and strategic issue cycling." *Academy of Management Review* 31.1 (2006): 10-29.

*Enforcement becomes more difficult but still seems essential if agency costs are to have any bound. The appropriation of corporate opportunities, excessive managerial compensation, and consumption of managerial perks can be still more judgmental, and probably the legal rules less effective, but the order of magnitude is also often less. And when one reaches conflicts highly intertwined with the regular operation of the business, such as excessive diversification, or self-retention by less competent managers, the fiduciary duty of loyalty probably offers little protection”.*⁸²⁷

Self-dealing transactions

This is one of the major conflicts of interest situations that corporate law in the US now pays attention to. In most of the provisions, it is defined as

*“ a transaction between a company and one or more of its directors or officers...or an organisation in which one or more of its directors or officers are directors or officers, or have a financial interest”.*⁸²⁸

Such transactions need to be accepted by a vote of impartial directors or shareholders but subject to prior full disclosure. There are many faults in the regulation and they range from reliance on formalities to the inability to distinguish the “abuse of control” from the “abuse of trust”.⁸²⁹

⁸²⁷ K. Scott, “The Role of Corporate Governance in South Korean Economic Reform,” *Journal of Applied Corporate Finance*, Vol. 10 (1998).

⁸²⁸Del. Code Ann. tit. 8, § 144 (2005).

⁸²⁹ Bratton, Kathleen A., and Kerry L. Haynie. "Agenda setting and legislative success in state legislatures: The effects of gender and race." *The Journal of Politics* 61.3 (1999): 658-679.

The major issue in a self-dealing transaction is that those who stand to benefit from it is in a position in the firm to determine its ultimate endorsement. The normal pre-supposition is that the two independent parties in a transaction should determine on the transaction after disclosure of their own non-interest. The setback of an abuse of trust transaction is that the management board has interests and private benefit in the transaction, which is not disclosed under agency law and which is not considered by the eventual decision maker. The ultimate decision is however given by the principals.⁸³⁰ As a result:

- I. The rule, in the way it is stated, is so open that it entails a transaction between a firm and any person with an official position of an officer, either a subordinate or an external principal who has no influence in the decisions of the management and the board. There arises a problem; should an official with hidden agendas have an obligation to divulge the information to the Chief Executive.⁸³¹
- II. This rule is narrow and as such does not define in itself the terms that cover the transactions involving a controlling entity that is not a constituent of the board such as a majority shareholder or parent company. Courts in an attempt to seal this gap have ended up considering the controlling shareholder as the fiduciary.
- III. So long as the directors are not benefitting in the transaction directly, they are considered as “disinterested”. This is in regardless of whether they have power over the selection and their continued presence on boards consisting of the benefiting members. The term “disinterested” does not have the same implication in attitudes and actions. It

⁸³⁰Breyer, Stephen. "On the uses of legislative history in interpreting statutes." *S. Cal. L. Rev.* 65 (1991): 845.

⁸³¹ Ibid pp. 40

means that the consent demanded by law offers is not a guarantee that there would be an arm's length negotiation.⁸³²

- IV. The approval from the management is acknowledged irrespective of whether or not it comes from the shareholders with a considerable holding of shares in the firm. It does not take into consideration whether the person in control is a major shareholder or a dominant CEO. If that is the case then "formal approval" is likely to offer very weak protection.
- V. The Justice in this kind of transactions is considered by some jurisdictions as a concern that needs to be addressed especially if the approval has been obtained from disinterested shareholders or disinterested board. Evidence that the self-dealing transaction has a controlling party involved, through outside and independent legislation, the terms of the deal should be reviewed. The various obvious forms of dealing transactions such as misappropriation and theft do not fall into this category. Thus can be handled by criminal law through the imposition of fines and penalties where the subject has been proved and culpable intent shown.⁸³³

Private law actions are left with the responsibility of recovering inappropriate gains. As outlined above, the faults in the legal rules have allowed the controlling individuals to influence the formal approval processes in favour of their interests. The degree to which the CEOs have exploited the corporate resources to further their own individual expenses has been the focus of considerable attention in the cases of John Riga's and Dennis Kozslowski in Adelphia

⁸³²Martin, Lisa L. *Democratic commitments: Legislatures and international cooperation*. Princeton: Princeton University Press, 2000.

⁸³³Macey, Jonathan R. "Promoting public-regarding legislation through statutory interpretation: an interest group model." *Columbia Law Review* 86.2 (1986): 223-268.

Communications and Tyco International respectively.⁸³⁴ John Rigas was accused by the prosecutors for making the firm his “personal piggy bank” while Dennis Kozlowski was accused of using the company as “his personal machine”. In spite of these cases concluding with the sentencing of the CEOs, the Security Exchange Council, and (SEC) emphasised on this subject and initiated mandatory disclosure requirements that are meant to clearly identify prospective self-dealing abuse transactions.⁸³⁵

It is a lot easier and preferable that a statute regulating to the self-dealing transaction be drafted and implemented. It should emphasise that the individuals with the “controlling power” compared with those merely occupying management positions.⁸³⁶ The statute should provide a defence that depending on the rationale of the transaction and not on the nature of the process (approval and disclosure). In addition, it should address the various needs of personnel with undisclosed interests. Even though, the legal provisions when necessary offer some protection to shareholders but they still fall short of full protection. This means that the courts have to deal with unjustness in the protection of shareholders.⁸³⁷

⁸³⁴Kristin A. Kennedy "An Analysis of Fraud: Causes, Prevention, and Notable Cases". University of New Hampshire, 2012, pp 15 -20

⁸³⁵ Ibid.

⁸³⁶ Ibid pp 33

⁸³⁷Stapledon, Geof P., and G. P. Stapledon. *Institutional shareholders and corporate governance*. Oxford University Press, 1997.

United States (US) Enforcement of Rules of legal liability

Up until now consideration has been given to the hindrances to corporate conflict of interest and as the protection against such. This does not exclude poor performance of investments made by the investors. If the legal rules are not effectively and efficiently put into effect, their weakness and scope have no effect; apart from the influence they may have in maintaining morals.

In order to ensure an effective and efficient enforcement of the legal rules, there are several measures that have to be taken into account. First, the plaintiff must have full information disclosure of the putative violation. One source of such information is the disclosure rules, which are, implemented the capital market requirements on disclosure of information about the performance of the firm. They play a secondary role in highlighting the conflict of interest transactions deals by people in power. The financial press, outside counsels, accountants, and employees whistleblowers, amongst others, can be other channels through which the public authorities can be acquainted with instances of “conflict of interest” and accounting frauds. The Sarbanes–Oxley Act of 2002 has several provisions that assist these channels and are intended to increase the chances of reporting the prospective violation to the boards.⁸³⁸

When awareness does not help to correct the matter within the firm, the conflict of interests may be enforced through placing criminal sanctions violations. The prosecutors may be forced or influenced to act when; the high ranking managers are misappropriating corporate assets such as loans in spite of the warnings given or for personal expenses without the formal approval procedures of the board. Alternatively, when they make substantial profits from self-

⁸³⁸The Sarbanes–Oxley Act of 2002, Pub.L. 107–204, 116 Stat. 745

dealing transactions brought about by their inside knowledge as to how certain events might influence share prices.⁸³⁹

In the U.S corporate environment, there are cases rising every day and the prosecutors with their limited resources are not able to handle these frauds and thefts. They have given priority to other crimes, not self-dealing transactions. Alternatively, the Security Exchange Council (SEC) with its restructured staff still may not be in a position to handle every corporate transgression that is identified. The affected shareholders in defending their own interests are constrained by a number of issues; some practical while some are legal. The legal constraints arise when under the provisions of the law in the United States; the shareholders are not allowed to directly sue in order to recuperate losses attributed to insider conflict of interest. They are instead expected to file a “derivative suit”.⁸⁴⁰

The logic in these issues entails potential contravention of the fiduciary duty of loyalty. Where the fiduciary duties of directors and the officers belong to the firm as an entity, which is separate from its owners. It is therefore clear, that the firm is the one that is entitled to field a case against its insiders. The shareholders have to sue the company in order to have transgressing members of the management brought to book over the loss of reputation of the firm because of the violations.⁸⁴¹

⁸³⁹Hermalin, Benjamin E., and Michael S. Weisbach. *Boards of directors as an endogenously determined institution: A survey of the economic literature*. No. w8161. National Bureau of Economic Research, 2001.

⁸⁴⁰Because the recuperation for failure to achieve care standards is unlikely. This discussion is limited to loyalty violations.

⁸⁴¹Helland, Eric, and Michael Sykuta. "Who's monitoring the monitor? Do outside directors protect shareholders' interests?." *Financial Review* 40.2 (2005): 155-172.

Since the board on behalf of the shareholders manages the activities of the firm, the shareholders have demanded that the board files an action on behalf of the firm. It is also worth noting, that in situations where there are sensible reservations as to whether the board is biased or not, under Delaware Law provisions, these demands have to be examined. Similarly, when the board is unwilling to address the demand regardless of the request from the shareholders, the shareholders are automatically refrained from pursuing the action. On the contrary, this can be made viable, a viable action when the refusal by the board is outside the protection of business rules.⁸⁴²In essence that it undermines the resolutions to sue any of the insiders for the violation of loyalty. Whereas, when a demand is excused like in case of the board constituents sharing in the conflict of interest transactions, the shareholders are allowed to proceed to raise a case.

In these particular types of cases, boards are allowed to appoint special litigation committees, which consist of disinterested or extremely new members who are then expected to carry out an investigation into the intrinsic worth of the action and see if it can be allowed to proceed. This resolution is subject to the scrutiny of a judicial system under various standards and is meant to address the constitution of the committee and the procedures involved. Depending on whether the case is handled under Delaware laws or New York laws, it may give due attention to the shareholders' case or not respectively.⁸⁴³

It might be simplified, but the synopsis of the demand requirement inflicted on the derivative suits is an implication of the difficulty the shareholders failed by in bringing the case before the court, where the substance in contention can be ruled on at the trials. At every level, there is adequate time needed to allow for defensives to be put forward, appeals and delays.

⁸⁴² Ibid 33

⁸⁴³Kerr, Jeffrey, and Richard A. Bettis. "Boards of directors, top management compensation, and shareholder returns." *Academy of Management journal* 30.4 (1987): 645-664.

There are other unusual burdens considered under this class of action the current reputable necessities for the petitioner, preparing a bond for defendant's legal fees and as well imposing a demand on the other shareholders to allow the petitioner to start the action on their behalf. This is done to rationalize the purpose of securing action from being struck out without gain, and the issue is subject to a financial settlement.⁸⁴⁴

The eventualities reveal that the "derivative suits" are surely endangered species. The decisions may fall short of making the various vital distinctions required in the derivative suit. One, they do not identify the difference between care suits which may diminish the value and loyalty suits which are necessary for the protection of the shareholder's interests. Secondly, the difference between derivative actions in opposition to external management indiscretion in managing the organisation and against the insiders in which their elected counterparts are not trusted to oversee their conduct. The contemporary stand of the law has the shareholders with convincing reasons being able to advance towards bringing their grievances in way of direct actions. These actions are meant to justify their own rights, unlike the derivative actions, which are intended to assert the corporate rights.⁸⁴⁵

The loyalty violations have to be by way of derivative actions provided they are clearly stated. This is so owing to the fact to the fiduciary rights is considered as being owed to the firm. This has indeed lead to better procedures under securities laws, which create a private right of action, for the buyers and sellers of securities who may receive a recovery. In the course of the transaction, the real issue is the failure to reveal it in line with a number of securities transactions by the firm or insider and not the self-dealing transaction in itself. This type of action is not deal

⁸⁴⁴ Ibid pp 33

⁸⁴⁵Wiegand, Shirley A. "Fifty Conflict of Laws Restatements: Merging Judicial Discretion and Legislative Endorsement." *La. L. Rev.* 65 (2004): 1.

adequately with violations of fiduciary duty but does provide protection for some. Practical and legal constraints to be effective and efficient enforcement of shareholders rights need direct actions.⁸⁴⁶

The Law about the Protection of Members of a Firm

The protection of members of a firm against unfair prejudice is found in Section 1265 of the Companies Act 2006. Sections 994 to 998 also restate Sections 459, 460 and 461 which provide for a resolution to situations in which the dealings of the firm are performed in a manner that is unreasonable prejudicial to the interest of its own interests. Section 999 confers supplementary provisions in which an organisation's constitution is changed. This Section makes certain that the updated firm's articles, following a court order under Part 30 (Amending the Company's Articles), are registered and a replica of the court order is distributed with the amendments incorporated into it.⁸⁴⁷

Generally, Part 30 describes the provisions for the protection of members of a firm against unfair prejudice. One of the main provisions, Section 994 a company member may initiate a petition. Under Subsection (1A) (1a), the removal of an auditor of the company from office is considered as unjustly detrimental to the interests of a section of a firm's members. This may base on a divergence in opinions on audit procedures or accounting treatments or based on any other unacceptable basis.⁸⁴⁸

⁸⁴⁶ Ibid

⁸⁴⁷ Companies Act 2006 Sections 460 and 461, 994 to 998, 1265

⁸⁴⁸ Companies Act 2006, Part 30, Section 994 Subsection 1A, 1a and 1A,2

Petition as made by the Secretary of State

This is another instance in which a company can be separated from mismanagement. It involves a petition by the Secretary of State. It applies to a company in which the following presumptions have been made. First, the Secretary of State has acquired an inspector's report as stated in under Section 437 of the Company's Act of 1985. Secondly, when the Financial Service Authority or the Secretary of State has exercised his/her powers and authority in accordance with Sections 447 and 448 of the Companies Act 1985. Including the powers to demand information and document or have search warrants.⁸⁴⁹ Thirdly, the Secretary of State or the Financial Service Authority has exercised their powers in accordance with Part 11 of the Financial Services and Markets Act 2000. This is associated with powers that allow for acquisition of information alongside investigation. Lastly, when the secretary of state has been given a report by investigation bodies that he has been appointed or those by the Financial Services Authority under part 11 of the Financial Services and Markets Act 2000.⁸⁵⁰

The Secretary of State may proceed with the petition to apply for an order if it occurs to him that the company is infringing on the law, when the company's' activities are carried in ways that are unreasonably prejudicial to that of its member as a whole or section of it. And also when there are an omission and or, actual or proposed activities of the company that is likely to be prejudicial. The Secretary of State, in his decisions, may either decide to, present a petition to close the firm or sue the companies for the negligence of the hereby stated provisions or the two.⁸⁵¹

⁸⁴⁹ Companies Act 1985 sections 443, 447, 448

⁸⁵⁰Financial Services and Markets Act 2000 part 11

⁸⁵¹ Ibid

The term “company “can be used herein or for the purpose indebted to this section, refers to any corporate body that is bound to be closed as stated under the Insolvency Act of 1986. For the purposes of this section and in the other provisions of this Part, “company “means anybody corporate that is liable to be wound up under the Insolvency Act 1986.⁸⁵²

5.4 Conclusion.

In the discussion of takeovers, the major issue that arises is the plight of the minority shareholders. This chapter looked into the interest and protection of the shareholders in both the friendly and hostile takeovers. Takeovers have the potential to fundamentally affect a number of stakeholders, the most notable of which are the target and bidder companies, the employees of both firms, and the management and shareholders of both firms. Minority shareholders are in a disadvantaged situation in takeovers as their rights could be easily ignored by the majority shareholders during takeovers.⁸⁵³ They have been defined as members of a company with small amounts of shareholders and with no voting rights;

These minority shareholders are deprived of the influence in the company activities and thus are left hanging in a precarious position as to what is placed before them by the majority shareholders’ actions. In certain cases, the minority shares have a low value compared with the majority shares holdings, whereas there is no difference between the share types but rather a mere size of the shareholding. Mistreatments can largely be prevented and enforcing provisions that advocate for the equal treatment of the shareholders protects the minority shareholders.

In addressing the plight of these disadvantaged groups, this research analyses the weakness in the regulatory regimes within England and the U.S takeover systems. It has

⁸⁵² Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)).

⁸⁵³ Ibid

evaluated more causes of the mistreatment and even presented resolutions that can be enforced to protect the shareholders.

CHAPTER 6: Comparisons between the English and US Systems In Takeover Bids Law.

6.1 Introduction

This chapter comprehensively and critically examines the takeover defences applied by both the US and English systems. It is worth mentioning that the law regarding takeovers as developed in the English system differs in substance and approach as compared to the US systems. It is also important to note, that there are significant similarities existing between the two systems.⁸⁵⁴ As examined in the earlier chapters, the regulations and control of takeovers existing in different countries are of the utmost importance given the rapid increase in the corporate control markets in both countries. The major businesses are applying takeovers and mergers as strategies to expand and maintain their activities beyond the boundaries of their home countries. In the process of carrying out the takeovers or mergers strategies, there are numerous challenges and benefits to be faced and procedures need to be followed throughout the entire process. It is vital to identify the various stakeholders that are affected by the takeover transactions of a company such as the shareholders, directors and employees.⁸⁵⁵

This section of the research focuses on the English takeover system, particularly the self-regulatory rules (The City Code) on takeovers that are administered by the Takeover Panel. The Takeover Panel has statutory powers to enforce and supervise the entire process of a takeover. This research also explores the application of the common law rules on takeovers in England and how the laws are enforced to control and govern the whole process of takeovers.⁸⁵⁶ The statutory

⁸⁵⁴Vyas, Vidhisha, Krishnan Narayanan, and A. Ramanathan. "Determinants of mergers and acquisitions in Indian pharmaceutical industry." *eurasian Journal of Business and economics* 5.9 (2012): 79-102.

⁸⁵⁵Henderson, William D. "From big law to lean law." *International Review of Law and Economics* 38 (2014): 5-16.

⁸⁵⁶Auer, Peter, ed. *Code-switching in conversation: Language, interaction and identity*. Routledge, 2013.

provisions and the Stock Exchange provisions for the takeovers in England are also examined in order to understand the set procedure for conducting the entire takeover process.⁸⁵⁷

In analysing the takeovers regulations in England, the study considers the fact that there is full disclosure of financial information to allow the bidder to consider its implications before taking any steps towards a takeover or merger.⁸⁵⁸ Disclosure of financial information together with providing information on service agreements or management control, issuing of block of shares to friendly shareholders, application of defensive mergers, purchasing of shares from the market and reconstruction of capital together with their implication in providing a defence against any potential or attempted takeover of the target company.⁸⁵⁹

This research will also consider the effectiveness of the US systems in handling the issue of takeovers and mergers. In the US system, the law governing the takeovers are categorised into the US Federal defence law and the US takeover defence law. The two sections are critically analysed particularly, the US takeover defence law that is further categorised into the “pre-bid defence tactics” including the poison pills, shark repellents, golden parachutes and the “post – bid defence tactics” such as the greenmail, white knights, white squire, Pac – Man etc. ⁸⁶⁰

⁸⁵⁷Kay, John. "The Kay review of UK equity markets and long-term decision making." *Final Report* 112 (2012).

⁸⁵⁸Mehdi, Rubya. "The Islamic state in the PostModern World, the Political Experience of Pakistan by Louis D. Hayes. Publisher Ashgate, England. 2014, ISBN 978-1-4724-1262-1." *Tidsskrift for Islamforskning* 9.2 (2017): 149-151.

⁸⁵⁹Kai, Liu, and Hasani Mohd Ali. "Hostile Takeovers and Anti-Monopoly Regulations in China and Malaysia with Special Reference to US and UK Experiences." *Pertanika Journal of Social Sciences & Humanities* 22 (2014).

⁸⁶⁰Salvatore, Dominick. "Corporate Takeovers: Causes and Consequences. Edited by Alan J. Auerbach. Chicago: NBER—University of Chicago Press, 1988. Pp. ix, 343, \$45.00."

To conclude this chapter, the similarity and differences derived from the analysis of the two systems is projected clearly in a bid to create a harmonised defence tactics against the potential or attempts by dominant companies to unfairly take-over the target company. The final defence tactic that will be derived from the weaknesses of the two systems forms the basis of the strategy to be applied in both countries. The chapter is thus vital to the entire context of the research as it helps to identify the application of the various laws in the process of takeovers and the comparisons assists in establishing a more enlightened approach to defence tactics.

6.2 English Takeover Defence

This section specifically focuses on the English system of handling the process of corporate takeovers. In exploring the English system, it is important to mention the role and conduct of the Takeover Panel. The English Parliament formed the independent, statutory body and granted them the power to formulate and enforce the laws governing the processes of corporate control market.⁸⁶¹ The verdict arrived by the Panel represents the final direction and requirement of the takeover conflict. It conducts its operations independently, especially from the Courts of Law of the English system. The Panel is made up of professionals drawn from the corporate and legal fraternity to overview the implementation and supervision of the whole takeover process. For the purposes of the study and context of the research, it is significant to mention how the English system applies the self-regulatory approach known as the City Code,

⁸⁶¹Hazel Fox, Q. C., and Philippa Webb. *The law of state immunity*. Oxford University Press, 2013.

the common law rules, statutory and stock exchange provisions in the administration of justice on the conflicts arising from the dispute.⁸⁶²

6.2.1 Self-Regulatory Rules (the City Code) for Takeovers

This approach of regulation and supervision of the takeover is particularly attributed to the English system. As discussed earlier, the City Code was developed in 1968 by professionals who had a common interest in the field of corporate takeovers. They had a common objective of setting up a proper framework to overview that appropriate business standard are adhered to during the takeover process to ensure that the rights of the shareholders are not violated. In pursuant to the implementation of the Takeover Directive (2004/25/EC) by following the Part 28 of the Companies Act 2006, the regulations drafted in the City Code have a statutory foundation based on the powers conferred upon it by United Kingdom in compliance with the relevant requirements of the directive.⁸⁶³

The City Code on takeovers is based upon the six principles, which underscore the importance of commercial behaviour. The Code is designed with a principle idea of ensuring that the shareholders of the target company are treated fairly in matters concerning takeovers, regardless of the number of shares held. The City Code is enforced by the Panel and provides the direction that is found to be highly essential in directing the firm from acting in breach of the City Code or sometimes ensuring there is maximum compliance. In certain cases, the Panel through the City Code can ensure the company provides compensation for acts of the breach.

⁸⁶²Kraakman, Reinier, et al. *The anatomy of corporate law: a comparative and functional approach*. Oxford University Press, 2017.

⁸⁶³ Companies Act 2006, Part 28, The Takeover Code and the Takeover Directive 2004/25/EC

The Code, which predominantly governs the takeover process in England, not only regulates the powers that are exercisable by the directors of a company but also the applicable defences in a takeover bid.⁸⁶⁴ The board in this regard is not allowed by the provision of the Code to take any actions that may result in any offer being blocked when that offer has become imminent. Shareholders' approval is a requirement for the implementation of any defence strategy. The provision of the Code also ensures that the shareholders are consulted during the takeover and provide a decision on whether a takeover proposal by the board should proceed. For instance, as experience in *Howard Smith v Ampol Petroleum Ltd* where the court rejected the intentions of the management of the target company reached a verdict, to transfer shares to a preferred offeror, in an attempt to block a takeover bid that was favoured by the majority of the shareholders.⁸⁶⁵

As discussed earlier in this Section, the City Code is based on general principles (six in number) that are referred to as standards of commercial behaviour. From these principles arise numerous rules accompanied by short notes to offer intuitive explanations on how the principles apply. The rules and principles of the Code are expressed in simple and non-technical language to enhance understanding and easy interpretation so that the spirit and the intentions are easily achieved.⁸⁶⁶ The City Code is only implemented to the companies: those which has its registered office in England, the Channel Islands or the Isle of Man and has its securities admitted to

⁸⁶⁴Aguilera, Ruth V., Michel Goyer, and Luiz Ricardo Kabbach-Castro. "Regulation and comparative corporate governance." (2012).

⁸⁶⁵*Howard Smith Ltd v Ampol Petroleum Ltd* [1974] UKPC 3

⁸⁶⁶Muchlinski, Peter. "Implementing the new UN corporate human rights framework: Implications for corporate law, governance, and regulation." *Business Ethics Quarterly* 22.1 (2012): 145-177.

trading on a regulated market in England (i.e. the Official List and virt-X but not AIM) or on a Stock Exchange in the Channel Islands or the Isle of Man;

- (i) Which has its registered office in England but its securities are admitted to trading on a regulated market in another Member State; or (ii) which has its registered office in another Member State and its securities admitted to trading only on a regulated marketing England or on a regulated market in one or more Member States, including England. But, in these cases, the Panel will share jurisdiction with the relevant regulator in another Member State; and which does not fall into the two paragraphs above and which satisfies the residency test (i.e. it is incorporated in, and has its central place of management and control, in England, the Channel Islands or the Isle of Man).⁸⁶⁷

However, there are exceptions as to the institutions or companies that the City Code is applicable to.⁸⁶⁸ For instance, in events where the offeree is a private company and it is to be taken over by a public firm listed on the London Stock Exchange. In analysing the City Code, below are the six general principles that govern the entire takeover process in England as administered by the Takeover Panel.⁸⁶⁹

⁸⁶⁷ The Takeover Code - <<http://www.thetakeoverPanel.org.uk/wp-content/uploads/2008/11/code.pdf>> accessed 23 April 2016

⁸⁶⁸ Filatotchev, Igor, Gregory Jackson, and Chizu Nakajima. "Corporate governance and national institutions: A review and emerging research agenda." *Asia Pacific Journal of Management* 30.4 (2013): 965-986.

⁸⁶⁹ Collison, David, et al. "Financialization and company law: A study of the UK Company Law Review." *Critical Perspectives on Accounting* 25.1 (2014): 5-16.

- a) All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
- b) The holders of the securities of an offeree company must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must provide its views on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business.
- c) The board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.
- d) False markets must not be created in the securities of the offeree company, by the offeror company or of any other company concerned by the bid in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.⁸⁷⁰
- e) An offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration, if such is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.
- f) An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.⁸⁷¹

⁸⁷⁰Gregory, Alan, and Sheila O'Donohoe. "Do cross border and domestic acquisitions differ? Evidence from the acquisition of UK targets." *International Review of Financial Analysis* 31 (2014): 61-69.

⁸⁷¹The Takeover Code - <<http://www.thetakeoverPanel.org.uk/wp-content/uploads/2008/11/code.pdf>> accessed 23 April 2016

Through the formally created timetable, the City Code recognises that presenting the offer for a takeover may upset normal activities of the target company. The City Code consequently spells out the time limits concerning the general time span of an offer and the various steps within it. It is mandatory that these rules need to be included in the offer document as contractual stipulations of the offer.⁸⁷²

6.2.2 Defensive Mergers

One of the provisions of the City Code, a “takeover offer” refers to the acquisition of shares in a firm and it is subject to the requirement of the following presumptions. First, the acquisition of the shares should entail the entire shares available in that firm. In a situation where there are more than one class of shares existing in that company, it should involve the purchase of more than one class of shares other than the shares that by the given date are already in the possession of the offeror.⁸⁷³

The second condition, as stipulated in Section 975, Article (3) refer to the offer terms that are required to be the same for all the shares under that offer, or in situations where the shares are divided into classes, it has to be the same across all the classes.⁸⁷⁴ Further in Section 976, the provisions regarding the satisfaction of these terms are contained in subsection (4). According to subsections (3) and (1), the term “shares” denotes shares, other than relevant shares, that have been distributed on the offer date. However, in connection with subsection (5), a takeover offer

⁸⁷²Hopt, Klaus J. "Takeover defenses in Europe: a comparative, theoretical and policy analysis." *Colum. J. Eur. L.* 20 (2013): 249.

⁸⁷³Aguzzoni, Luca, et al. "Ex post merger evaluation in the UK retail market for books." *The Journal of Industrial Economics* 64.1 (2016): 170-200.

⁸⁷⁴Manuela Jr, Wilfred S., and Dawna L. Rhoades. "Merger activity and short-run financial performance in the US airline industry." *Transportation Journal* 53.3 (2014): 345-375.

can include among the associated shares the entire shares or some that are distributed after the offer date but prior to a specified date. As well the related shares may be all or any relevant shares of that treasury that have then ceased to held as treasury shares before a set date or any other treasury shares.⁸⁷⁵

The “relevant treasury shares” have been defined further in Section (6) as shares, which are owned by the company as treasury shares on the date that the offer is made, or become ashore of the company as treasury shares beyond that date but prior to a set date. In this context, the terms “specific date” are taken to imply a date that is set or determined with regard to the terms of the offer.⁸⁷⁶

The shares that are already held by the offeror in line with Section 974 (2) include a reference to shares which he transacted to acquire subject to terms being met or unconditionally. This is subject to subsection (2) which unlike Section 974 (2) does include a reference to shares that are the focus of a contract. The contract is designated to ascertain that the holder of the shares will agree to the offer once made and entered in to. In this scenario “entering into” maybe by deed and for no consideration, or for consideration of negligible value or even for consideration comprising of a promise made by the offeror to initiate the offer.⁸⁷⁷

In certain situations, it might be necessary to review an offer to reflect the required changes. In such situations according to Section (7) that considers where the terms of the offer

⁸⁷⁵ Wilmarth, Arthur E. "Narrow banking: an overdue reform that could solve the too-big-to-fail problem and align US and UK regulation of financial conglomerates." (2012).

⁸⁷⁶ Saulsbury IV, Albert O. "The availability of takeover defences and deal protection devices for anglo-american target companies." *Del. J. Corp. L.* 37 (2012): 115.

⁸⁷⁷ Eleftheriadis, Iordanis, and George A. Drogalas. "A Note on Evaluation of Merger Waves Diachronically and a Proposition for Business Risk Reduction in the New Era."

have made provision for their review and for acceptance of the initial terms, to be considered as acceptance of the reviewed terms. When the terms of that offer are reviewed with respect to the stated provisions, the revision is not going to be considered as an initiation of a fresh offer and the date of the offer is to be read as the date of the initial offer.⁸⁷⁸

When it is said that the offer is on the same terms,⁸⁷⁹ it also requires the satisfaction of the conditions and terms in Section 974 (3) where the subsections (2) or subsection (3) applies. This subsection (2) applies when there exist differences in the value of the contemplated offered for the shares distributed earlier as opposed to that offered for those that were distributed later. It also applies where shares hold a right to a certain dividend, which additional shares of the similar class will not carry when they are later allotted. The disparity may just show the variation in the right to the dividend, and the conditions in Section 974 (3) would be fulfilled even though for that difference.⁸⁸⁰

When a takeover has been made and within that period commencing with the date of the offer and finishing when the offer can longer be accepted, the offeror is expected to acquire or unconditionally contract to acquire any of the shares in which they are associated. They do not do it by virtue of acceptance of the offer. In elaborating this, those shares are considered as excluded from those, which are associated with the offeror.⁸⁸¹ The shares contractually acquired or held by an associate of the offeror regardless of whether at the date of an offer or later are not

⁸⁷⁸Kai, Liu, and Hasani Mohd Ali. "Hostile Takeovers and Anti-Monopoly Regulations in China and Malaysia with Special Reference to US and UK Experiences." *Pertanika Journal of Social Sciences & Humanities* 22 (2014).

⁸⁷⁹Terms of offer to be the equal for all shares or for all shares of particular classes

⁸⁸⁰Uddin, Moshfique, and Agyenim Boateng. *Cross-border Mergers and Acquisitions: UK Dimensions*. Vol. 59. Routledge, 2014.

⁸⁸¹Arif, Raja Zahoor. "The Effects of Mergers and Acquisitions (M&A) on Share Price'(With Reference to UK Top Five Banks from 2006-10)." (2015).

regarded as shares that relate to the offer. That applies even when the offers extend to those shares. In the context of this subsection, the term “contracted” is taken to imply contracted unconditionally or subject to the terms being satisfied. Above all, it worth noting that this section is subject the two subsections 979 (8) and 979 (9).⁸⁸²

Subsection 974 (2) and (3) also apply where the two conditions are considered. First, where the regulations of a nation not within England prevents an offer of consideration, that is in the form or any of the forms specified in the terms of the offer except after complying by the offeror with terms and conditions with which he is unable to comply with or which he considers excessively heavy.⁸⁸³ Second, the individuals to whom an offer of consideration in the form specified by terms and conditions is prevented are able to achieve consideration in a different form that is significant of equal value, and the terms outlined in section 974 (3) would then be met but for the reality is that an offer of consideration in form specified to those individuals is prohibited.⁸⁸⁴

Section 978 clarifies the issue of lack of communication or accepting the offer. It states that an offer can be stopped from being a takeover, where the holders of the shareholders in the target firm are not communicated. However, this is subject to certain terms; for the purpose of this chapter, if the shareholders of the target firm do not have a registered address in the United

⁸⁸² Ibid pp. 19

⁸⁸³ GRAY, SIDNEY J. "INTERNATIONAL MERGERS: THE PURSUIT OF GLOBAL MARKET LEADERSHIP?." *Perspectives in Industrial Organization* 13 (2012): 195.

⁸⁸⁴ Budzinski, Oliver, and Jürgen-Peter Kretschmer. "Implications of unprofitable horizontal mergers: a positive external effect does not suffice to clear a merger!." (2016).

Kingdom (UK).⁸⁸⁵ Secondly, if by means of not contravening the law of a territory not within England, the acquirer fails to communicate to the shareholders of the target firm. Moreover, the offer can be a takeover without prior communication if either it was available in the Gazette or where the offer could be viewed, or a copy achieve at a place that can be on a website or in an EEA state, and a notice thereafter printed in the Gazette giving the location details for the place or website.⁸⁸⁶

Whether by means of the law of a territory outside England, the holders of shares in target firm are not allowed or are in a difficult position to accept the offer; it has no implication that the offer cannot be a takeover. For the purpose of this particular section, it is not to be presumed that an offer not communicated to the shareholders in the firm lest the terms stated in paragraphs (a) up to (c) of subsection (1) are satisfied. Alternatively, it cannot be inferred that offers that particular people cannot or find it difficult to accept cannot be a takeover not unless the rationale behind the impossibility or difficulty are those mentioned in subsection (2).⁸⁸⁷

Squeeze-out

This is defined in Section 979 that the interest of the acquirer to buy out the shares of minority shareholders.⁸⁸⁸ The subsection (2) of this section is applicable in a scenario where the takeover offer is not concerned with the shares of different classes. In that effect, when an offeror

⁸⁸⁵Ahammad, Mohammad F., et al. "Motives for cross border mergers and acquisitions." *Mergers and Acquisitions in Practice* (2016): 16.

⁸⁸⁶Chen, Juan. "Regulating Takeover Defences: The UK Model in Books and the US Model in Action." *Regulating the Takeover of Chinese Listed Companies*. Springer Berlin Heidelberg, 2014. 137-173.

⁸⁸⁷Yaghoubi, Reza, et al. "Mergers and acquisitions: a review. Part 1." *Studies in Economics and Finance* 33.1 (2016): 147-188.

⁸⁸⁸ Subsection (2)

through acceptance has unconditionally transacted to acquire fewer than 10% of the shares associated with the offer and in a situation where the associated shares are voting shares, he acquires more than 90% of the voting right by those shares. Consequently, the offeror may notify the holders of any remaining shares to which the offer effects and that he has not obtained or unconditionally transacted to get, that he may wish to get them.⁸⁸⁹

The subsection (4) deals with the situation, which the takeover bid, involve shares that are divided into classes. In that case, when an offeror through acceptance has achieved or unconditionally transacted to acquire more than 90% of the shares of any class associated with the offer, and in a case where the associated shares of that class are voting shares, he acquires more than 90% of the voting right by those shares. Consequently, the offeror may notify the holders of any remaining shares to which the offer relates and that he has not acquired or unconditionally transacted to get, that he may wish to acquire them.⁸⁹⁰

There may arise a case where the takeover bid may include in its associated shares, the shares that are selected after the date of the offer, or even relevant shares of the treasury,⁸⁹¹ then the offer's right to notification outline in subsection (2) and or (4) on any specified date shall be as though the shares to which the takeover offer is associated with did not comprise of any selected shares, or those ceasing to be held as shares of the treasury, on or after the date.⁸⁹²

⁸⁸⁹Subsection (3)

⁸⁹⁰Krishnan, C. N. V., et al. "Shareholder litigation in mergers and acquisitions." *Journal of Corporate Finance* 18.5 (2012): 1248-1268.

⁸⁹¹Which in accordance to section 974, which cease to considered as treasury share beyond the date of offer.

⁸⁹² Subsection (6)

The subsection (7) is applicable where the terms and conditions for notification stipulated in subsection (2) and (4) are met and the share in that firm which the offeror or his associate has acquired or transacted to get subject to the term getting satisfied and in line with which the contract has not been unconditional.⁸⁹³ For the purpose of this subsection, the offer's right to issue a notice as sates in subsections (2) and or (4) shall be determined as though the associated shares of the offer entail shares found within paragraph (b) in section (6) and in line with shares found in that paragraph., the terms "by virtue of acceptance of the offer" in were omitted.⁸⁹⁴

The offeror may as well though not by way of acceptance of the offer, acquire or unconditionally transact to obtain any shares associated with the offer. However, this is only so when a takeover is made during that time from the offer date of being made to the time when it is not accepted anymore. Moreover, subsection (10) is valid, and for the use of this section, section 977 (1) does not exclude those shares from those associated with the offer, and that the acquirer is considered to have acquired or contracted to acquire the share by virtue of acceptance of the offer.

Similarly, an associate of the acquirer is allowed to acquire or unconditionally contract to acquire the shares that are associated with the offer when a takeover offer is made, during the time the date of the offer is given to when it can no longer be accepted.⁸⁹⁵ According to subsection (10) in regard to this section, the acquired shares are not exempted by 977 (2) from those, which are associated with the offer. And when the terms are subsequently revised such that

⁸⁹³Roberts, John. "Between the letter and the spirit: Defensive and extensive modes of compliance with the UK Code of Corporate Governance." *The SAGE Handbook of Corporate Governance*. London: SAGE (2012): 196-217.

⁸⁹⁴ Subsections (2) and (4)

⁸⁹⁵ Subsection (9)

when the revision is proclaimed at the time stipulated initially, the value of the acquisition consideration should exceed the value of the one specified in the terms of the offer. However, this subsection is subject to the acquisition consideration not exceeding the value of consideration placed in the terms of the offer and this is at the time when the shares are obtained or contracted to be acquired as stipulated in subsection (8) or (9).⁸⁹⁶

According to subsection (3) of Section 980, it may be applied to a takeover offer if the period that the offer is open is guided by the rules which are under Section 943 (1) that give effect to the Takeovers Directive under Article 7.⁸⁹⁷ In the context of this subsection, the term “Takeover Directive” has the definition and implication in Section 943.

In Section 980, further provisions regarding the issuance of notices as stated in Section 979 (1) are noted. It is required that in the issuance of a notice, a particular procedure as stated in Section 979 must be followed. However, no notice might be given as indicated in Sections 979 (2) or 979 (4) after the end of a three month period as from the day after the last day of accepting the offer or six months period starting with the date of the offer in which that period winds earlier and the offer is one in which subsection (3) is applicable.

In subsection (4), the first issuance of a notice is clearly stipulated which is as under Section 979, regarding an offer. The offeror must send to the company a copy of the notice and a statutory pronouncement by him in the approved form, declaring that terms and conditions of issuing a notice are met. Subsection (5) clearly states that the declaration must be signed by a director regardless of the offeror being a company or not.⁸⁹⁸ It is, however,

⁸⁹⁶ Ibid Subsection (9)

⁸⁹⁷ Subsection (9)

⁸⁹⁸ With the meaning of this particular act

an offence committed if an individual fails to send a notice and a statutory proclamation or declaration as stipulated in subsection (4).⁸⁹⁹ Better still, if he signs a declaration for the requirements of that subsection knowing it is false or with reasonable doubt that it is true.

Subsection (7) provides a defence mechanism for persons charged with an offence related to notices.⁹⁰⁰ The defence may require the accused to prove that he undertook reasonably and approved procedures for ensuring he complied with subsection (4).⁹⁰¹ Further, in subsection (8), a person found guilty of an offence under this section,⁹⁰² he is liable on conviction on indictment, to imprisonment for a term not exceeding two years or fine or even both.⁹⁰³

The impact of notices as applicable to courts is discussed in Section 981; this is as stated under Section 979 and subject to Section 986. These provisions concern a time when the notice is issued to the shareholder by the offeror in line with the requirements.⁹⁰⁴ The offeror has then the right to obtain the shares that the notice refers to on the terms of the offer. The terms in this context are such that they offer the shareholder a choice of consideration and in so doing the notice must provide particulars of the choice and give certain requirements. Firstly, the shareholder is expected through a written document sent to the offeror to the address detailed in

⁸⁹⁹ See subsection of Section 980: regarding crimes associated with notices

⁹⁰⁰ Of section 980

⁹⁰¹ Issuance of a notice

⁹⁰² Section 980

⁹⁰³ Part (a) of subsection 8

⁹⁰⁴ prescribed manner stated in section 979

the notice.⁹⁰⁵ Secondly, a state which of the consideration specified in the offer will apply if the offer does not indicate a choice. The reference found in the subsection (2) to the terms of the bid is to be read as appropriate. Subsection (3) applies regardless of time limit or other terms applicable to choice in the terms of the offer seeking compliance.⁹⁰⁶

When the consideration offered by the offeror to the shareholder is not cash and the offeror is not at a position of providing it, or was to be provided by another third party who then not any more is bound or unable to provide it, the consideration is presumed to consists of cash, due by the acquirer, which is equivalent of the consideration offered or at the date of the notice. In subsection (6) it is required that at the end of the six weeks from the date the notice was initiated, the acquirer must send to the company, and as well pay to the firm the consideration for the shares associated with the notice.⁹⁰⁷

When the shares associated with the notice are registered, according to subsection 6 (a), a copy of the notice accompanied by an instrument of transfer implemented on the behalf of the shareholders by an individual appointed by the offeror, have to be sent the company.⁹⁰⁸ Where the consideration is comprised of securities to be selected by the acquirer, the reference found in paragraph (b) to the transfer of the consideration will have to be read as a reference to the firm. Thereafter, following the reception of the instrument, the target firm must register the acquirer as

⁹⁰⁵ (a)

⁹⁰⁶ Subsection 5

⁹⁰⁷ Or as the case may be chosen by shareholder

⁹⁰⁸ Papadopoulos, Thomas. "Cyprus Company Law: Board Neutrality and Breakthrough in Takeovers." (2013).

the owner of those shares.⁹⁰⁹ On the target firm having to receive the statement, it is obligated to give the acquirer warrants and or other instruments regarding the shares as those that already exist concerning the same shares become invalid.⁹¹⁰

After the acquirer has transferred the consideration to the target company, the target firm is compelled by subsection (6) (b) to hold any money or consideration given to it, on trust for the initial shareholders of the acquired firm. The firm's duties on handling the funds are described in Section 982. Perhaps, we should consider more provisions regarding the consideration held on trust, which is found in Section 981 (9). This particular section is applicable to a situation where the acquirer pays or transfers consideration to the target firm outlined in Section 981 (6). It requires that the target pay or transfer the consideration into a separate bank account in compliance with subsection (3) which includes the money it receives and dividend or money accruing from the consideration it receives if any as outlined in the same paragraph.⁹¹¹ Examination of the bank account provisions reveals that it is compliant if the balance it contains bear interest at a market rate and can be withdrawn by notice as is required.⁹¹²

It is rare to find that the person to whom consideration is entitled is missing however for such persons, subsection 4 handles the situation. In line with subsection (9) of Section 981 that

⁹⁰⁹ Phalippou, Ludovic, Fangming Xu, and Huainan Zhao. "Hunting the hunters: New evidence on the drivers of acquirer's announcement returns in M&As." *Available at SSRN* (2012).

⁹¹⁰ Brouthers, Keith D. "A retrospective on: Institutional, cultural and transaction cost influences on entry mode choice and performance." *Journal of International Business Studies* 44.1 (2013): 14-22.

⁹¹¹ As outlined in paragraph (b) of Section 981 (6)

⁹¹² If there is any

the person cannot be traced then subsection (5) applies.⁹¹³ It requires that the consideration includes all the interests and benefits it has accrued be paid to the court. It is worth noting that this applies in a situation where considerable enquiries have been made at reasonable intervals and after 12 years after the company was wound or the consideration received still there is no such person found.⁹¹⁴ In subsection (6), this is described with respect to firms registered in Scotland where subsections (7) and (8) apply instead of (4). Subsection (7) states that when the person being sought cannot found and subject to subsection (5), the trust winds up the firm or when the firm is also ready terminated, a liquidator has to sell any consideration except the benefits such as cash that have accrued from the consideration.⁹¹⁵ After which a sum denoting the consideration provided is in cash the progress of any sale as outlined in paragraph (b), and any benefits including dividends and interests that have thus resulted from the consideration have to be deposited in the court's accountant name in distinct bank account complying with subsection (3).The deposit receipt should then be transferred to the accountant of the court.⁹¹⁶

⁹¹³ Subsection 4 (a)

⁹¹⁴ Subsection 5

⁹¹⁵ 7 (a)

⁹¹⁶ (c)(i) and (c) (ii)

US and English Cases

In the United States, *Weinberger v. UOP, Inc.*,⁹¹⁷ the case involves the 1974 Signal Companies, Inc. acquisition of a 50.5 % stake of UOP, Inc.'s shares. During the period, Signal selected and chose six of the thirteen board directors at the former's board. Three years later, in 1977, Signal Companies, Inc. showed interest in the acquisition of the remaining shares of the UOP at an unsettled price of a maximum of \$24 per UOP shares. Signal obtained a fairness opinion from the Lehman Brothers, indicating that \$21 per share price was fair, despite the fact that the fairness opinion may have been founded on inconclusive and rushed assessment.⁹¹⁸ The board of directors at Signal passed a unanimous vote that proposed a merger at the stated price of \$21. After obtaining the offer, UOP's board indicated to the shareholders the significance of accepting the merger; it was ratified in May 1978. Later, the plaintiff lodged a class action, acting for the minority shareholders of UOP, and challenged the fairness of the merger contract terms.

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In its judgment, the Court indicated that in long-form squeeze-out takeovers, the defendants are tasked with the role of ascertaining the "Entire Fairness Test", which has two phases of fair price and fair dealing. First, in terms of fair dealings, the case is concerned with the process of the agreement; the methods, duration, location, and approval processes. The obligation of loyalty, as indicated by a manifestation of good faith, is intrinsic to fair dealing. Further, when directors and the majority shareholders are on either side of the agreement, it is

⁹¹⁷*Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983)

⁹¹⁸ 7 (B)

⁹¹⁹*Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983)

almost impossible to indicate that the agreement was in fact conducted at arms-length. What is more, the directors can attempt to mitigate their burden through the creation of a non-partisan negotiating committee of external directors. Second, the fair pricing aspect is involved with the terms of the contract; to determine whether fair pricing was involved, it is important to consider all the relevant factors in the company's stock.⁹²⁰

Against this background, the Court dismissed the applicability of the need for complainants to satisfy the commercial purpose of the fairness test. With regards to the effectiveness of the exclusive assessment remedy and the high standard of manifesting wholesome fairness, the business objective test does not offer any add further meaningful protection to the minority shareholders of a company.⁹²¹

*Fiske Nominees Ltd v Dwyka Diamond Ltd*⁹²² is a case that involved a take-over bid and acquisition of shares of dissentients. The majority shareholders were unfair in accepting the offer made by the defendant. Later, the plaintiff made an application to the dissentient shareholders for a court declaration that Dwyka Diamond Ltd is neither bound nor entitled to acquire the company stocks. Lastly, the case questioned whether the defendant had offered sufficient information for the shareholders to make an informed decision.⁹²³

In the case, the proceedings arising out of a takeover offer by the defendant for the share company of the company, the Court ruled “inter alia”, that the defendant had not provided

⁹²⁰Ibid

⁹²¹ Ibid

⁹²²*Fiske Nominees Ltd v Dwyka Diamond Ltd* [2002] 2 BCLC 123

⁹²³Ventoruzzo, Marco, et al. *Comparative corporate law*. West Academic Publishing, 2015.

sufficient information that would have assisted the plaintiff to make an appropriate decision with regard to the offer and thus entered a declaration that the defendant should not be entitled and bound to obtain the shares.⁹²⁴

6.2.3 Sell out

Unclassified Shares

“Sell out” as seen in previous chapters refers to the purchase of the minority shareholders by the offeror. The rights of the minority shareholder to be purchased by the acquirers are contained in Section 983 of the Companies Act 2006.⁹²⁵ In a situation where the takeover concerns all the shares in a firm, subsections (2) and (3) apply. In that effect, an offer will involve all the shares in a firm if it is an offer to acquire all the shares in that firm with respect to the interpretation of Section 974. The subsection (2) states that such an acquirer who wants to purchase the minority shareholder may be able to do so if he has by virtue of acceptance of the offer or unconditionally contracted to acquire part of the stock relating to the offer and in exception of the shares he had initially purchased. This is valid only when done during the period the offer is open and the purchase has met certain requirements of the voting rights and voting shares. This means that amount acquired should be more than 90% in value of the entire voting shares in the company and similarly contain more than 90% of the voting rights in the firm.⁹²⁶

⁹²⁴ Ibid

⁹²⁵ Ibid

⁹²⁶ But would do so for section 990 (1)

Classes of shares

In cases where the takeover involved the sale of shares of various classes, the offeror can only be allowed to purchase those shares if within the period the offer is open, he has by way of acceptance of the bid acquired or unconditionally contracted to acquire part of the stock relating to the offer.⁹²⁷ In addition, they have to exclude those classes of shares they have already acquired in that firm or had contracted to acquire in regardless of whether it was unconditional or subject to satisfaction of the requirements. In so doing, the acquirer must ensure that they have obtained an amount greater than 90% of the entire shares of that class if the shares of that class are voting shares. It is then that the acquirer will be able to purchase the shares of those who have not accepted the offer.⁹²⁸

Section (5) is relevant to sections (2) to (4) defining precisely the shares already acquired by an offeror at the time the offer is still open. This has significance in the calculation of the 90% of any shares expected as a requirement. It outlines that the shares held by the company as treasury shares are shares already acquired by the firm. Subsection (7) is applicable where a shareholder is putting into effect his rights as found in subsections (2), (3) and or (4). By the time the shareholder is exercising his rights, there should be shares in the firm that the acquirer has already contracted to acquire on satisfactory terms and with respect to which the contract has not become unconditional. ⁹²⁹

The shareholder is however regarded not to have exercised his rights with due regard for Section 985 of the Companies Act 2006 not unless the requirements defined in paragraphs (2b),

⁹²⁷ Contained in Section 4

⁹²⁸ Ibid pp 29

⁹²⁹ Section 4

(3b) and (4b) would be satisfied and subject to certain terms.⁹³⁰ Firstly, the reference to other shares in the firm found in that paragraph, which acquirer has already contacted to acquire conditionally or not was a reference to shares that the acquirer himself has unconditionally contracted to acquire. Secondly, the periods within which the offer can be accepted as outlined in the subsection were a reference to the period in Section 98 (2). It is worth noting that the references in subsections (2b), (3b), (4b), 6 or 7 to shares acquired by the acquired or contracted are comprised of a reference to shares which a fellow acquirer has acquired or contracted to acquire.⁹³¹

Section 984 is also furthering the rights of the shareholder as outlined in Section 983 (1) of the Companies Act 2006.⁹³² It clarifies that a shareholder by virtue of subsections (2), (3) or (4) exercises his right through written communication to the acquirer.⁹³³ These conferred rights are only valid and can be put into effect provided it is within three months from the time the offer was closed or if later, the notice date should be given as outlined in subsection (3). That is to say within the one month of the period stipulated in subsection (2), (3) or (4), the acquirer has to issue the target shareholders who have not consented to the offer a notice in the predefined manner of regards to the rights that are liable to the shareholder within that subsection and the

⁹³⁰ Outline in subsection (7)

⁹³¹ Section 7

⁹³² Sheikh, Saleem. *A guide to the Companies Act 2006*. Routledge, 2013.

⁹³³ Under Section 983 of the Companies Act 2006

period of putting the rights into effect.⁹³⁴ The notice should indicate the offer remains open for acceptance provided it is not yet the end of the offer period.

In subsection (4), when acquirer gives the shareholder a notice regarding the shares under transaction in Section 979, then subsection (3) does not apply. According to Section (5), an acquirer who does not comply with subsection (3) commits an offence. In case of a company the officer who is his ignorance has caused the failure that is ultimately responsible for the offence.⁹³⁵ Where an offeror is charged with an offence rather than the firm for non-compliance with subsection (3), in defending himself, he is required to establish that all reasonable steps were taken so as to ensure compliance with subsection (3).⁹³⁶

An individual found guilty of an offence under the subsection (3) is held responsible on conviction on indictment to a fine, which is determined by the verdict, but not exceeding maximum set by the statute. For continued breach of the laws, the offender is fined for each daily default not overlapping the maximum set out by the statute.⁹³⁷

Section 985 of the Companies Act 2006 refers to the impact of the requirements stated in Section 983 (1) with respect to Section 986 of the Companies Act 2006. It is applicable where a shareholder puts into effect his rights stated in Section 983 of the Companies Act 2006 regarding the shares he holds.⁹³⁸ The acquirer is hence obliged to obtain those shares on the terms and

⁹³⁴ Sections 983 and 984 of the Companies Act 2006

⁹³⁵ Sub section (4)

⁹³⁶ Subsection (3)

⁹³⁷ Subsection (3)

⁹³⁸Clark, Gordon L., and Eric RW Knight. "Implications of the UK Companies Act 2006 for institutional investors and the market for corporate social responsibility." *U. Pa. J. Bus. L.* 11 (2008): 259.

conditions of the offer as concurred.⁹³⁹ When the offer is one in which the acquirer wants to provide the shareholder with a choice of consideration, the target firm should indicate its choice of terms on which the acquirer can acquire the shares. In that situation, the notice given to the target firm or shareholder is stipulated in Section 984 (3) of the Companies Act 2006, it must specify the available options and of the rights accorded by the section. Moreover, it should state which consideration outlined in the offer would apply if it does not indicate a choice. Even so, the reference outlined in subsection (2) to the conditions of the offer is to be read as required.⁹⁴⁰

In subsection (4), the subsection (3) is applicable regardless of the time limit or other terms that apply to the designated choice. Subsection (5) outlines a situation where the consideration offered to the shareholder is not in a cash form and the acquirer is not in a position anymore of providing it. The consideration is to be regarded as comprising of cash, due by the offeror, which when required by the shareholder should be equal to the consideration offered.⁹⁴¹

Under Section 986 of the Companies Act 2006, applications may be made to the court regarding the content. The subsection one under this refers to a situation where a notice is issued to the shareholder as required by Section 979.⁹⁴² The court on an application of the shareholder declares that the acquirer is entitled and bound to acquire the shares of the offer on the terms and conditions applicable for the entitlement as the court sees fit. Subsection (2) requires that the application under (1) be made within six weeks from the date the notice was given. The Section

⁹³⁹ Subsection (2)

⁹⁴⁰ Subsection (2)

⁹⁴¹ Subsection (4)

⁹⁴² Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

981 (6) does not have any impact unless the application has been disposed of. This is so when at the end of the period, the application to the court as outlined under subsection (1) is still pending. The shareholder under this process utilises his rights as mentioned in Section 983 regarding any shares he owns, the court will declare the terms that the acquirer is entitled to and bound to acquire the shares as it deems fit under subsection (6).⁹⁴³

In subsection (4) of Section 986, subject to an application made under the subsection (1) or (3), the court might not require consideration of a higher value exceeding that in the terms of the offer to be issues for the shares in the transaction unless the target shareholder shows that the offer value is not fair. Similarly, following the application under subsection (1) or (3), the court may not require a consideration of a lower value than the offer value to be accorded to the shareholder.⁹⁴⁴

Considering subsection 5, the court may consider ordering for costs or expenses on a shareholder for making an application as outlined in subsection (2) and (3) if the application is unnecessary and improper, there was unreasonable delay in the application, and that the shareholder conducted the proceedings of the application in an inappropriate and unacceptable manner.⁹⁴⁵ As required in subsection (6), an acquirer should be issued with an application made under subsection (1) and (3) by the shareholder. Further, in subsection (7), an acquirer issued with the notice must issue a copy of the notice to any other individual who has received a notice

⁹⁴³ Subsection 4

⁹⁴⁴ Subsection 1

⁹⁴⁵ Subsection 6

under Section 979 of the Companies Act 2006, and anyone who has practised his rights as outlined in Section 983.⁹⁴⁶

In subsection (8), any acquirer who writes an application in subsection (3) is required to issue a notice of the application to anyone who under Section 979, a notice has been issued and anyone exercising his rights as outlined in Section 983. In a case where a takeover bid has not been acknowledged to such a degree that he is required to issue notices as outlined in subsections (2) and (4)⁹⁴⁷, the court may allow them to make the notices under those subsections following an application they have made and meeting certain requirements. Firstly, the offeror has made enquire about the shareholder of the shares mentioned in the offer and it is all in vain. Secondly, that the offeror and the shareholder accepting the offer would have led to the satisfaction of the requirements. Lastly, if the consideration offered is just and reasonable. This is however subject to subsection (10). The court may only make an order if it has considered it “just and equitable” with regard to the shareholders who have been traced but have not acknowledged the offer.⁹⁴⁸

Joint offers

In Section 987 of the Companies Act, 2006 where a takeover bid has been made by two or more persons combined, known as joint offers, this section with the subject to other parts of the chapter will have an effect.⁹⁴⁹ In this scenario, putting into effect the rights conferred under

⁹⁴⁶ Ibid

⁹⁴⁷ Of section 9797

⁹⁴⁸ Langevoort, Donald C. "Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America, The." *Harv. L. Rev.* 101 (1987): 96.

⁹⁴⁹ Subsection (1) of section 987

Section 979 are met when the acquisition involves acceptance of the offer by the joint acquirers acquiring or unconditionally contracting to achieve the relevant shares combined. In other situations, it may be the combined acquirers acquiring or unconditionally contracting to acquire the relevant shares either as a group or individually.⁹⁵⁰

In terms of putting into effect the rights mentioned in Section 983, they are met when the takeover involves acceptance of the offer by the combined acquirers acquiring or unconditionally contracting to acquire the relevant shares together. Alternatively, it may be the mutual offerors unconditionally contracting to acquire or acquiring the relevant shares either as a group or individually. Subject to the provisions of Sections 979 to 985⁹⁵¹ as in subsection (5) of this Section, subsection (4) of this section states that the rights and obligations of the acquirer outlined in Sections 979 to 985 are joint rights and joint obligations of the combined acquirers. The subsection (5) states that a provision of Sections 979 to 986 that authorises a notice to issue to the joint acquirers is only achieved compliance when the notice or other document is sent to any of the acquirers.⁹⁵²

According to Subsection (6), the joint acquirers and where at least one is a company, the director must sign the statutory declaration demanded by Section 980 (4). The references⁹⁵³ to the acquirer are to read as references to any or all of the join acquirers.⁹⁵⁴ Further, in subsection

⁹⁵⁰ Subsection 2

⁹⁵¹ As outlined in subsection 5

⁹⁵² Morse, Geoffrey, and Sarah Worthington. *Palmer's company law: annotated guide to the Companies Act 2006*. Sweet & Maxwell, 2009.

⁹⁵³ That are found in sections 974 , 977, 979 (9), 981 (6) , 983(8) and 988

⁹⁵⁴ Subsection (7)

(8), the references in Section 981 (7) and 981 (8) to the acquirer are to be regarded as the references to the joint acquirers. The Subsection covers the failure to provide the consideration by the acquirers. As outlined in Sections (5) (a) and 985 (5) (a), the references to the failure of the acquirer are to be read as the references to none of the joint acquirers being able to provide. Subsections 10 outlines that the references found in Section 986 to the acquirers are to be regarded as references to the joint acquirers in except in the following reasons. Firstly, that an application may be made by any of them as outlined in subsections (3) or (9). Secondly, the references in subsections 9(a) to the failure of an acquirer to find any of the shareholders of the target firm are to be read as a reference to the joint acquirers being unable to get the shareholders of the target firm.

6.3 Takeover Defences in England

While in the U.S, the regulations of the are undertaken by judicial laws and statutes which consider takeover defences as one which is run vastly by the internal management of a company, the English system of a legal and regulatory framework has placed a legal framework to be considered by institutional investors who in many situations make up the bulk of the shareholder. The outstanding regulatory structure towards takeovers is directed towards protecting the interest of the shareholder.⁹⁵⁵ It has been argued that the predominant difference in English and the US takeover regulation lies in the handling of the takeover defences. The takeovers in England are regulated by the Takeover Code, which oversees the powers bestowed upon the directors of a company in an occurrence of a takeover and the applicable defences.

⁹⁵⁵ Skeel, D, Armour J, "Who Writes the Rules for Hostile Takeovers, and Why?-The Peculiar Divergence of US and UK Takeover Regulation" Centre for Business Research, University of Cambridge, September 2006

The board of directors is often barred from involving in deeds that may hinder or frustrate takeover processes⁹⁵⁶ when the offer is forthcoming. The shareholders' approval is always a precondition for the adoption of any takeover defence by the firm through the board of directors.⁹⁵⁷ The code has provisions that entitle the shareholders to rights of assessment and decision making with regard to acknowledging takeovers. For instance, in takeover between Howard Smith v Ampol Petroleum Ltd, the target firm was prevented from transferring the treasury shares to a favoured offeror by the court.⁹⁵⁸

6.4 U.S Takeover Defence Law

Just as in any other legal battle, the board or management of the target company may choose to accept a takeover bid or reject it by pursuing a legal suit in a bid to defend it against a hostile takeover bid launched by a dominant company. The measure involves the employment of an effective legal mechanism to stall every attempt by the raiders from succeeding in carrying out their takeover operation.⁹⁵⁹ The management may advance the takeover defence mechanisms after the bid has been made or may have been advanced prior to the making the bid. However, before discussing the available defence tactics under the US takeover law, it is important to mention that the most obvious method for defending the target company against any hostile

⁹⁵⁶ Rule 21.1(a)

⁹⁵⁷ Supplemented by the Companies Act 2006 (CA 2006)

⁹⁵⁸ Howard Smith Ltd v Ampol Petroleum Ltd [1974] UKPC 3

⁹⁵⁹ Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

takeover is by rejecting an initial bid, citing that the company is seeking to receive a higher bid offeror intending to invite a competitive offeror.

If the target company is in a stronger position to receive a better and higher bid it may initiate a vigorous defence against any potential attempt thus prolonging the takeover attempt. The defence may also be based on the fact that the company's net worth is higher than the available takeover bid or that there are hidden assets. Such a defence is only possible if the management has highly sensitive and confidential information about the firm that would substantially increase the market value. By advancing such a defence tactic, the board may be able to increase the net value of the target company, hence blocking the bid offeror ultimately fetching a higher price for the shareholders should the bid be successful. Additionally, the reason for mounting a defence by the management is the strategic belief that the firm would operate as a going concern by remaining independent. The other important element to consider in this research is the fact that any transactions involving takeover bid will only gain acceptability or rejection depends on the social and political viewpoint of the country.

Lately, there has been vast attention accruing towards the takeover regulation in the U.S by judicial proceedings and academic researchers. The review of this literature is not within the limit of the discussion. It is of significance to consider the legal framework of the takeover regulation in U.S. In so doing, certain issues must be addressed; the coercive aspects of the two-tier offer.⁹⁶⁰ It is also important to note that the European takeover bid is not explicitly concerned with shareholder value rather more fundamental issues.⁹⁶¹

⁹⁶⁰Ronald J. Gilson and Reinier Kraakman, Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?, 44 *Business Law* 247 (1989).

⁹⁶¹Berglöf, Erik, and Mike Burkart. "European takeover regulation." *Economic Policy* 18.36 (2003): 171-213.

Generally, there are various laws, which govern the takeovers in the US. These are the state statutes, federal statutes and common law judicial decisions. At this instance, the Williams Act, the Unocal/ Revlon case decisions and the state anti-takeover statutes will be considered.⁹⁶²

6.4.1 The Williams Act (1968)

The contemporary federal regulation in US expanded with the passing in 1968 of the Williams Act in the form of an amendment that passed the Securities Exchange Act of 1934.⁹⁶³

The Act was intended to

“Make the relevant facts known so that shareholders have a fair opportunity to make their own decisions”.⁹⁶⁴

The Act contains the rules in order to manage takeover bids. It basically requires the offerors to disclose information regarding the offers and as well establish procedures directing the tender offers.⁹⁶⁵ The disclosure of information by the offeror is outlined in Section 13 (d) of the Act. Where an offeror has acquired a certain percentage of shares exceeding a specified limit, a duty to disclose relevant information regarding the offer is activated. The offeror has to reveal its identity and background; the source of funds he is using in the acquisition, the rationale behind the acquisition, whether they aim to liquidate the target firm or restructure the business and the shares they have already acquired in the target firm.

⁹⁶²Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)

⁹⁶³ Ibid

⁹⁶⁴ This is in line the sponsor of the amendment, Sen. Harrison Williams, S. REP. No. 90-550, at 3 (1967).

⁹⁶⁵15 See CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987), for a similar analysis.

The Williams Act in Section 14 (d) outlines the rules and principles that define how the process should proceed.⁹⁶⁶ An offer initiated should remain open for a period of at least 20 days and those shareholders who tendered their shares may withdraw them within the first 7 days of the tender offer period. In circumstances where a large number of offers have been tendered exceeding the expectation of the offeror, then the purchases will have to be made through a “pro rata” strategy. Significantly, the acquirer must pay equally for all the shares tendered in an offer.⁹⁶⁷

The Security Exchange Council (SEC) regulations also monitor closely and find a firm liable for false and misleading information with respect to the tender offer.⁹⁶⁸ The duties of directors in a firm especially during the takeover process are outlined and regulated by their fiduciary duties.

6.4.2 Unocal/ Revlon Duties

In the U.S the majority of the regulations regarding takeovers are predominantly to be found in the Unocal/Revlon case decision.⁹⁶⁹This, therefore, has an implication that Federal regulation forms only a portion of the takeover regulation in the United States. The state law fiduciary duties are highly considered for addressing cases pertaining to the duties of directors of a company in the event of a takeover. The controversy arises as there are over 50 varied state

⁹⁶⁶The Williams Act 1968, s 14 (d).

⁹⁶⁷The Williams Act 1968, s 14 (e).

⁹⁶⁸Security Exchange Council Act of 1934 § 14(e), 15 U.S.C § 78n (1995); 17 C.F.R § 240.14e13 (2008).

⁹⁶⁹ Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)

based jurisdictions in the U.S. Even though, the situation is eased by the fact that the corporate laws in U.S are predominantly influenced by Delaware case law. The Delaware Court of Chancery through its proficiency and suppleness has meant that many large corporations /holding companies are registered under Delaware law. Consequently, the Delaware court rulings impact on the cases across the various states.⁹⁷⁰ Over time, the Delaware courts have developed an “intermediate standard” of review for the actions of the directors in the course of takeover bids.⁹⁷¹

In a takeover bid between Unocal Corp v Mesa Petroleum Co, the Delaware Supreme Court maintained that “directors are of necessity confronted with conflict of interest” due to the threat of removing the serving board of directors.⁹⁷² As a result of conflict in interests, the court disregarded the defence measures that were in place and established a “bi-influence” type of rules that impacted on both the target and the offeror. This had an intention of determining whether the target board was allowed to put in place defensive measures. In response the board was expected to have grounds for believing that the takeover would have a non -positive effect on the firm. On the same note, the defences that were to be implemented were to be reasonable as compared to the threat imposed. The rationale for resisting a takeover is shown by good faith and

⁹⁷⁰ For example, the famous case of Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), has been cited favourably by 12 of the 13 circuit courts and 15 state courts. See Dana M. Muir and Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?*, 8 N.Y.U. J. LEGIS. and PUB. POL’Y 279, 354 (2005) (describing how Delaware courts have scrutinised director decisions to resist hostile takeovers).

⁹⁷¹For a more extensive examination of this “intermediate standard,” see generally Gilson and Kraakman, *supra* note 11. (2009)

⁹⁷²493 A.2d at 955

the attempt to carry out a reasonable investigation.⁹⁷³ The shareholders' approval was not required by the court for the board of directors to initiate a defence mechanism.

In the Unocal test, the court allowed the application of a poison pill defence in *Moran v Household Int'l, Inc.*⁹⁷⁴ Merely, a year later, the Supreme Court of Delaware constrained the freedom of director's by holding in *Revlon, Inc. v MacAndrews and Forbes Holdings, Inc.* that, provided a sale was initiated, the duties of directors were expected to be minimal towards the protection and the maintenance of the firm and extending towards seeking the highest price for the benefit and interests of the shareholders.⁹⁷⁵ In simpler terms, the directors should not engage in frustrating the sale but instead be auctioneers who are attempting to acquire the highest bidder. In the case of *Paramount Communication Inc. v Time, Inc.*, the board of directors was given an opportunity of initiating a defence by the court, even when it had been inevitable that the firm was to be sold.⁹⁷⁶ The verdict of the court had it in its reasoning that the board of directors of the target firm could still consider factors such as the information available to the shareholders, the terms and conditions accompanying the offer, and the timing of the offers besides monetary value of the offers.⁹⁷⁷ To some extent, these factors were believed to justify the need for defensive measures.

⁹⁷³Bid.

⁹⁷⁴ *Moran v Household Int'l, Inc.* 500 A.2d 1346, 1357 (Del. 1985).

⁹⁷⁵ *Revlon, Inc. v MacAndrews and Forbes Holdings, Inc.* 506 A.2d 173, 182 (Del. 1985).

⁹⁷⁶ *Paramount Communication Inc. v Time, Inc.*, 571 A.2d 1140 (Del. 1989).

⁹⁷⁷Id. at 1153

The two resolutions arrived in the 1990's clearly meant out the duties of directors during takeover fights and elaborated more on the availability of defensive measures. Considering in *Paramount Communications, Inc. v QVC Network, Inc.* the Court asserted that a more advanced scrutiny to be implemented towards the directorial defensive actions in, though only once the Revlon duties were activated, or, simply, when the sale of a firm was inevitable.⁹⁷⁸ The QVC network proposed that the pre-bid anti-takeover strategies were presumptively more reasonable and sensible owing to the fact that was applicable prior to an occurrence of a potential threat.

In *Unitrin, Inc. v American General Corp*⁹⁷⁹ the Delaware Supreme Court extended the discretion of directors to resist aggressive takeovers. In its judgment, it considered the defensive measures acknowledged by an independent board as being permissible provided they were not draconian and were reasonable.⁹⁸⁰ The effect of these cases in Delaware is that boards of directors in companies in the United States have a range of mandate to deter aggressive takeovers provided they do it in “good faith” after adequate analysis and measures taken should be measurable to the threat posed.

6.4.3 State Anti-Takeover Statutes

Alongside, the federal regulations and the state law fiduciary duties, there are antitakeover statutes overseeing the takeover activities. The mentioned statutes offer protection to the firms within the state against the potential acquirers who are outside of the state.⁹⁸¹ These

⁹⁷⁸*Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994)

*Unitrin, Inc. v American General Corp.*⁹⁷⁹ 651 A.2d 1361 (Del. 1995).

⁹⁸⁰*Id.* at 1387-88.

⁹⁸¹See, for example ALASKA STAT. §§ 45.57.010-45.57.120 (2000); MASS. ANN. LAWS ch. 110C, §§ 1-13 (1995 and Supp. 2002); TENN. CODE ANN. §§ 48-103-101—48-103-505

statutes have undergone evolution in three generations and within the various states. It can consequently be observed that:

“State takeover acts are similar to snowflakes—if you think you have found identical ones, you are probably not looking closely enough”.⁹⁸²

The first era of takeover statutes oversaw the takeovers in a manner that gave the regulator the mandate to review the advantages associated with a bid or how much it has disclosed itself.⁹⁸³ In most of the cases, the regulator or rather the administrator frequently held hearings on bids and even imposed waiting periods within the time period remained open. Many aspects of the takeover statute were exempted from the federal regulations, concluding in the *Edgar v MITE Corp* decision.⁹⁸⁴ Where, the Supreme Court proclaimed the Illinois anti-takeover statute unconstitutional. In line with the view of the court,

“While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting non-resident shareholders”.⁹⁸⁵

⁹⁸²Symposium, State Reregulation of Tender Offers, 7 J. CORP. L. 603 (1982) (footnote omitted) quoted in James D. Cox and Thomas Lee Hazen, 3 COX and HAZENON CORPORATIONS 1491 (2d ed. 2003).

⁹⁸³See, LA. REV. STAT. ANN. § 51:1501(E) (repealed 1987); 70 PA. CONS. STAT. § 74(d) (Supp. repealed 1993). Most of these statutes were implemented to secure particular local industries. A lively example is Indiana which enacted its first anti-takeover statute to shield a company notably Arvin Industries. The company was a distinctive member of the community in Columbus, Indiana, with 2000 employed workers and giving support to local schools. In the vicinity of the Belzberg family, known green-mailers, a takeover was looming, Arvin influenced a state legislator to draft the takeover bill. More information: Michael W. Miller, How Indiana Shielded a Firm and Changed the Takeover Business, WALL ST. J., Jul. 1, 1987, at 1.

⁹⁸⁴ *Edgar v MITE Corp* 457 U.S. 624 (1982).

⁹⁸⁵*Id.* at 644.

Thus, a negative infliction on the transaction of the in-state firms breached the commerce clause.⁹⁸⁶ In such a case, the Illinois statute allowed for hearing regarding the tender offer's terms and the waiting period.

The second era of anti-takeover statutes was aimed at protecting the target firm by considering the disclosure of information. The remarkable aspect of these statutes was the The "control share acquisition" statute, in which most the of the minority shareholders were required to consent on an offer to acquire the firm. In the case between CTS Corp. v Dynamics Corp. of America, the Supreme Court endorsed the Indiana's control share statute. The statute required that the voting rights were to be denied to any shareholder with shares exceeding 20% of the target firm's not unless the autonomous stockholders have allowed such voting rights in a general meeting. Other statutes within the second era were "fair price" which required that the offers were to consent on by a super majority of shareholders except when they had a good price from the offeror and we also had "stakeholder" statutes, which allowed the management to put in mind the interest of the stakeholders rather the stockholders.⁹⁸⁷

Eventually, the third era of takeover statutes has improved on the protection of the in-state targeted firms. These statutes are of two kinds namely, the freeze statute and the disbursement statute. The first one has an implication in the state of New York where it forbids a merger, which may accord the offered control over the target firm within five years unless the directors the target firm before the acquisition began acknowledged it. The disbursement rule is, however, Pennsylvania oriented in that it has a requirement that any owner of shares exceeding 20% of a firm's shares to issue out any profits realised within a period of eighteen months.

⁹⁸⁶Id. at 645.

⁹⁸⁷CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987)

Generally, the third era statutes have endured the challenges that have been mounted under the constitution in the federal courts. The states in giving the boards of directors wide capacities to consider more defensive measures shows how much they have protected the target firm against the hostile takeovers.

Duties of director and controlling shareholders

In US, the directors of target companies are constrained by their fiduciary duties under the national law determined by the target's incorporation.⁹⁸⁸ When adopting the defence techniques, Delaware has an extensive system of corporate case law and considered the most vital jurisdiction for publicly traded companies in the U.S. Under Delaware law, the application of defence tactic by directors of the target company is preceded by a scrutiny of the target's board. In the event that the acquisition entails the sale of control of a company, Revlon duties apply and the board is mandated to determine the best reasonable bid price available for the shareholders.⁹⁸⁹

However, in plan, share for share mergers, the Revlon requirement on duties does not apply. They are characterised by widely held holdings of the public company's shareholders with no individual holding forming a controlling block of shares.⁹⁹⁰ Even though in these cases, the target firm's intentions to adopt defence mechanisms are viewed the Unocal standard. In this standard, the target company is required to have valid grounds in believing that the acquirer is

⁹⁸⁸Gilson, Ronald J., and Jeffrey N. Gordon. "Controlling controlling shareholders." *University of Pennsylvania Law Review* 152.2 (2003): 785-843.

⁹⁸⁹see *Revlon Inc. v. MacAndrews and Forbes Holdings Inc.*, 506 A.2d 173 (Del. 1986)

⁹⁹⁰*Paramount Communications, Inc. v. Time Inc.*, 673 A.2d 1140, 1152 (Del. 1989)

likely to launch an aggressive acquisition that it is a threat to the policy before it can launch an appropriate defence mechanism. Further, the target firm should resolve on a mechanism that is equally reasonable in response to the threat.⁹⁹¹ Better still, there is a general rule that prohibits a target's board from adopting takeover defence tactics that, either individually or by acting with another would deter a higher bid from materialising.⁹⁹²

6.5 Divergence in the US and English Takeover Regulations

In spite of the close interrelationship of the different issues of the takeover laws in the U.S and England, they fundamentally differ in the control and regulation of the unfriendly takeovers.⁹⁹³ These conflicts are discovered in the legal tactic available for publicly traded companies in the stock markets. For instance, the application of higher termination fees and a wide range of unwelcome provisions in the U. S as compared with England. Judging from the Delaware jurisdiction when controlling public companies in the US, Target Company's management is barred from using shareholders' sustained agreements and other tactics that are not specified under the procedures of the takeover in a bid to prevent a takeover bid from taking place.⁹⁹⁴

Comparably, in England, a bid that observes the rules and regulations hence attaining the requirements is by law permitted to continue in the quest to take over the company by

⁹⁹¹Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (1995)

⁹⁹²Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (1995)

⁹⁹³Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." *Geo. LJ* 95 (2006): 1727.

⁹⁹⁴Aguilera, Ruth V., et al. "Corporate governance and social responsibility: A comparative analysis of the UK and the US." *Corporate Governance: An International Review* 14.3 (2006): 147-158.

acquiring the target's shares, if exceeds a considerable amount of the total shares, successfully ensures the takeover is successful. The existing variations have sparked a lot of argument in the various jurisdictions, legal forums, the legal Panel's, various professional researchers and other interest parties in light of the new era of globalisation. In this context, it is important that insightful understanding of the control and regulation of takeovers specifically with regard to England and the US, will involve analysing the following aspects:

- The divergence in acquisition deals in England and the US;
- The rationale for protection mechanisms in the US;
- The English deal protection mechanisms

Structure and regulation of negotiated acquisitions in England the US

In the United States, a very short deal merger achieves the merger of the publicly traded company or otherwise a tender offer. The shareholders are vital in consenting to all the decision and agreement reached by the management of the company concerning the takeover.⁹⁹⁵ In the first instance, concerning the merger, the shareholders will give their consent through voting for the transaction, while in the other instance, concerning the provisions of the tender offer; shareholders are expected to tender their shares. The terms of acquisitions or mergers are conferred by parties, offeror and offered, are to be contained in the acquisition agreement. The US acquisition and mergers agreement include an obligation for the offeree firm to terminate the agreement should they find the deal to be inconsistent with the fiduciary duties of its directors and management.

The City Code on Takeovers and Mergers governs the activities of the takeovers scene, including the recommendations of the takeovers of England companies that are publicly traded.

⁹⁹⁵Miller, Geoffrey. "Political structure and corporate governance: some points of contrast between the United States and England." *Colum. Bus. L. Rev.* (1998): 51.

The Takeover Code comprises of the General Principles (fundamental standards of commercial behaviour) and Rules, intended to defend the shareholders. The Code is implemented and imposed by a Panel on Takeovers and Mergers selected to oversee the entire process. The update of the Code in May 2006 concerning the implementation of EU Directive 2004/25/EC on takeovers in England was aimed at converting the takeover Panel into a statutory framework in order to acquire legal authority. This actually managed to confer upon the Panel powers to regulate and govern the takeovers. It is otherwise vital to note that the 2006 amendments did not result in any important effects on application of takeover deal protection.⁹⁹⁶

Most of the publicly traded companies in England are severely affected when as target firms; they are exposed to unfriendly bid offers. Similarly, proper provisions are in place to enforce an agreed takeover where the share capital of the offeree is acquired so as the use of schemes of the agreement are increasingly becoming popular in England with most of the firms planning any takeover moves adopting this approach.⁹⁹⁷ However, there is a lot of argument concerning the level of control over the takeovers bid offers by the “shareholder activists” who become very vocal when the schemes are being considered. A practical scheme is subject to the consent of the majority of the offeree firm’s shareholders corresponding to 75% in value of the target’s shares and endorsed by the court of law. In comparison to the US system, the two parties do not by law have a bid in the transaction unless they are enforced by the schemes in the

⁹⁹⁶ Ibid

⁹⁹⁷Kapstein, Ethan B. "Resolving the regulator's dilemma: international coordination of banking regulations." *International Organization* 43.2 (1989): 323-347.

agreement. In view of this, the acquirers examine closely the implementation of the scheme of arrangement by the target.⁹⁹⁸

It is, however, emerging as a trend that in order to facilitate a takeover the target companies ensures payment of a “break fee” to the dominant company regardless of whether the takeover is being enforced by means of a scheme of arrangement or not. This fee is payable when the bidder is not ultimately successful, which includes being defeated by other competitive bids.

6.6 Reasons for deal protection mechanisms

Deal protection mechanisms are basically contractual agreements between the acceptable bidders and offered that are intended to dishearten competing bids and to shield the preferred bidder if a competing bid is received. From a bidder’s perspective, the requirement for deal protection arises as a result of the board of directors of Target Company not having the capacity to bind fully the target company to a change of control transaction.⁹⁹⁹ The bidders have to be worried about losing to other competitive bids. Transactions are very expensive, both in terms of actual out-of-pocket costs and opportunity costs. The approach is not only time-consuming but also diverts the management’s attention from the daily operations and strategies of the

⁹⁹⁸Angwin, Duncan. "Mergers and acquisitions across European borders: National perspectives on preacquisition due diligence and the use of professional advisers." *Journal of World Business*36.1 (2001): 32-57.

⁹⁹⁹Lampson, Butler W. "Dynamic protection structures." *Proceedings of the November 18-20, 1969, fall joint computer conference*. ACM, 1969.

organisation. The takeover where the bidder is then outdone, particularly if it is a competitor, may be viewed as an advantage over the bidder and its management.¹⁰⁰⁰

Consequently, bidding companies are unwilling to enter into contracts involving the acquisition of public companies without safeguarding the deal against the competition in all manners possible. Most target companies decline the deal protection mechanisms since they perceive that it is in the interest of their shareholders, if a higher bid is presented. However, there may be reasons that may facilitate the target companies' boards to comply with the demands of the bidder.¹⁰⁰¹ In a share-for-share transaction, the target company's board and management may have assurance on the long-term prospect offered by this arrangement. It may be an element that continues the board and management of the combined company. The board and management of the offeree may believe the anticipated transaction benefits its stakeholders including employees, customers, suppliers or community. Furthermore, providing the bidding company with deal protection may be crucial to ensure the success of the deal. The target company's management may be criticised for serving their self-interest in agreeing to protective mechanisms.¹⁰⁰² The recommended bidder rather than potential competing bidders may enhance their protection of sustained employment, promotion and improved compensation. For instance, the recommended bidder is venturing into a new market and requires the current management, while the opponent bidder is a consolidator with an aim of saving costs and rationalisation.

¹⁰⁰⁰Varallo, Gregory V., and Srinivas M. Raju. "A Process Based Model for Analyzing Deal Protection Measures." *The Business Lawyer* (2000): 1609-1647.

¹⁰⁰¹Rutter, Michael. "Psychosocial resilience and protective mechanisms." *American journal of orthopsychiatry* 57.3 (1987): 316.

¹⁰⁰² Ibid

The legal barriers against the use of some of the deal protection mechanisms, either single-handedly or in combination with other existing mechanisms, have been imposed due to the fact that there is too much deal protection; hence will indirectly exclude the materialisation of a better offer or inconvenience to the target's shareholders.¹⁰⁰³ Those barriers are basically imposed in the form of common law decisions by law courts in the US. On the other hand, in England, these types of constraints are enforced by Rule 21 of the Code, which efficiently precludes measures by the target that would discourage a competing bid once it has appeared and as well through the common law.¹⁰⁰⁴

6.7 Deal protection mechanisms in the US

6.7.1 Duties of the director

The directors of most US target companies while accepting the deal protection mechanisms are limited by their fiduciary duties under the law of the state in which the target companies are registered. Delaware is the most significant state for publicly traded holding companies in the US stock markets and has the largest body of company case law. Despite lacking the power to supersede other jurisdictions in the courts of law, the Delaware precedents are often, constantly, cited and relied on by other state courts of law.¹⁰⁰⁵ From the Delaware law,

¹⁰⁰³Adjaoud, Fodil, and Walid Ben-Amar. "Corporate governance and dividend policy: shareholders' protection or expropriation?." *Journal of business finance & accounting* 37.5-6 (2010): 648-667.

¹⁰⁰⁴ Ibid

¹⁰⁰⁵La Porta, Rafael, et al. "Investor protection and corporate governance." *Journal of financial economics* 58.1 (2000): 3-27.

the insertion of deal protection mechanisms in a transaction agreement increases the close examination of the target company's board of directors.

If the business deal in question involves the acquiring of control of the company, Revlon duties are used and the board is tasked with the obligation of securing the transaction by presenting the best value sensibly available to the shareholders.¹⁰⁰⁶ Despite this situation, Revlon duties are not relevant in calculated, share-for-share mergers, where the shares of the existing public company are widely held, without allowing individuals to hold a voting block.¹⁰⁰⁷ Additionally, in a share-for-share merger where Revlon duties are not pertinent, the target company's directors' decision to apply deal protection mechanisms will be scrutinised under the Unocal standard. In this standard, the management of the target company must be justified in supporting the fact that a third party bid would correspond to a threat to business policy, and that the protection mechanisms engaged in to defend the preferred bid stands for a rational response to the apparent threat.¹⁰⁰⁸ The common rule under both of these views lies in the fact that a target company's board cannot approve deal protection mechanisms that are either alone or in combination since it would prevent a higher bid from emerging.¹⁰⁰⁹

¹⁰⁰⁶Revlon Inc. v. MacAndrews and Forbes Holdings Inc., 506 A.2d 173 (Del. 1986)

¹⁰⁰⁷Paramount Communications, Inc. v. Time Inc., 673 A.2d 1140, 1152 (Del. 1989)

¹⁰⁰⁸Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (1995)

¹⁰⁰⁹In re Toys "R"Us Shareholder Litigation, 877 A.2d 975 (Del. Ch. 2005)

6.7.2 Frequently used deal protection mechanisms

The most regularly applied mechanisms to safeguard US takeover transactions include the following:

Termination or break-up fees

In this transaction, termination fees are “mentioned fees” to be paid to a bidding company under certain situation if the transaction with the bidder is not accomplished. The termination fees lessen the value of the target company and boost the price tag to a challenging bidder. The target companies in most cases request for the termination fees, which materialise only if the transaction is concluded and an optional transaction is accomplished within a given time period. They are not always successful in restraining the disbursement of the fee in those situations. The Delaware courts have upheld breakup fees even though the shareholders may discard the deal without a substitute deal.¹⁰¹⁰ In this case, the Delaware courts gave priority to a stipulation whereby half of the 3% fee was to be paid under such conditions. Termination fees are often explained in the business agreement as liquidated reimbursement. Delaware courts give priority to termination fees provided there is no exclusion of higher bids. The courts of law examined the legality of termination fees particularly focusing on protective mechanisms in the transaction agreement as a whole, and the extent to which the directors of the target argued practically in approving the termination fee. The termination fees ranging from 2.5% to 4% of the overall transaction are quite common in US public acquisition deals. However, the termination fees cannot be found within that range under a number of conditions.¹⁰¹¹

¹⁰¹⁰H.F. Ahmanson and Co. v. Great Western Financial Corp., C.A. No. 15650, 1997 Del. Ch. LEXIS 84 (1997)

¹⁰¹¹Melis, Andrea. "Strong blockholders and corporate governance structures that improve minority shareholders' protection: the case of Telecom Italia." *International corporate governance. A case study approach* (2006).

Non-solicitation provisions

The Non-solicitation provisions are promoted by bidders to reduce the target company's application of its "Fiduciary Out", by placing barriers on the target's ability to request or react to optional offers. A "no-shop" clause normally stipulates that a target cannot persuade, look for or ask for third party offers for the duration of the offer while providing rules on the situation under which targets may provide information to and confer with a third party that has made known its concerns in a transaction.¹⁰¹²

Delaware courts have ruled out some no-shop provisions and mechanisms including the no-talk provision, which hamper absolutely the ability of the target to provide information to or settle with a third party, and the factors, are no longer distinctive.¹⁰¹³

Commonly negotiated terms

The Non-solicitation provision and the Fiduciary Out are most commonly used provisions of US business agreements in the takeovers. There are a great number of variables to reflect on when judging the provisions to satisfy that a given situation and the parties' requirements. The following is the list of some existing options.¹⁰¹⁴

¹⁰¹²Cohn, Stuart R. "Securities Markets for Small Issuers: The Barrier of Federal Solicitation and Advertising Prohibitions." (1986).

¹⁰¹³Ace Limited. Capital Re (C.A. No. 17488 (Del. Ch. Oct. 25, 1999) and Omnicare Inc. v. NCS Healthcare Inc., 818 A.2d 914 (Del. 2003)

¹⁰¹⁴Babenko, Ilona, et al. "Clawback provisions." (2015).

Conditions to providing information or negotiating with third parties

1. The target company is by law required to obtain advice from outside counsel, written or uttered, that failure to offer information to or confer with a third party would be most likely lead to a violation of the fiduciary duties or may be inconsistent with the fiduciary duties.¹⁰¹⁵
2. The target, therefore, must ensure that some factors in relation to the proposal i.e. realistically are likely to lead to, an increased proposal, in most cases, needed to be based on the recommendation from financial experts.
3. The target must inform the bidder concerning information stipulations to, or in commencing negotiations with the third party.
4. The target must alert the bidder of offers obtained from the third party of details and the timing of providing notices.
5. The target must enter into a discretionary agreement with third party i.e. needed to be no less limiting than in the accord between the bidder and offeree.

Conditions to exercise of fiduciary termination rights or fiduciary right to alter recommendation

1. The target must acquire guidance from external counsel, written or uttered, indicating that the failure to end or modify its proposal would contravene the fiduciary duties.
2. The target company must establish that the greater proposal standard is adhered to.
3. The target company must give prior notice to the bidder concerning termination i.e. advance written notice including terms of the offer.¹⁰¹⁶

¹⁰¹⁵ Ibid p.49

¹⁰¹⁶Rydqvist, Kristian. "Takeover bids and the relative prices of shares that differ in their voting rights." *Journal of Banking & Finance* 20.8 (1996): 1407-1425.

Additional negotiated points

Determination of the fact that the bidder will bear a matching or top right in connection with a Fiduciary Out, including timings and parameters. Similarly, facilitation for payment and training of the termination fee. The situations in which the board of directors can disown its proposals to its shareholders and whether it is capable of acting similarly in the absence of a better proposal.¹⁰¹⁷

Matching or topping rights.

The Delaware law allows the target companies to offer bidders matching or topping rights in relation to a competing bid. In Toys “R” US Shareholder Litigation case, the matching right in inclining towards the preferred bidder specifically with the information in favour of the target’s board.¹⁰¹⁸ These requirements require the target to inform the bidder of the particulars of any third party suggestion, and the bidder is at liberty to match or improve such a proposal.¹⁰¹⁹

Force the vote requirements.

In 2013, the Delaware General Company Law (DGCL) was amended to ensure directors presented a transaction to the shareholders despite the board disagreeing with the proposal. Consequently, transaction agreements can require that the deal is disclosed to the shareholders of the target company, despite the existence of a competing bid and the target company’s directors

¹⁰¹⁷Grossman, Sanford J., and Oliver D. Hart. "Takeover bids, the free-rider problem, and the theory of the corporation." *The Bell Journal of Economics* (1980): 42-64.

¹⁰¹⁸Gompers, Paul, Joy Ishii, and Andrew Metrick. "Corporate governance and equity prices." *The quarterly journal of economics* 118.1 (2003): 107-156.

¹⁰¹⁹Toys “R”Us Shareholder Litigation, 877 A.2d 975 (Del. Ch. June 24, 2005)

disowning the proposals. The “force the vote” provisions may assist the bidder, since they can delay the proposed agreement of an optional transaction. The target company is often incapable of signing an agreement with the contending bidder, hence beginning “the proxy solicitation” and control approval process, at such a time when the shareholders reject the initial deal. As a result, the provisions may call for the target company’s shareholders to select between the transactions at hand, that is available for a short period after the voting, and the prospect of a deal with a higher value in the future. Such a provision may offer contract protection, particularly if the competing, higher bidder offers anti-trust issues.¹⁰²⁰

The efficiency of a “force the vote” stipulation in certain situation is exhibited by the battle between Cnooc and Chevron where the Chinese government supported Oil Company, to take over the control of Unocal. Chevron and Unocal had contracted into a merger accord which endorsed a force the vote provision, providing that Unocal present the Chevron deal to its shareholders. In spite of a significantly higher offer from Cnooc, actually disowned at the time of the vote, the shareholders of Unocal endorsed the Chevron transaction, citing fears that the Cnooc transaction had regulatory downturns, partially since some US government officials were predicting the likelihood of advancing a legislation to block the Cnooc bid.¹⁰²¹

¹⁰²⁰ Kathleen A. Kelley “Significant Amendments To Delaware General Company Law Enacted” August 6 2013 <http://www.mondaq.com/unitedstates/x/256218/Securities/Significant+Amendments+To+Delaware+General+Corporation+Law+Enacted>, accessed 26 April 2016

¹⁰²¹ Ben White “ Chinese Drop Bid To Buy U.S. Oil Firm” August 3, 2005 The Washington Post, <http://www.washingtonpost.com/wp-dyn/content/article/2005/08/02/AR2005080200404.html> accessed 26 April 2016

Shareholder support agreements (voting agreements, options, and others).

In this situation, a bidder generally seeks to develop its chances of success by engaging in an agreement with a significant number of shareholders of the target company, in connection with getting into the transaction contract. Considering the structure of the fundamental transaction, the support agreements may take the form of voting agreements or agreements to tender shares. The bidder is specifically using an enforceable option to acquire the shareholder's shares in the target company, should the shareholder be unsuccessful to fulfil its obligations. The practitioners once considered shareholders' support agreements to be an indisputable means of shielding the underlying transaction. Many cases have called into question how far a bidder can go in using the support accords in concurrence with other mechanisms. In the case of *Ace Limited v Capital Re Group*, the Vice Chancellor Leo Shrine found a severe no-shop provision unenforceable when used in combination with support agreements from the shareholders of 33.5% of the target's shares where the bidder held an extra 12.5% of the target company's shares.¹⁰²² The court ruled that, in the absence of an efficient Fiduciary Out, the support agreements impermissibly prohibited the target company's shareholders from receiving increased optional offers.¹⁰²³

Under *Omnicare Inc. v. NCS Healthcare Inc.*, The Delaware Supreme court prohibited a set of transaction protection mechanisms enclosed within the agreement, which included: supportive agreement from the shareholders of a majority of the shares of the target company. NCS Healthcare, a Delaware company, had been the object of rival bids, one by Genesis Health Ventures and another one by Omnicare. NCS ultimately approved the acquisition by Genesis

¹⁰²² *Ace Limited v Capital Re Group*, 747A.2d95 (Del. Ch. 1999)

¹⁰²³ *Ibid*

Health Ventures and the transaction agreement had the three deal protection mechanisms detailed earlier, that together made the undertaking of the transaction a sure.¹⁰²⁴

The Omnicare case established a combination to be irrationally preclusive, despite NCS had been systematically considered before approving the acquisition by Genesis and the NCS directors had carefully observed corporate formalities. The Omnicare resolution can be defined as meaning acceptance of a rule prohibiting board approval of locked up transactions (even though the entire span of the decision is still open to deliberation). After the decision, practitioners have been involved in including lock-up measures that totally preclude higher bids in transaction agreements governed by Delaware law. Despite all this, shareholders support agreements that do not exclude higher bids, which are still allowed under Delaware law.¹⁰²⁵

6.8 Stake-building

The transaction accord between the bidder and the target company is critically analysed. The span of these provisions is dependent on concession, but bidders will often look for ways of preventing the target company from finding any competing offers, engaging deliberations or negotiations with a third party, or from providing any information to a third party unless Rule 20.2 of the Takeover Code that requires the target company to provide a competing offeror with similar information on the target company disclosed to the earlier bidder, is used. The board of the target company will try to narrow the span of the non-solicitation obligations to safeguard the board's flexibility and defend them against any violations of their fiduciary duties. Realistically,

¹⁰²⁴ Omnicare Inc. v. NCS Healthcare Inc. 818 A.2d 914 (Del. 2003)

¹⁰²⁵ Ibid

no shop and non-solicitation in England transaction agreements tend to be quite short, and do not have as too much scope as non-solicitation agreements in the US merger agreements.¹⁰²⁶

Bidders enhance the possibility of succeeding in their offer by acquiring the shares in the target company. Stake-building is actually a scheme used with increasing success in takeovers in England. However, stake building may not be viable due to reason such as, the fact that adequate shares may not be present and the fact that purchases beyond stated amount must be provided. Provisions of rule 6 states that where a bidder has acquired shares in the target company in a particular time period before the declaration of a firms intent to make a bid, any offer presented by the bidder to the shareholders of a similar level must not be made on less affordable conditions. After making a declaration of a firm intention to present a bid for the target company, the bidder buys shares in the target company at price over the offer price, it is deemed to increase its offer to not less than the uppermost price paid for the shares it has bought.¹⁰²⁷

A bidder, therefore, needs to consider the information it has about the target company before undertaking to acquire the shares in the company apart from the fact of the intention to bid, in a bid to evade committing an unlawful offence under the Criminal Justice Act 1993. This is a civil offence of market abuse extracted from the Financial Services and Markets Act 2000, or to keep away from violating Rule 4 of the City Code.¹⁰²⁸

In addition, Rule 5 of the Code stops the purchase of a stake of 30% or more of the share capital, except if the attainment immediately goes before the announcement of a suggested offer. Rule 9 of the Code needs a bidder to make a compulsory cash offer for the company's share

¹⁰²⁶ The Takeover Code, pp199-200

¹⁰²⁷ The Takeover Code, pp 109-114

¹⁰²⁸ The Criminal Justice Act 1993, the Financial Services and Markets Act 2000 and The Takeover Code, rule 4

capital if it takes over 30% or more of the voting pattern in the target company. Moreover, stake building through open market operations is an intimidating way to starting off negotiations without any prior information hence not recommended the deal.¹⁰²⁹

6.9 Comparison of deal protection mechanisms in the US and England

The major distinctions between deal protection mechanisms in the US and England legal systems as detailed below:

In spite of the prospective span of any non-solicitation obligations, it is arguable that in England, in practice non-solicitation necessities tend to have fewer limitations on the behaviour of English targets and directors in comparison to competing for bid offers. This is as a result of the collaboration of the target company's board being less significant to a contending bidder in England.¹⁰³⁰ It is, however, likely to lock-up a transaction in England by the use of irreversible undertakings, while it is not easier to apply the same in the US, particularly where Delaware law is applicable right after Omnicare. Existences of 'Force the vote' provisions are not applicable to takeovers in England is due to the fact that takeover initiated by way of an offer has to be voted on. Stake-building is often applied in England, but is not a common method in negotiated dealings in the US.¹⁰³¹

In England, deal protection mechanisms are principally governed by the takeover Panel by means of the provisions of the Takeover Code. On the other hand, higher break fees are

¹⁰²⁹ The Takeover Code, rule 5 pp 105-108

¹⁰³⁰ Ibid

¹⁰³¹ Ibid

acceptable in the US as compared to England (almost 4% of the offer value has been mentioned under certain conditions by a Delaware law court, relative to a cap of 1% in England system).

6.10 Difference between the use of takeover defence tactics in England and the US

The use of defence tactics in England and the United States differs depending on the circumstances and the defence in question. For instance, the use of white squire defence in the United States is a prerogative of the Board of Directors but the New York Stock Exchange demands shareholders' approval for listing newly issued stock that exceeds 18.5% of the whole stock. Concerning restructuring the voting rights, the United States does not need shareholder approval when issuing proffered class of shares. In England, there is a need for shareholders' approval concerning issuing of certain voting rights.¹⁰³² The use of poison pills in US is justified by case laws, where it has the main purpose of furthering the company's development and expansion plans. The same defence has not been used extensively in England due to the provisions of the City Code, which prevents target board of directors from granting options over unissued shares of the entity after a bid has been made without shareholders' approval. It appears that the differences in the use of defence tactics in England and the US is based on whether shareholders' approval is needed or the board's decision is final. It therefore, depends on specific defence tactic being used.

¹⁰³² Matsusaka, J. G., & Ozbas, O. (2012). Shareholder empowerment: The right to approve and the right to propose. University of Southern California Law School, California, USA, Law and Economics Working Paper Series, Paper 142

6.11 Conclusion

This chapter has compared the English system of takeover regulation with that of the U.S system. It began with the English position of the takeover defences and this was found to be in two categories. In the first section, the regulation of the takeover defences with particular reference to the Self-Regulatory rules (The Takeover Code), Common Law rules and Statutory and Stock Exchange provisions on takeover defences have been discussed. The second section analysed defence methods such as disclosure of favourable financial information, service agreements or management controls, issuing of block of shares to protect where necessary or friendly holders, defensive merger, purchasing shares in the market and reconstruction of capital among others.¹⁰³³

On the other hand, the US position on the takeover regulations has also been viewed in two sections. In the first part, the regulation of the takeover defences in the Federal law has been exhausted. The second phased engaged in evaluating the both the pre-takeover and post-takeover defence tactics.¹⁰³⁴

In general the both systems laid emphasis on the following issues:

- Protection of a firm's shareholders' rights;
- The duties of the board of directors and their election and demotion;
- The role of the shareholders of a firm;
- Fostering of reasonable takeovers or protecting takeovers

¹⁰³³ Ibid pp.46

¹⁰³⁴ Ibid pp. 40

CONCLUSION

The prevailing mystery as to what factors cause merger waves has not been resolved yet. The number of mergers has been increasing since 1980s. Looking at the history of mergers in the US and England and it has been analysed that every merger had based on a different rationale. The difference in methods of payment, role played by companies involved and dealing types changed the nature of waves. A single explanation will never be sufficient enough to explain the growing existence of merger waves. Furthermore, even in their history, no model, theory or research has ever been able to explain this phenomenon.

Will it ever be possible to devise a model that will be able to explain the excessive growth of merger waves and as to why this is happening? Several models have been developed to explain and analyse the relationship between acquisition and merger activities and the economic growth/decline in the preceding periods. The superseding issue is that all of these models have failed to work outside the market and timeframe over which they were created.¹⁰³⁵ This has compelled researchers to conduct extensive research on acquisition and merger activities over different periods of time. Formulating a hypothesis that every merger does not have a similar reason behind it and that there is no particular mystery behind their development will save countless hours of concentration wasted on the history and nature of merger waves throughout the last century. Furthermore, with time variation comes variation in factors and it is also not necessary for all the characteristics to remain consistent, these change overtime too. Conclusively, economic and legal conditions of a company are the core causes of merger waves.

¹⁰³⁵ Gaughan, Patrick A. *Mergers, acquisitions, and corporate restructuring*. John Wiley & Sons, 2010.

Responding to both internal and external pressures is the responsibility of an entity known as a company.¹⁰³⁶

It is no longer acceptable to address firms by biological analogies but there are many similarities which efficiently explain the general life-cycle of a firm. First of all, a company after being born, struggles to stay alive it goes through the stages of adolescence and then finally becomes mature enough to exist independently. Even after its establishment, sooner or later it has to die. The reason for its death is either natural causes or slow descent because of old age or a predatory firm might become strong enough to absorb it. Acquisition and merger activity acts as a substitute to these options and provides a safe way to transfer assets of the company to another company. The attempt at literature study indicates that companies resort acquisition and merger activities due to economic factors. These companies are believed to react more to external pressures rather than internal ones and it is also believed that the changes in an economy are what pressurise a firm to enter into a market for corporate control. Continuous changing economic conditions are what affect the economic value and opinions of companies. The generated differences of opinions in companies is what leads to an increment in levels of acquisition and merger activity.¹⁰³⁷ This theory works particularly well as a generalised statement in order to implement it in reality, it could be extremely necessary to identify the economic conditions that contribute to the formation of this relationship. Stock markets seem to be a dominant factor that can explain this phenomenon in existing literature on this topic. The rise in share prices is a strong indication that the economy of a country is strengthening.

¹⁰³⁶ Barney, Jay B. "Returns to bidding firms in mergers and acquisitions: Reconsidering the relatedness hypothesis." *Strategic Management Journal* 9.S1 (1988): 71-78.

¹⁰³⁷ Datta, Deepak K. "Organizational fit and acquisition performance: Effects of post-acquisition integration." *Strategic management journal* 12.4 (1991): 281-297.

The strengthening of economy leads to an increment in the profit levels of the many firms. This chain reaction also increases the level of acquisition and merger activities. The main advantage of rise in stock markets is that instigates acquisition and merger activity either by giving the companies a choice to increase finance and profitability by issuing new shares or by giving them a chance to use new shares as the medium of exchange in the deal. If declining interest rates are coupled with the above stated factors then it becomes easy to raise finance and the main roadblock which hinders acquisition and merger activity is removed.¹⁰³⁸

However, it must also be noticed that how easily these advantages overrule the fact that the target firm's market price will also face an elevation due to rising share prices. The overall size of an economy is a factor that cannot be neglected while determining the level of acquisition and merger activity. These sorts of deals are easier to make in a large economy. It is easier to find a company of the same level for an acquisition or merger when considering entering into the market for corporate control. There are noticeable differences between the levels of activities in various industries when considering the behaviour of the market for corporate control.¹⁰³⁹ The time to conduct acquisition/merger is industry specific is a fact that cannot be overlooked. These patterns vary with the shocks that industries receive and these shocks result in changes in economic/regulatory conditions. It becomes a necessity for an industry to make changes to survive when a sizeable shock is received. In numerous situations these acquisition and merger activities are the fastest way to respond and many times prove to be cheaper than any other alternatives to it. The important stipulation to all of these theories forming a relationship between

¹⁰³⁸ Bruton, Garry D., Benjamin M. Oviatt, and Margaret A. White. "Performance of acquisitions of distressed firms." *Academy of Management Journal* 37.4 (1994): 972-989.

¹⁰³⁹ Ibid 3

economic factors and the level of acquisition and merger activity is that a common assumption has been made that external factors seem to dominate internal factors and indeed based on these external factors decisions within the firms are made.¹⁰⁴⁰ This case might be true the majority of times but there will be instances where internal factors will either instigate the entry of a firm into the market for corporate control or will either disallow it. More challengingly, whilst these theories prove to be effective/efficient within the data sets they are constructed, they do not show the same behaviour and accuracy when implemented in other data sets.¹⁰⁴¹

Despite the availability of the defence tactics for avoiding acquisitions and mergers of corporate entities, in most cases, the acquiring company being very powerful, the defence tactics do not seem to have any positive impact on a proposed acquisition and merger of corporate entities. In England, the provisions for the protection of minority shareholders in the Companies Act, 2006, provide such shareholders an opportunity to resist acquisitions and mergers, but examples of “squeezing out” are also available.

The Takeover Panels in England seem to be more concerned with the issue of whether the required procedures for acquisitions and mergers have taken place rather than the over-use of the financial muscles of the acquiring company. As explained in this research that the social issues, namely, the consequential unemployment of a large number of employees do not seem to have receive much attention during an acquisition and merger process.

In this context it should be pointed out that the hypotheses laid in the Introduction to this research have been confirmed. Furthermore, by studying the acquisition and merger processes in both England and the US, it may be observed that neither the Panels nor the business community

¹⁰⁴⁰ Shaw, Richard A. "Merger and Acquisition Strategies." *Atlanta. Law. Review.* 34 (1995): 630.

¹⁰⁴¹Cartwright, Sue, and Cary L. Cooper. "The psychological impact of merger and acquisition on the individual: A study of building society managers." *Human relations* 46.3 (1993): 327-347.

pays much attention to the issue of corporate social responsibility in effecting acquisitions and mergers.

This research also identified the existing legal regimes in both the jurisdictions, but the irony is that on balance, all the jurisdictions also have very elaborate legislation promoting acquisitions and mergers. Thus, it is also suggested that the adverse social effect of acquisitions and mergers and the issue of protecting the interests of minority shareholders be considered by all the jurisdictions discussed in this research be paid very serious consideration by them.

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