

**DEAL STRUCTURE AND MINORITY SHAREHOLDERS**  
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*COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES* (eds. Umakanth Varottil and Wan Wai Yee) (Cambridge University Press forthcoming 2016)

## Introduction

Takeover transactions are often the most significant activity affecting corporations and their shareholders. Accordingly, there are intense debates about the value and impact of takeovers and the extent to which law should regulate such transactions. One area of focus for takeover regulation has been the potential impact of takeovers on minority shareholders. The focus on minority shareholders is not surprising as research suggests that laws which protect minority shareholders are associated with stronger financial markets.<sup>2</sup>

This chapter discusses three methods of effecting a takeover, focusing on tender offers, schemes of arrangement, and triangular mergers, and assesses both the theoretical and empirical literature on their impact on minority shareholders of bidders and targets. The chapter primarily focuses on how two common law jurisdictions, the United States (“US”), the United Kingdom (“UK”), govern such transactions. In each jurisdiction, law makers, regulators and courts have attempted to address the potential for harm to minority shareholders under various deal structures. At times, regulators have arrived at different sets of rules for different types of transaction structures. These rules often provide different rights for shareholders of bidders and targets, and vary among various transaction structures, even when economically similar transactions are undertaken.

This chapter chronicles the use of regulatory and judicial tools to address the rights of minority shareholders under each particular structure in the US

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<sup>2</sup> For some of these studies, see R. La Porta, F. López-de-Silanes, A. Shleifer & R. Vishny, *Corporate Ownership Around the World*, 54 J. Fin. 471 (1999); R. La Porta, F. López-de-Silanes, A. Shleifer & R. Vishny, *Law and Finance*, 106 J. Pol. Econ. 1113 (1998); R. La Porta, F. Lopez-de-Silanes & A. Shleifer, *What Works in Securities Laws?* 61 J. Fin. 1 (2006); J. Armour, B. S. Black, B. R. Cheffins, and R. Nolan, ‘Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US’, *Journal of Empirical Legal Studies*, 6 (2009), 687.

and UK. An important regulatory concern in designing laws to govern various deal structures is how to balance shareholder interests with the costs of the legal requirements imposed. What is clear is that the US and UK have arrived at different tools to address minority shareholder rights in each of these transactions. While the UK takeover regime focuses primarily on ex ante regulation, the US system uses some ex ante regulation but focuses primarily on ex post policing through the courts.<sup>3</sup>

What is less clear and needs further empirical enquiry is which of the tools used in the US and UK regimes better protect minority shareholders. To date there have been few studies that empirically evaluate the differences between the US and UK rules. Nevertheless, a few insights are suggested by the empirical research chronicled in this paper. First, despite the differences in each jurisdiction's regime, target shareholders gain in takeover transactions in both jurisdictions, and in the US regime these gains are higher in tender offers than in mergers. Second, recent research suggests that the UK's takeover rules better protect bidder shareholders in large transactions than US regulation which largely deprive bidder shareholders a role in acquisition transactions. Finally, the research on US transactions suggests that different regulatory treatment of economically similar acquisition structures may make a difference to minority shareholders.

This chapter proceeds as follows. Part I provides a brief introduction of each deal structure, while the following parts delve into the key differences in each jurisdiction's laws. Part II discusses the legal regime governing the two most commonly-used acquisition methods in the US—tender offers and triangular mergers. The legal rules governing these two acquisition structures differ significantly in the US, as do the degree of protection the law provides in each of these structures for minority shareholders of bidders and targets. Part III addresses the UK, focusing on schemes of arrangement and takeover bids. UK law tends to be much more shareholder centric than US law, although UK minority shareholders are afforded somewhat less protection in schemes of arrangement than in takeover bids. Part IV then provides an overview of the empirical literature on takeovers, and summarizes the literature that seeks to empirically test the potential effects of takeover laws on minority shareholders under the rules applicable to different acquisition structures. The chapter concludes by addressing the implications for takeover regulation of the differences in legal regimes governing takeovers and of the findings from the empirical literature discussed in Part IV.

## **Part I. Effecting a Corporate Takeover: A Comparative**

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<sup>3</sup> R. Kraakman, et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2nd ed (Oxford: Oxford University Press, 2009), 199-203.

## Perspective

Deal makers can use a variety of structures to effect a takeover transaction—i.e. the transfer of control and ownership of an entire corporate entity. Before addressing the nuances of US and UK takeover law, this section provides a brief overview of the most commonly-used structures—tender offers, schemes of arrangement and triangular mergers. The tender offer structure is used in both the US and the UK, although the rules governing this structure are quite different with respect to minority shareholder rights. The US merger structure and the UK scheme of arrangement structure are similar types of transactions; however the two jurisdictions' rules vary with respect to this structure as well.<sup>4</sup>

Although the UK and the US have developed from a common legal tradition, corporate and securities laws in each jurisdiction differ significantly.<sup>5</sup> The US employs a federal system where corporate law is governed primarily by state legislation and state courts, and securities law is primarily administered by the federal Securities and Exchange Commission (“SEC”), with room for development by federal courts through case law.<sup>6</sup> In the US, tender offers are mainly regulated by the SEC, with fiduciary law issues addressed in state courts. Meanwhile, merger transactions remain primarily the domain of state corporate law. The UK has statutory corporation law with some room for court-developed standards.<sup>7</sup> The UK regulatory system for tender offers is self-regulated, i.e. a market-based structure, and is generally not enforced by courts.<sup>8</sup> Schemes of arrangements, on the other hand, are governed by a combination of company law and judicial oversight.

**Tender Offers.** A tender offer is a solicitation by the bidder to purchase all or a substantial percentage of a target's shares. The offer is usually conducted in a limited period of time, set at a fixed price at some premium over market price, and is typically contingent on shareholders tendering in a

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<sup>4</sup> With respect to the US, this chapter's corporate law discussion focuses on Delaware law. Delaware is the leading state for U.S. corporate law, and the national leader for new and existing companies. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 6–8 (1993). A majority of public company acquisition agreements are governed by Delaware law, and the Delaware courts are widely recognized as having an experienced and sophisticated judiciary along with well-developed corporate case law. See M. D. Cain and S. M. Davidoff, 'Delaware's Competitive Reach', *Journal of Empirical Legal Studies*, 9 (2012), 92.

<sup>5</sup> For an overview of comparisons between the US and the UK, see C. M. Bruner, *Corporate Governance in the Common-Law World* (Cambridge University Press, 2013).

<sup>6</sup> R.S. Karmel, 'Transnational Takeover Talk-Regulations Relating To Tender Offers And Insider Trading In The United States, The United Kingdom, Germany, And Australia', *University of Cincinnati Law Review*, 66 (1998), 1133.

<sup>7</sup> Karmel, 'Transnational Takeover', 1133.

<sup>8</sup> Armour et al., 'Private Enforcement of Corporate Law', 694-695.

fixed number of shares.<sup>9</sup> Tender offers are a form of a takeover bid, and may be friendly or hostile. Unlike a merger transaction, in a tender offer the bidder can bypass the target's board and approach target shareholders directly. Shareholder action in this case involves the individual decision to sell shares rather than voting to approve the transaction.<sup>10</sup>

Not all shareholders may tender in their shares in response to an offer, especially if the target is publicly-traded. Often, however, the bidder desires to eliminate the outstanding minority shares by acquiring the remaining target shares that the bidder does not own. In the US, a second step squeeze-out merger is done so that the bidder can obtain full ownership of the target. Essentially the transaction involves “two formal steps – bid plus squeeze-out – that produce the same result as a reverse triangular merger or scheme of arrangement.”<sup>11</sup> In the UK, however, two-step transactions are prohibited, although UK takeover regulation does in certain circumstances allow a squeeze-out transaction.

***Triangular Mergers.*** One of the simplest methods to effect a takeover transaction in the US is through a statutory merger. Every US state provides for a merger so long as statutorily required steps and formalities are completed.<sup>12</sup> Unlike tender offers, in a merger the bidder must deal directly with the target's board. In order to validly consummate a merger, board approval from each constituent (combining) corporation is necessary. Following board approval, the transaction must be submitted to the shareholders of each constituent corporation (with exceptions as discussed in Part II below) for their vote (most often a majority of the outstanding voting stock).<sup>13</sup> Once all regulatory and shareholder approvals are received, upon closing of the merger, shareholders will have their stock in the constituent corporations converted into the right to receive the merger consideration. State statutes provide a lot of flexibility regarding the type of consideration that can be used in a merger, for example, cash, stock of the buyer, or a combination of cash and stock.<sup>14</sup> Once the deal closes, typically one corporation is deemed the surviving corporation.

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<sup>9</sup> U.S. Securities and Exchange Commission, *Tender Offer*, [www.sec.gov/answers/tender.htm](http://www.sec.gov/answers/tender.htm) (last accessed 15 April 2015).

<sup>10</sup> F.H. O'Neil and R.B. Thompson, *Oppression Of Minority Shareholders And LLC Members*, rev edn, 2 vols. (Thomson Reuters, 2014), vol. I, section 5:26.

<sup>11</sup> J.C. Coates IV, 'Mergers, Acquisitions, and Restructuring: Types, Regulation, And Patterns Of Practice', in *Oxford Handbook on Corporate Law and Governance* (Oxford University Press, 2015), 5.

<sup>12</sup> Coates, 'Mergers, Acquisitions, and Restructuring', 16.

<sup>13</sup> See T. H. Maynard, *Mergers and Acquisitions*, 3 (2013), 41. Many states, including Delaware, also allow for a short-form merger without the consent of target shareholders when the bidder is already a controlling stockholder of the target with 90% or more of the target's voting rights.

<sup>14</sup> Maynard, *Mergers and Acquisitions*, p. 45.

The acquisition of public companies in the US uses the aforementioned statutory merger in a triangular form. In a triangular merger, one corporation that is “combining” through the statutory merger process is a newly created shell corporation that is wholly-owned by the bidder.<sup>15</sup> The bidder’s wholly-owned subsidiary is then capitalized with the consideration to be used in the takeover (for example, the cash to be issued as acquisition consideration). The statutory merger then occurs between the target and this wholly-owned subsidiary. A triangular merger may be forward (i.e., where target merges with and into bidder’s merger subsidiary, with the subsidiary as the surviving entity) or reverse (i.e., where bidder’s merger subsidiary merges with and into target, and target becomes a wholly-owned subsidiary of bidder). Following the merger, the surviving entity—either the acquisition subsidiary in a forward triangular merger or the target in a reverse triangular merger—becomes a wholly owned subsidiary of the bidder.

**Schemes of Arrangement.** A scheme of arrangement is a flexible tool that can be used to reorganize a company’s capital.<sup>16</sup> The UK Companies Act defines a scheme of arrangement as: “[a] compromise or arrangement between a company and its creditors, or any class of them, or its members, or any class of them.”<sup>17</sup> The broad statutory language means that schemes can address any subject matter so long as the parties properly agree to the scheme and obtain requisite approvals. Schemes can be used as an alternative to a takeover bid, and “have become the structure of choice for recommended bids” in the UK.<sup>18</sup>

The UK scheme can be used to achieve the same results as the US triangular merger. Similar to a triangular merger, when a scheme is used as an alternative to a takeover bid, the relationship is not between the bidder and the shareholders, but is between the bidder and the target company.<sup>19</sup> Because a scheme is a corporate action of the target, the process is controlled by the target board and thus must be friendly. Also like triangular mergers, shareholder voting is required from target shareholders. The scheme must receive 75 percent supermajority approval of the shareholders present and voting from each class of shareholders affected by the scheme. Moreover, following shareholder approval, the target must seek court approval of the scheme and the court must be satisfied with “the procedural fairness of the

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<sup>15</sup> Coates, ‘Mergers, Acquisitions, and Restructuring’, 17

<sup>16</sup> J. Payne, *Schemes of Arrangement: Theory, Structure, and Operation*, (Cambridge University Press, 2014), 1-2. Schemes of arrangement are permitted and codified in Part 26 of the Companies Act 2006, Sections 895-899.

<sup>17</sup> Companies Act 2006, S. 895.

<sup>18</sup> J. Payne, ‘Schemes Of Arrangement, Takeovers And Minority Shareholder Protection’, (2011a) *Journal of Corporate Law Studies*, 67-68.

<sup>19</sup> Practical Law, ‘Public mergers and acquisitions in the UK (England and Wales): overview’, 2.

class representation and voting.”<sup>20</sup>

While these three types of acquisition structures can be used to achieve “economically identical (or highly similar)” results, as discussed in Parts II and III below, the legal treatment and rules governing these transactions can vary significantly in each jurisdiction.<sup>21</sup>

## Part II. Triangular Mergers and Tender Offers in the US

Takeovers of US public companies are often accomplished through one of two structures—a one-step triangular merger, or a two-step transaction which involves a tender offer followed by a merger.<sup>22</sup> Target shareholders are provided a say under both structures, either through a vote or through the decision to sell their shares. In addition, target shareholders can seek access to courts to address any harm they have suffered.

US law, however, does little to address harm to bidder’s shareholders. The failure to address the rights of bidder shareholders is perplexing as “a bad deal—whether the failure is rooted in the concept [i.e., the ‘logic of the deal,’ that is, the business justification for the proposed acquisition], the price, or the execution—is probably the fastest legal means of destroying [the company’s value].”<sup>23</sup> Nevertheless, US corporate law generally excludes bidder shareholders from any decision-making role in acquisitions. Moreover, bidder shareholders cannot meaningfully seek any redress through the courts.

In the context of either structure, one important area of concern with respect to target minority shareholder protection is the regulation of squeeze-out transactions, i.e. transactions whereby controlling stockholders or insiders take the firm private.<sup>24</sup> In setting the rules for squeeze-outs, courts and legislatures have long struggled with designing rules that are fair and efficient in protecting controlling stockholder bidders from free-riding minority shareholders, while at the same time protecting minority shareholders from abusive or opportunistic transactions. As discussed below, in the US there are strong disclosure rules to address squeeze-out transactions, but the formal rules under state corporate law and federal

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<sup>20</sup> Armour et al., ‘Private Enforcement of Corporate Law’, 720.

<sup>21</sup> Coates, ‘Mergers, Acquisitions, and Restructuring’, p. 7.

<sup>22</sup> Coates, ‘Mergers, Acquisitions, and Restructuring’, 4-5.

<sup>23</sup> Ken Smith, *The M&A Buck Stops at the Board*, MERGERS & ACQUISITIONS: DEALMAKER’S J., Apr. 2006, at 48, 49, available at 2006 WLNR 5570070. Various empirical studies on the overall return to acquisitions find that such deals may lead to destruction of value, particularly for bidder shareholders who suffer significant losses. For a detailed discussion of this bidder overpayment problem, see generally A. Afsharipour, ‘A Shareholders’ Put Option: Counteracting the Acquirer Overpayment Problem’, *Minnesota Law Review*, 96 (2012), 1018.

<sup>24</sup> For further discussion of consolidating offers, see Paul Davies, ‘The Transactional Scope of Takeover Law in Comparative Perspective’, in Umakanth Varottil and Wan Wai Yee (eds.), *Comparative Takeover Regulation*, Cambridge University Press (forthcoming).

securities laws protecting shareholders against underpriced squeeze-outs are not particularly strong. Thus, in many ways, minority shareholders are left having their real option be accessing the courts in either appraisal or fiduciary duty litigation.

### **A. Triangular Mergers under State Corporate Law**

Over the past several decades, the triangular merger structure has emerged as one of the most popular—if not the most popular—acquisition structure. In a triangular merger, the statutory direct merger requirements apply to the constituent corporations (the shell and target) rather than the bidder and target. In addition to board approval of the transaction, mergers involve shareholder approval of the merging entities. Under Delaware General Corporation Law (DGCL) Section 251(c) a majority of the outstanding shares of each constituent corporation must vote to approve the merger. Public-company triangular mergers often require the target to solicit the vote by preparing and disseminating the extensive disclosures required by the federal proxy rules.

Furthermore, Delaware law provides the voting shareholders with appraisal rights, subject to a market-out exception which eliminates appraisal rights when the target is a listed on a national exchange. However, such elimination does not apply where target shareholders are required to accept merger consideration that consists of anything other than stock in either the surviving corporation or stock of some other corporation with publicly traded shares. Thus, target shareholders generally have both voting and appraisal rights if the consideration consists of cash or some combination of cash and stock.

The rights of bidder shareholders are generally not considered under state corporate law when the triangular structure is used. In fact, for transaction planners, the triangular merger form achieves two important goals: it deprives the bidder's shareholders of (1) voting rights and (2) appraisal rights.<sup>25</sup> Under DGCL Section 251(c), only shareholders of a “constituent” corporation are entitled to vote on the transaction, and under Section 262(b)(2), appraisal rights are similarly available only to voting shareholders of a “constituent” corporation to the merger.<sup>26</sup>

For public-company bidders that use their own stock as acquisition consideration, the ability to avoid the vote of bidder shareholders is somewhat limited. First, if bidder does not have sufficient authorized and

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<sup>25</sup> K.C. Cannon and P.J. Tangney, ‘Protection Of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders As Residual Claimants And Maximizing Long-Term Share Value By Restricting Directorial Discretion’, *Columbia Business Law Review*, 1995, 762. The triangular merger also has several other benefits related to successor liability, tax and accounting issues.

<sup>26</sup> DELAWARE GENERAL CORPORATION LAW §§ 251(c), 262(b)(2) (West 2014).

unissued shares, it will need to obtain a shareholder vote to amend its charter to authorize additional shares. This vote is a “de facto referendum on the deal” since “shareholders will be voting on the amendment with full knowledge that the amendment is necessary to effect the deal as structured.”<sup>27</sup> Second, the use of bidder shares may trigger shareholder voting rights under stock exchange rules that require a shareholder vote in transactions where the bidder issues stock amounting to more than 20% of its outstanding shares.<sup>28</sup> Neither of these circumstances would provide appraisal rights under state law to bidder shareholders.

Bidders can structure transactions to avoid triggering the above-described shareholder votes. In addition to using cash instead of shares to avoid share authorization requirements, in transactions where bidder shares are used, the acquisition agreement often provides that no more than 19.9% of issued and outstanding bidder shares will be issued as acquisition consideration.<sup>29</sup> Avoiding the vote for bidder shareholders has other repercussions. While bidders will communicate with their shareholders about the transaction through other means, such as press releases or analyst calls, these communications are far less detailed than the extensive disclosure required by the proxy rules, particularly with respect to the bidder’s motivations for undertaking the deal and the expected impact on the company moving forward.<sup>30</sup>

## **B. Tender Offers in the US**

In the US, takeovers of public companies using the two-step structure involve both federal law which regulates tender offers and state law which governs the second step merger.

### **1. Tender Offer Regulations under Federal Securities Laws**

The Williams Act, which is codified in Sections 13(d) and 14(d)(1) of the Securities Exchange Act of 1934, regulates tender offers.<sup>31</sup> The Williams Act seeks to protect investors through disclosure and procedural protections that

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<sup>27</sup> S. Bainbridge, *How and Why Kraft is Evading Shareholder Voting in the Cadbury Deal*, PROFESSORBAINBRIDGE.COM (Jan. 21, 2010, 11:27 AM) [www.professorbainbridge.com/professorbainbridgecom/2010/01/evading-shareholder-voting-in-a-merger.html](http://www.professorbainbridge.com/professorbainbridgecom/2010/01/evading-shareholder-voting-in-a-merger.html).

<sup>28</sup> Afsharipour, ‘A Shareholder’s Put Option’, 1046-1047.

<sup>29</sup> Afsharipour, ‘A Shareholder’s Put Option’, 1046-1047.

<sup>30</sup> If the bidder is purchasing a private-company target—without a shareholder voting requirement—it may largely avoid the minimal disclosure requirements under the SEC’s 8-K rules. See U. Rodrigues and M. A. Stegemoller, *An Inconsistency in SEC Disclosure Requirements? The Case of the ‘Insignificant’ Private Target*, 13 J. CORP. FIN. 251, 252 (2007).

<sup>31</sup> For an overview of the history of the Williams Act, see C. M. Sautter, *Tender Offers and Disclosure: The History and Future of the Williams Act*, in *Research Handbook on Mergers and Acquisitions*, Steven Davidoff Solomon and Claire Hill, eds., Edward Elgar Publishing (Forthcoming 2016), available at <http://ssrn.com/abstract=2697755>.

aim to provide equal or fair rights to shareholders to participate in a tender offer.<sup>32</sup> Both bidders and targets must file extensive disclosure documents with the SEC.<sup>33</sup> The rules promulgated by the SEC pursuant to the Williams Act provide considerable procedural protections for target shareholders. In addition, the disclosures provided pursuant to the Williams Act provide shareholders information on which a fiduciary duty or appraisal lawsuit can be based.

The Williams Act was in large part intended to protect minority shareholders. When proposing tender offer legislation, Senator Harrison Williams described tender offers as “raids” and expressed concern for the plight of minority shareholders.<sup>34</sup> Senator Williams was worried that in the course of a tender offer, the offeror would pay a premium for a “working majority” of the shares and proceeds to loot the firm, thus harming minority shareholders.<sup>35</sup>

Williams Act rules include several important procedural protections for target shareholders. For example, under Rule 14e-1 the bidder must keep the offer open for twenty days. In addition to the 20-day offering period, target shareholder have the right to withdraw their shares at any point during the offering period so as to allow shareholders “substantial opportunity to change their minds, especially if a better offer comes along.”<sup>36</sup> Moreover, if purchasing less than all of the outstanding shares, the bidder must purchase a pro rata amount of the shares of each shareholder who tenders her shares so that an equal opportunity is given to all tendering shareholders to cash in their shares. Most importantly, a central tenet of tender offer regulations is the “Best Price” rule which requires that the bidder pay to all shareholders the highest price paid to any shareholder in the course of the tender offer meaning that if the bidder increases its offer price during the offering period, it must pay the increased amount to any shareholder who has previously tendered shares into the bid.

In addition to the requirements applicable to all tender offers, Rule 13e-3 imposes significant disclosure obligations in controlling shareholder squeeze-

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<sup>32</sup> J.E. Fisch, ‘Imprudent Power: Reconsidering U.S. Regulation Of Foreign Tender Offers’, *Northwestern University Law Review*, 87 (1993), 526. The extensive disclosure requirements of the Williams Act have long been the subject of heated debate. *See generally* Sautter, *supra* note X.

<sup>33</sup> Securities and Exchange Act § 14(d) - (f); SEC Regulations 14D and 14E; Schedule TO. For an overview of such disclosure obligations, *see* S. M. Bainbridge, *Mergers and Acquisitions*, 3<sup>rd</sup> Ed. (Foundation Press 2012), 209-220.

<sup>34</sup> 111 Congressional Record 28257-58 (1965)

<sup>35</sup> F.H. Easterbrook and D.R. Fischel, ‘The Proper Role Of A Target’s Management In Responding To A Tender Offer’, *Harvard Law Review*, 94 (1981), 1184-85. *See also* Davies, ‘The Transactional Scope of Takeover Law in Comparative Perspective’, p.x., regarding further discussion of Saturday Night Specials.

<sup>36</sup> Bainbridge, *Mergers and Acquisitions*, p. 216.

outs.<sup>37</sup> Under Rules 13e-3, controlling shareholders in a going-private transaction must provide detailed information on the terms of the transaction, including the purpose of the transaction, any source of funds, and why alternative methods for achieving the same purpose were rejected, as well as the post-transaction plans of the parties. Parties must also include “a fairly extensive description of the fairness of the transaction.”<sup>38</sup> The SEC adopted these extensive disclosure rules in order to lessen the likelihood of abuse of minority shareholders, stating:

. . . The nature of and methods utilized in effecting going private transactions present an opportunity for overreaching of unaffiliated security holders by an issuer or its affiliates [i.e., controlling shareholder(s)]. This is due, in part, to the lack of arm’s length bargaining and the inability of unaffiliated security holders [i.e., minority shareholders] to influence corporate decisions to enter into such transactions. Additionally, such transactions have a coercive effect in that [minority shareholders] confronted by a going private transaction are faced with the prospects of an illiquid market, termination of the protections under the federal securities laws and further efforts by the proponent to eliminate their equity interest.<sup>39</sup>

The Williams Act disclosures support target minority shareholders’ efforts to protect their interests through various legal challenges to the deal, including claims for appraisal rights, breach of directors’ or controlling stockholders’ fiduciary duties or disclosure violations of federal securities laws.<sup>40</sup>

While shareholders of the target have layers of protection in tender offer transactions, bidder shareholders in general have little protection under federal or state corporate law. The Williams Act does not contemplate a role for bidder shareholders. Similarly, under Delaware law, there is no statutory requirement for bidder shareholders to have a vote in a tender offer transaction. Moreover, if the bidder is using cash or less than 20% of its outstanding stock as the acquisition currency, then the stock exchange rules necessitating a shareholder vote would not apply.<sup>41</sup>

## **2. Why Tender Offers?**

Despite involving two steps, tender offers can be more attractive than triangular mergers due to their speed. A 2015 study by Offenber and Pirinsky studies the choice between US mergers and tender offers and finds

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<sup>37</sup> T.H. Maynard, *Mergers and Acquisitions* 434, 3 (2013), 765-766.

<sup>38</sup> Maynard, *Mergers and Acquisitions*, 434.

<sup>39</sup> SEC Release No. 34-17719 (April 13, 1981).

<sup>40</sup> Marco Ventoruzzo, ‘Freeze-Outs: Transcontinental Analysis and Reform Proposals’, *Virginia Journal of International Law*, 50 (2010), 841, 854.

<sup>41</sup> See NASDAQ, NASDAQ STOCK MARKET RULE 5635(a)(1)(B) (2011); NYSE, LISTED COMPANY MANUAL § 312.03(c)–(d) (2011).

that tender offers are both more likely to be completed and to have a shorter time toward completion than mergers.<sup>42</sup> They find that since a tender offer will not require a proxy statement filing and a shareholder vote from target shareholders, two-step deals on average close 73 days faster than traditional mergers. This faster completion time reduces the chance of a topping bid from a rival bidder.

In order to achieve the efficiencies connected with completing the deal more quickly, until recently bidders would often condition the offer on obtaining 90% voting control so as to be able to execute the second step merger without a vote of the remaining minority.<sup>43</sup> If bidders were unable to obtain this 90% threshold, they would devise remedies in the acquisition agreement, like the use of top-up options, to reach the 90% threshold. Otherwise, bidders would be forced to undertake an expensive long-form merger process which would require preparing, filing and disseminating a proxy statement and holding a stockholders meeting, even though the result of such meeting and voting was essentially a foregone conclusion. The need for such a process was often the source of frustration for transaction planners.

Since 2013, tender offers have become even more attractive as Delaware law changed to permit the use of a second-step merger transaction without the vote of the remaining shareholders under certain circumstances. Specifically, DGCL Section 251(h) permits a second-step merger without a shareholder vote when following a tender offer the buyer owns a sufficient percentage of the shares (usually a simple majority of the outstanding shares) of its publicly held target as would be necessary to approve the merger agreement under Delaware law and the target's charter.<sup>44</sup> Hence, bidders will usually be able to effectuate a two-step tender offer quickly with only 50% shareholder tender. While controlling stockholders were initially excluded from using section 251(h), this exclusion was eliminated in 2014 so that stockholders owning 15% or more of the target's stock may now take advantage of section 251(h).<sup>45</sup>

In part to provide minority shareholders the same protection that they would have had under the traditional two-step merger transaction, Section 251(h) imposes several requirements on the transaction. Not only must the

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<sup>42</sup> D. Offenberger and C. Pirinsky, 'How do acquirers choose between mergers and tender offers?', 116(2)(2015), *Journal of Financial Economics*, 331-348.

<sup>43</sup> O'Neil and Thompson (2014), section 5:26. In a short form merger, fiduciary duty litigation will fail, leaving minority shareholders with appraisal as the sole remedy. In *Glassman v. Unocal Exploration Corp.* (777 A.2d 242 [Del. 2001]), the Delaware Supreme Court held that a short-form merger is not subject to entire-fairness review.

<sup>44</sup> Delaware General Corporation Law, Section 251(h).

<sup>45</sup> See Cahill, *Certain Recent Amendments to Delaware Law Affecting Mergers and Acquisitions*, August 7, 2014.

acquisition agreement affirmatively opt to be governed by 251(h), but the agreement must require the second-step merger to occur as soon as practicable following completion of the first-step tender offer. Accordingly, the acquisition consideration will be available to non-tendering stockholders soon after the offer closes. In addition, Section 251(h) requires that (i) the first-step tender offer be for “any and all” of the target’s outstanding stock that, absent Section 251(h), would be entitled to vote on the merger, (ii) the tender offer be made on the terms provided for in the merger agreement signed and disclosed to shareholders, and (iii) the consideration paid in the second-step merger be the same as that paid in the front-end tender offer. Most importantly, target shareholders are provided appraisal rights in Section 251(h) transactions. The Delaware legislature also noted that while Section 251(h) offers an efficient way to effect a two-step transaction, it “does not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that will apply to the decision to enter into such a merger agreement, each of which will be determined based on the common law of fiduciary duty, including the duty of loyalty.”<sup>46</sup>

As expected, Section 251(h) transactions have become quite popular. Reports indicate that almost all two-step tender offers after 251(h) became effective have opted into the 251(h) scheme.<sup>47</sup> In addition, a recent study found an increase in tender offers for Delaware target companies acquired after 251(h) came into effect.<sup>48</sup>

The study by Boone, Broughman and Macias also sheds light on whether the lower authorization threshold brought into effect by Section 251(h) affects bidder and target shareholders. The study finds that target shareholders do not appear to be harmed by the passage of Section 251(h) as “acquisition premiums and target cumulative abnormal returns are significantly higher and deal completion times significantly faster for Delaware targets after passage of the new law” versus targets incorporated in other states.<sup>49</sup> Moreover, bidder shareholders do not appear to be harmed by 251(h) transactions as the study finds “that bidders’ cumulative abnormal returns are significantly higher and bidders capture a larger relative share of the combined gains when acquiring a Delaware corporation after passage of 251(h).”<sup>50</sup> The authors posit that their finding that both groups of shareholders appear to benefit from Section 251(h) “suggests that the parties are able to choose a more efficient deal structure when the threat of holdup is

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<sup>46</sup> H.B. 127, 147th Gen. Assembly, 79 Del. Laws, c. 72, § 6 (2013).

<sup>47</sup> See, e.g., C. Sanchez, E. Razzano and L. McGurty, *Tender Offers: Past, Present and Future – The Evolution of Section 251(h)*, Paul Hastings: Stay Current (May 2014).

<sup>48</sup> See A. Boone, B. Broughman and A. Macias, *The Cost of Supermajority Target Shareholder Approval: Mergers versus Tender Offers* (January 13, 2016), Indiana Legal Studies Research Paper No. 331, available at <http://ssrn.com/abstract=2629424>.

<sup>49</sup> Boone et al., *The Cost of Supermajority Target Shareholder Approval*, p.4.

<sup>50</sup> Boone et al., *The Cost of Supermajority Target Shareholder Approval*, p.4.

reduced.”<sup>51</sup> In addition, they argue that Section 251(h) does not appear to have increased the likelihood of managerial opportunism, but caution that in Delaware shareholders of the target “have several layers of protection such as fiduciary obligations, appraisal, competition from rival bidders, and securities fraud penalties that reduce the need for supermajority shareholder approval.”<sup>52</sup>

### **C. The role of the courts in protecting minority shareholders**

Theoretically minority shareholders may experience harm in either tender offers or triangular mergers. There are generally two common concerns in the tender offer context. First, in the event the bidder proposes a tender offer for less than all the target’s outstanding shares, holdout minority shareholders may experience coercion to tender their shares (i.e., the well-documented “stampede effect”).<sup>53</sup> Second, if the bidder is a controlling stockholder, a tender offer may be an attractive acquisition structure through which the controller can squeeze-out the minority. In triangular deals, there is concern that the target’s minority shareholders will be offered less than the fair value of their shares if the majority votes in favor of the sale transaction.

Given these concerns, the Delaware courts play an important policing role in regulating the parties’ behavior. In both one-step and two-step transactions, target minority shareholders generally have access to two methods of protection, exercising appraisal rights and fiduciary duty litigation. While these two avenues provide some protection for target minority shareholder, for minority shareholders of the bidder, both of these avenues provide little recourse. As discussed in Part A, triangular transactions would not afford bidder shareholders any appraisal rights. In addition, bidder shareholders are generally unable to use fiduciary litigation as a tool for holding majority shareholders or the board accountable.

#### **1. Appraisal Rights**

In certain types of takeovers, appraisal rights have been made available under US state corporate law in order to protect dissenting minority shareholders of the target. Appraisal is not available in every type of acquisition transaction. For example, in a reverse triangular merger where the target is listed on a national exchange and its shareholders receive only public company stock of the bidder as the deal consideration, appraisal rights are not available. For purposes of the two types of transactions discussed in this chapter, in both triangular mergers where the acquisition consideration consists of cash or a combination of cash and stock, and in two-step transactions (i.e. tender offer followed by a back end merger under DGCL

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<sup>51</sup> Boone et al., *The Cost of Supermajority Target Shareholder Approval*, p.4.

<sup>52</sup> Boone et al., *The Cost of Supermajority Target Shareholder Approval*, p.26.

<sup>53</sup> O’Neil and Thompson (2014), section 5:26.

Sections 251, 253 or 251(h)) dissenting minority shareholders have the right to seek appraisal.<sup>54</sup> When shareholders are provided appraisal rights, they can refuse to accept the consideration offered in the deal and instead seek out the courts to determine the “fair value” of their shares.

Appraisal has long been seen as a somewhat limited remedy given significant costs and delays connected with the exercise of appraisal rights, and the uncertainties of the valuation process.<sup>55</sup> Appraisal rights require the shareholder to work through a number of convoluted steps. Many scholars have criticized the appraisal process as “providing little help to the ordinary investor because its technicalities make its use difficult, expensive, and risky.”<sup>56</sup>

More recently, appraisal actions have gained some steam due to certain sophisticated investors, particularly hedge funds, acting as dissenting shareholders.<sup>57</sup> In a 2015 study, Korsmo and Myers found a marked increase in appraisal activity: while stockholders filed an average of approximately 10 appraisal petitions per year from 2004 through 2010, an average of more than 20 petitions were filed each year from 2011 through 2013, with nearly 30 petitions filed in 2013 alone.<sup>58</sup> The study also found that while only about 5% of appraisal-eligible transactions attracted appraisal litigation from 2004 through 2010 that number had increased to more than 15% by 2013.<sup>59</sup> As important as the documented rise in appraisal actions by minority shareholders are the study’s findings about the value of these actions. The study found that “appraisal petitioners target deals where the merger premium is low and where controlling stockholders are taking the company private.”<sup>60</sup>

The rise in appraisal action in the US has not been without some road blocks. In some case, courts have struggled with the challenges associated with acting as arbiters of fair value.<sup>61</sup> In several of the appraisal actions resolved in 2015, the Delaware courts granted the minority shareholders

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<sup>54</sup> Maynard, *Mergers and Acquisitions*, 59-60.

<sup>55</sup> For an overview of the limits of appraisal rights, see Ventrizzo (2010), 858-858.

<sup>56</sup> Maynard, *Mergers and Acquisitions*, 58. For an overview of the appraisal process and debates about its value, see C. R. Korsmo and M. Myers, ‘Appraisal Arbitrage and the Future of Public Company M&A’, *Washington University Law Review*, 92 (2015), 1551, 1558-66.

<sup>57</sup> Korsmo and Myers, ‘Appraisal Arbitrage’, 1572-76. The authors report that these sophisticated petitioners typically decide to purchase shares of the target after a merger deal has already been announced, with the express purpose of seeking appraisal—a practice they describe as “appraisal arbitrage.”

<sup>58</sup> Korsmo and Myers, ‘Appraisal Arbitrage’, 1568.

<sup>59</sup> Korsmo and Myers, ‘Appraisal Arbitrage’, 1570.

<sup>60</sup> Korsmo and Myers, ‘Appraisal Arbitrage’, 1583.

<sup>61</sup> See S. D. Solomon, ‘Delaware Courts Pause on the Deal Price Do-Over’ *N.Y. Times* (Feb. 19, 2015).

seeking appraisal the merger consideration as the “fair value.”<sup>62</sup> In one high-profile appraisal litigation, minority shareholders had their appraisal action dismissed as they could not prove that they continually owned their shares from the time of dissenting until completion of the deal.<sup>63</sup>

Despite its challenges, appraisal litigation may allow courts to address concerns about opportunistic timing of a squeeze-out by controlling stockholders. Scholars and courts have noted that “the risk of opportunistic conduct on the part of the controller is high, especially as to the financial terms and timing of the offer”<sup>64</sup> especially as the controller or management “may take advantage of a trough in a company’s performance or excessive investor pessimism about the Company’s prospects (a so-called anti-bubble).”<sup>65</sup> For example, in the 2016 *Dell* appraisal litigation, the Delaware court did not find any significant fiduciary concerns with respect to the conduct of the target company board and the founder stockholder. Nevertheless, in awarding a fair value far above the acquisition price paid by the company’s founder and a consortium group, the court noted that there was “extensive and compelling” evidence of a “valuation gap between the market’s perception and the Company’s operative reality.”<sup>66</sup>

## **2. Fiduciary Duty Litigation**

### **a. Target Minority Shareholders**

While fiduciary duty litigation is a mainstay of public company M&A transactions in the US, with respect to minority shareholder rights such litigation often arises in squeeze-out transactions. Delaware courts have struggled with fiduciary duty issues in controlling stockholder transactions, aiming to strike a balance between adhering to the deferential business judgment rule<sup>67</sup> and the need to discourage self-dealing.<sup>68</sup> Traditionally,

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<sup>62</sup> See, e.g., *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (consol.), memo. op. (Del. Ch. Jan. 30, 2015); *Merion Capital LP v. BMC Software, Inc.*, No. 8900-VCG (Del. Ch. Oct. 21, 2015); *Huff Fund Investment Partnership v. CKx, Inc.*, 2015 WL 631586 (Del. Feb. 12, 2015), aff’g 2013 WL 5878807 (Del. Ch. Nov. 1, 2013).

<sup>63</sup> See S. D. Solomon, ‘Funds Challenging Dell Bid Find Shares Aren’t Really Theirs’ *N.Y. Times* (July 21, 2015).

<sup>64</sup> Davies, ‘The Transactional Scope of Takeover Law in Comparative Perspective’. Cain and Davidoff make a similar argument with respect to management-led buyouts. Matthew D. Cain & Steven M. Davidoff, ‘Form Over Substance? The Value of Corporate Process and Management Buy-Outs’, *Delaware Journal of Corporate Law* 36 (2011), 849, 862 (2011).

<sup>65</sup> *In re: Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016).

<sup>66</sup> *In re: Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016). In evaluating fair value in a founder-led buyout, the Delaware court reviewed both the empirical and theoretical literature regarding such transactions and noted that “the weight of authority suggests that a claim that the bargained-for price in an MBO represents fair value should be evaluated with greater thoroughness and care than, at the other end of the spectrum, a transaction with a strategic buyer in which management will not be retained.” *In re: Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016).

<sup>67</sup> The business judgment rule is a judicial presumption that holds that directors’

controlling stockholder squeeze-outs were viewed under the stringent entire fairness framework. The entire fairness standard involves the court's analysis of both the substantive fairness (i.e. price) and the procedural fairness (i.e. process) of the transaction.<sup>69</sup>

The Delaware courts have begun to move away from entire fairness review, even in squeeze-outs. In 2001, in *In re Siliconix Shareholders Litigation*, the Delaware Chancery Court held that a squeeze-out executed as a tender offer would not be subject to entire fairness review.<sup>70</sup> Thus began “a bifurcated approach” to analyzing squeeze-outs: (1) entire fairness review in a negotiated merger transaction; and (2) business judgment review, “unless actual coercion or disclosure violations are shown,” where the controlling stockholder seeks to buy out minority shares through a tender offer.<sup>71</sup> In several subsequent decisions, the Delaware Chancery Court further expanded upon the condition necessary to avoid entire fairness review in a going-private tender offer.<sup>72</sup> To obtain deferential business judgment review, the controlling stockholder must: “(1) condition the offer on a non-waivable majority of the minority condition (“MOM”); (2) ensure that the transaction was accompanied by a special committee process (“SC”) in which independent directors of the target board had “adequate time” and “free rein” to react to the tender offer; (3) not make retributive threats; (4) agree to a short-form merger at the tender price promptly after the tender accomplished a 90% ownership threshold; and (5) adequately and accurately disclose information related to the offer.”<sup>73</sup>

The inconsistency in standards of review between squeeze-outs accomplished through a negotiated merger versus those accomplished via a tender offer was heavily criticized by some scholars and members of the

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decisions have been made “on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the corporation and its shareholders.” *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). The burden is on the plaintiff to prove that a majority of the directors breached their fiduciary duties in reaching the decision. *See id.*

<sup>68</sup> S. Jain, E. Klingsberg, and N. Whoriskey, ‘Examining Data Points In Minority Buy-Outs: A Practitioners’ Report’, *Delaware Journal of Corporate Law*, 36 (2011), 941. In evaluating director fiduciary duties, the Delaware courts use three tiers of standards of review to evaluate director decisions: the business judgment rule, enhanced scrutiny, and entire fairness. *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 457 (Del. Ch. 2011).

<sup>69</sup> *Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110 (Del. 1994). The courts have consistently indicated that “price may be the preponderant consideration outweighing other features of the merger.” *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

<sup>70</sup> *In re Siliconix, Inc. Shareholders Litigation*, 2001 WL 716787 at \*17 (Del. Ch. 2001).

<sup>71</sup> Jain, Klingsberg and Whoriskey, ‘Examining Data Points In Minority Buy-Outs’, 946-47.

<sup>72</sup> *See, e.g., In re CNX Gas Corp. Shareholders Litigation*, 4 A.3d 397 (Del. Ch. 2010).

<sup>73</sup> Jain, Klingsberg and Whoriskey, ‘Examining Data Points In Minority Buy-Outs’, 946-947; *see In re CNX Gas Corp. Shareholder Litigation*, 4 A.3d 397 (Del. Ch. 2010).

judiciary. For example, then Vice-Chancellor Strine noted that it made little sense to treat “economically similar transactions as categorically different” especially when both transaction structures “pose similar threats to minority stockholders.”<sup>74</sup> In another case, he explicitly proposed a unified approach to squeeze-outs, arguing that business judgment review should be available in all controlling stockholder squeeze-outs, *regardless of form*, where the transaction was both (1) negotiated and recommended by a fully-empowered special committee with the full authority of the Board (including authority to negotiate, consider alternatives, and adopt a stockholder rights plan), and “(2) approved by a MOM in satisfaction of an unwaivable condition to this effect.”<sup>75</sup> Several other decisions made similar arguments.<sup>76</sup>

In 2014, the Delaware Supreme Court finally addressed the appropriate standard of review with respect to merger squeeze-outs. The court agreed that business judgment review would be available in squeeze-out mergers, where the merger is conditioned at the outset upon (1) an independent, adequately empowered special committee that fulfills its duty of care, *and* (2) the uncoerced, informed vote of a majority of the minority shareholders.<sup>77</sup> The court reasoned that the “simultaneous deployment” of an empowered special committee and MOM condition rendered the transaction similar to third-party mergers which are reviewed under the business judgment standard.<sup>78</sup> The court noted that with both of these protections “a potent tool to extract good value for the minority is established” because from the outset of the deal the controlling stockholder “cannot bypass the special committee’s ability to say no” and “cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move.”<sup>79</sup>

The move toward business judgment review under the above conditions was explained by the courts as being protective of minority shareholders. The Delaware Chancery Court asserted that the carrot of a lower standard of review would provide a “strong incentive” for controlling shareholders to use a transaction where the minority stockholders “get the benefits of independent, empowered negotiating agents to bargain for the best price and say no if the agents believe the deal is not advisable for any proper reason,

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<sup>74</sup> *In re Pure Resources, Inc., Shareholder’s Litigation*, 808 A.2d 421, 434-435 (Del. Ch. 2002).

<sup>75</sup> Jain, Klingsberg and Whoriskey, ‘Examining Data Points In Minority Buy-Outs’, 946-947.

<sup>76</sup> *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397 (Del. Ch. 2010); *In re John Q. Hammons Hotels Inc. S’holder Litig.*, No. 758-CC, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009); *In re MFW S’holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).

<sup>77</sup> *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. May 29, 2013), *affirmed* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

<sup>78</sup> M&F Worldwide, 88 A.3d at 644.

<sup>79</sup> M&F Worldwide, 88 A.3d at 644.

plus the critical ability to determine for themselves whether to accept any deal that their negotiating agents recommend to them.”<sup>80</sup>

### **b. Bidder Minority Shareholders**

With respect to bidder shareholders, fiduciary duty litigation has generally not been a fruitful avenue for addressing shareholder rights in triangular mergers or tender offers. The norm is for public company boards to approve significant acquisitions despite the lack of a specific statutory requirement. Hence, in theory, bidder boards may be vulnerable to shareholders challenging the acquisition decision on fiduciary duty grounds.

Nevertheless, unless there is a clear conflict of interest or duty of loyalty violation, bidder shareholders have been unable to use fiduciary duty litigation to police the board. A damages claim against directors for violations of the duty of care is unavailable since most companies’ charters include a statutory exculpation provision limiting such claims.<sup>81</sup> Statutory exculpation provisions mean that even a showing of grossly negligent conduct—i.e. a violation of the duty of care—provides little relief to bidder shareholders. In addition, whether a triangular merger or a tender offer, bidder shareholders generally do not lose their shareholder status and must bring a derivative suit on behalf of the corporation when alleging that directors have violated their fiduciary duties.<sup>82</sup> Shareholders, however, face significant procedural hurdles when bringing derivative suits. Perhaps most importantly, bidder shareholders are unable to overcome the broad discretion and deference afforded to the board by courts that begin any analysis of a board’s decision by applying the presumptions of the business judgment rule. With respect to director actions to undertake an acquisition, courts begin with a presumption that “directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith.”<sup>83</sup> Thus, no established body of case law examines fiduciary duties of bidder boards.<sup>84</sup> Overall, few shareholder actions are brought by bidder shareholders, and the few that have been brought are rarely successful.

## **Part III. Offers and Scheme of Arrangements in the United**

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<sup>80</sup> *In re MFW Shareholders Litigation*, 67 A.3d 496 (Del. Ch. May 29, 2013)

<sup>81</sup> See DEL. CODE ANN. tit. 8, § 102(b)(7).

<sup>82</sup> Shareholders can bring fiduciary duty claims directly if they, rather than the corporation, suffered the injury. Such direct claims tend to be limited to claims brought by shareholders of target companies. See R. B. Thompson and R. S. Thomas, ‘The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions’, 57 *Vanderbilt Law Review* 133, 167–68 (2004).

<sup>83</sup> *Gries Sports Enters., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963–64 (Ohio 1986).

<sup>84</sup> See L. A. Hamermesh, ‘Premiums in Stock-For-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties’, 152 U. PA. L. REV. 881, 909 (2003).

## Kingdom

Takeover structures and the rules governing them differ significantly between the US and UK. An acquisition of a UK public company takes place through the acquisition of shares in the target by the bidder either through an offer (similar to a US tender offer) or through the nearest UK analogue to a US-style merger, a “scheme of arrangement”. There is no analogue to the US two-step transaction, and a UK bidder cannot combine a takeover bid with a scheme of arrangement.

While the economic substance of these transactions are similar in the US and UK, the steps that must be followed and the methods of minority shareholder protection in these transactions are quite different. Unlike the US where hostile takeover activity is difficult, the UK has been characterized as “probably the most open and non-protectionist market in the world”<sup>85</sup> and one where shareholder primacy is the core principle. UK law, however, provides significantly less protection to minority shareholders in schemes of arrangement than it does in takeover bids, thus providing acquisition parties with a chance to undertake transactions that can bind the minority much more readily than in takeover bids. Another significant difference between the UK and US is that where in the US policing of minority shareholder rights in takeovers often happens through appraisal rights and fiduciary duty litigation against corporate directors, the appraisal remedy is not available in the UK and studies of the UK “indicate that the chances of a director of a publicly traded U.K. company being sued under corporate law are virtually nil.”<sup>86</sup>

### A. The regulation of Offers

In a takeover offer, the relationship between the bidder and shareholders is contractual, though the entire process is regulated by the UK takeover statutory regime. Takeovers in the UK are regulated at the highest level by the EU through its Takeover Directive, and domestically by the Panel on Takeovers and Mergers (“Panel”), a self-regulatory body<sup>87</sup> that regulates takeovers pursuant to the City Code on Takeovers and Mergers (“City Code”).<sup>88</sup> The Companies Act (2006) provides a statutory status for the Panel,

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<sup>85</sup> S. Cooke, *To-may-to To-mah-to: 10 Surprises For A US Bidder On A UK Takeover*, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, 4 April 2014, [corpgov.law.harvard.edu/2014/04/04/to-may-to-to-mah-to-10-surprises-for-a-us-bidder-on-a-uk-takeover](http://corpgov.law.harvard.edu/2014/04/04/to-may-to-to-mah-to-10-surprises-for-a-us-bidder-on-a-uk-takeover).

<sup>86</sup> Armour et al., ‘Private Enforcement of Corporate Law’, 690.

<sup>87</sup> See, generally, J. Armour and D. A. Skeel Jr, ‘Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation’ (2007) 95 *Georgetown Law Journal* 1727-94.

<sup>88</sup> On the U.K. regulation, see generally THE PANEL ON TAKEOVERS AND MERGERS, *THE CITY CODE ON TAKEOVERS AND MERGERS* (11th ed. 2013) (U.K.), [www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf](http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf).

although the Panel “remains firmly rooted in the private sector, both in composition and in practice.”<sup>89</sup> The City Code has statutory force in the UK and the Panel has statutory authority to regulate corporate actions to which the code applies.<sup>90</sup> The Panel does not review the merits of a deal, but seeks to ensure that shareholders are given adequate information.

UK takeover regulation is by design focused on “safeguarding the interests of shareholders.”<sup>91</sup> The Panel and the City Code take the approach that shareholders own the company and should decide its future, especially during a takeover.<sup>92</sup> The general principles that underpin the City Code and its 38 rules have been summarized as (i) “all shareholders of the same class in a target company must be treated equally and must have adequate information to reach a properly informed decision;” (ii) “a false market must not be created in the securities of the offeror or the target company”; and (iii) “the management of a target company must not take any action which would frustrate an offer without the consent of its shareholders.”<sup>93</sup> Several of the rules implementing these principles, including the mandatory bid rule and the sell-out rule discussed below, are designed to protect minority shareholders. The mandatory bid rule and sell out rule protect the minority in light of two main concerns: (1) the bidder, upon obtaining control, may oppress the remaining minority, and (2) shareholders should be entitled a right of exit upon a change of control.<sup>94</sup>

The Code extensively regulates the relationship between the bidder and target shareholders.<sup>95</sup> One of the central elements of the takeover regulations is equal treatment of target shareholders.<sup>96</sup> In general UK bidders must pay the same price to all shareholders within a class who wish to accept an offer, including providing a comparable offer for each class in case the company has

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<sup>89</sup> Bruner (2013), 32. For a detailed description of the panel’s operations, see Emma Armson, ‘Assessing the Performance of Takeover Panels: A Comparative Study’, in Umakanth Varottil and Wan Wai Yee (eds.), *Comparative Takeover Regulation*, Cambridge University Press (forthcoming).

<sup>90</sup> Slaughter and May, ‘A Guide To Takeovers In The United Kingdom’, (March 2015), 3, [www.slaughterandmay.com/media/39320/a-guide-to-takeovers-in-the-united-kingdom.pdf](http://www.slaughterandmay.com/media/39320/a-guide-to-takeovers-in-the-united-kingdom.pdf).

<sup>91</sup> J. Payne, ‘Minority Shareholder Protection In Takeovers: A UK Perspective’, *European Company and Financial Law Review*, 8 (2011b), 146.

<sup>92</sup> R. Bruner, ‘Does M&A Pay? A Survey of Evidence for the Decision-Maker,’ *Journal of Applied Finance*, 12 (2002), 48-68.

<sup>93</sup> Slaughter and May, ‘A Guide To Takeovers In The United Kingdom’, 3-4; *See also* Payne, ‘Minority Shareholder Protection In Takeovers’, (2011a), 72-73; J. Armour, J.B. Jacobs and C.J. Milhaupt, ‘The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework’, *Harvard International Law Journal*, 52 (2011), 219-85.

<sup>94</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 150.

<sup>95</sup> Payne, ‘Schemes of Arrangement’, 73.

<sup>96</sup> *See, generally*, Armour and Skeel (2007).

more than one class of equity share capital.<sup>97</sup> Moreover, the City Code bans bidders from cutting favorable side deals with some shareholders before or during the offer period.<sup>98</sup> In addition, similar to the US Best Price rule in tender offers, if the price of the offer is increased the bidder must pay all shareholders the higher price.<sup>99</sup>

Unlike the US where two-step and 251(h) transactions allow a squeeze-out to follow a tender, the ability of bidders in the UK to implement a squeeze-out transaction is more limited. Generally, the bidder's offer is conditional on shareholders tendering in greater than 50% of the voting power of the target. Only when the bidder acquires greater than 90% of target's shares can the bidder squeeze-out the remaining 10% and compulsorily acquire their voting shares (called the sell-out rule).<sup>100</sup> The protective aspect of the sell-out rule is that the dissident 10% have a right to be bought out at the same price paid per share as other shares bought out in the offer. Non-consenting shareholders can object in court to the squeeze-out, although courts will often allow the transaction to move forward unless the non-consenting shareholders "can demonstrate that the final offer is not indicative of fairness, for example where the 90 per cent shareholders are not independent of the bidder."<sup>101</sup>

The strongest protection of minority shareholders in the UK comes through the mandatory bid rule.<sup>102</sup> The Code requires a mandatory bid whenever a person acquires a controlling stake, i.e. 30% of shares carrying voting rights, or holds between 30 to 50% and acquires additional shares holding voting rights.<sup>103</sup> The offer must be extended to the holders of any class of equity share capital (voting or non-voting) and also to the holders of any other class of transferable securities carrying voting rights. Not only must the offer be a cash offer, or with a cash alternative, but the offer must be at the highest price paid by the offeror or a member of his concert party within the 12 months prior to the commencement of the offer.<sup>104</sup>

## **B. Schemes of arrangement.**

Over the past decade, schemes of arrangement have become a commonly used acquisition structure in friendly transactions, and have been used as

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<sup>97</sup> City Code, General Principle 1, Rule 14.

<sup>98</sup> City Code, Rule 16.

<sup>99</sup> City Code Rules 14, 16 and 32.3.

<sup>100</sup> Payne, 'Schemes of Arrangement', 71; Coates, 'Mergers, Acquisitions, and Restructuring', 18.

<sup>101</sup> Payne, 'Minority Shareholder Protection In Takeovers', 148.

<sup>102</sup> For a discussion of the potential shortcomings of the mandatory bid rule, see Johannes W. Fedderke and Marco Ventoruzzo, 'The Biases of an "Unbiased" Optional Takeovers Regime: The Mandatory Bid Threshold as a Reverse Drawbridge'.

<sup>103</sup> City Code, Rule 9.1.

<sup>104</sup> City Code, Rule 9.5

alternatives to takeover bids.<sup>105</sup> Schemes have been popular because a successful scheme of arrangement assures 100% ownership in the target for the bidder.<sup>106</sup> Until recently, schemes were also popular due to tax considerations, such as the potential to mitigate stamp duty and stamp duty reserve tax costs.<sup>107</sup> Similar to the merger structure in the US the use of a scheme of arrangement involves shareholder approval of target shareholders, but it also includes an extensive role for the courts.

For parties undertaking an acquisition transaction, there are several important differences between schemes and takeover bids. First, the extensive involvement of courts in schemes impacts the timetable of the deal. While a typical scheme can take seven to eight weeks from posting to close, takeover bids can vary widely in terms of timing.<sup>108</sup> Second, in a scheme a majority of the shareholders of each class can bind the minority, including any dissident shareholders, so long as the scheme is subsequently sanctioned by the court.<sup>109</sup> However, in the context of a takeover bid, dissident shareholders are not required to sell their shares unless 90% of outstanding shares have been acquired by the bidder.

Schemes involving takeover transactions involve two separate approvals, shareholder approval and court approval, and involve multiple steps to come to fruition. After a takeover or merger scheme is proposed by a company's board to its shareholders, the company must go to the court for an order to approve a meeting of the shareholders to vote on the scheme. Under Section 907 of the UK Companies Act, "[t]he scheme must be approved by a majority in number, representing 75% in value, of each class of members [shareholders] of each of the merging companies, present and voting either in person or by proxy at a meeting."<sup>110</sup> The court decides at a later hearing whether to sanction the scheme (considering, among other factors, fairness).<sup>111</sup> Upon approval, the scheme is binding on the target and all of its shareholders, including dissidents. The court may set aside the scheme only in limited circumstances, for example, if consent has been obtained by fraud.

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<sup>105</sup> Payne, 'Minority Shareholder Protection In Takeovers', 146.

<sup>106</sup> W. Morris, *The End for Scheme of Arrangement in UK Takeovers*, available at [www.walkermorris.co.uk/end-schemes-arrangement-uk-takeovers](http://www.walkermorris.co.uk/end-schemes-arrangement-uk-takeovers).

<sup>107</sup> Practical Law, '*Public mergers and acquisitions in the UK (England and Wales): overview*', URL. The ability of bidders to use a cancellation scheme to avoid the payment of stamp duties in acquisitions was impeded by an amendment to the UK Companies Act which now bans takeovers from being effected by cancellation scheme. See HM Revenue and Customs, *Guidance on Stamp Duty and Stamp Duty Reserve Tax: Transfer Schemes of Arrangement*, update November 9, 2015, available at <https://goo.gl/ShJjzw>.

<sup>108</sup> Payne, 'Schemes of Arrangement', 71.

<sup>109</sup> W. Morris, *The End for Scheme of Arrangement in UK Takeovers*, available at [www.walkermorris.co.uk/end-schemes-arrangement-uk-takeovers](http://www.walkermorris.co.uk/end-schemes-arrangement-uk-takeovers).

<sup>110</sup> UK Companies Act 2006, Section 907.

<sup>111</sup> Practical Law, '*Scheme Of Arrangement*', [us.practicallaw.com/0-107-7201](http://us.practicallaw.com/0-107-7201) (last accessed 15 April 2015).

The scheme is effective upon delivery to the Registrar of Companies.

Some have argued that perhaps minority protection in the scheme context should be greater than that in the traditional bid/takeover context since in a scheme even dissenting shareholders are forced to sell once the scheme has been approved.<sup>112</sup> Nevertheless, there is a strong argument that protection for minority shareholders is built into the structure of the scheme itself – namely the 75% majority requirements for shareholder approval and court sanction.<sup>113</sup> In this vein expert have argued that the lower protections in the scheme are justified given that there is little risk in schemes that a bidder can “divide and conquer” the target shareholders.<sup>114</sup> There is also no concern about providing minority shareholders exit rights as there may be in a takeover where a bidder obtains control, but less than 100% control, of the target.<sup>115</sup> Moreover, unlike in takeovers where minority shareholders could potentially be oppressed by the majority after a successful bid, in a scheme there is no risk of post-transaction minority oppression.<sup>116</sup>

### **C. Bidder Minority Shareholders in the UK**

Similar to the US regime, neither the City Code nor the Companies Act provide a specific role for bidder shareholders in acquisition transactions.<sup>117</sup> Nevertheless, unlike the United States where there is little involvement in acquisition transactions for bidder shareholders, the UK regime expressly contemplates a role for bidder shareholders in substantial acquisitions. For shareholders of listed companies Listing Rule 10 of the United Kingdom Financial Services Authority requires prior approval from shareholders of the acquirer in transactions that are large relative to the acquirer (Class 1 transactions). The UK Listing rules use several measures of relative size to determine a class 1 transaction, so that a class 1 transaction means a transaction that amounts to 25% or more of any of the acquirer’s gross assets, profits, or gross capital, or in which the consideration is 25% or more of the market capitalization of the acquirer’s common stock.

## **Part IV. The Impact of Takeovers on Minority Shareholders: Evidence from Empirical Studies**

There are deep differences between the ways in which the US and the UK regulate different types of acquisition structures. Unlike the US which

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<sup>112</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 154.

<sup>113</sup> As Davies states, UK courts often discount the vote of controlling bidders in approving a scheme essentially “replicating” the majority of minority condition found in Delaware jurisprudence. Davies, ‘The Transactional Scope of Takeover Law in Comparative Perspective’, p. x.

<sup>114</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 158.

<sup>115</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 158.

<sup>116</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 159.

<sup>117</sup> Payne, ‘Minority Shareholder Protection In Takeovers’, 169-171.

focuses on ex post litigation to protect minority shareholders, litigation is not commonly used in the UK. Instead, the UK protects minority shareholders by focusing primarily on ex ante rules rather than private enforcement. This thus raises the question of whether differences in legal rules governing different deal structures translate into a quantifiable impact on minority shareholders.

Both legal and finance scholars have studied the law and economics of takeover transactions, and their impact on both bidder and target shareholders. Generally, scholars have fairly consistently found that target shareholders “enjoy returns that are significantly and materially positive.”<sup>118</sup> More recently, studies have explored whether differences in the rules applicable to different deal structures actually make a difference in terms of wealth effects for shareholders or in how shareholders behave. These studies focus on the US, and thus far there are no specific studies addressing the shareholder wealth effects of the UK rules applicable to takeover bids versus schemes of arrangement.

### A. Shareholder Wealth Effects of Takeovers Generally

In general, studies have long confirmed that target shareholders gain significantly in takeover transactions, particularly when the bidder is a publicly traded company.<sup>119</sup> The evidence on bidder shareholder wealth returns is decidedly more mixed. While several early studies reported that bidder shareholders benefit or remain neutral from acquisitions, others reported losses. A significant body of more recent finance literature finds evidence that many, although clearly not all, acquisitions destroy value for long-term bidder shareholders.<sup>120</sup> This is particularly true in the case of takeovers of publicly traded targets by publicly traded acquirers.

A few studies evaluate the shareholder wealth effects of tender offers versus mergers in the US. Empirical studies suggest that target shareholders fare better in tender offer transactions than they do in mergers. A 2015 study by Offenberg and Pirinsky build upon these earlier studies that showed that

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<sup>118</sup> R. Bruner, ‘Does M&A Pay? A Survey of Evidence for the Decision-Maker,’ *Journal of Applied Finance*, 12 (2002), 48-68.

<sup>119</sup> M. Martynova and L. Renneboog, ‘A century of corporate takeovers: What have we learned and where do we stand?’, *Journal of Banking & Finance*, 32(10) (2002), 2148-2177. For a comprehensive overview of studies on acquisition transactions, see generally S. Betton et al., *Corporate Takeovers*, in 2 HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 291 (B. Espen Eckbo ed., 2008).

<sup>120</sup> See G. Andrade et al., ‘New Evidence and Perspectives on Mergers,’ *Journal of Economic Perspectives*, Spring 2001, at 103, 110–11; T. Loughran and A. M. Vijh, ‘Do Long-Term Shareholders Benefit from Corporate Acquisitions?’ 52 *Journal of Finance* 1765, 1773–89 (1997); S. B. Moeller et al., ‘Firm Size and the Gains from Acquisitions’, 73 *Journal of Financial Economics* 201, 202, 226 (2004); S. B. Moeller et al., ‘Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave,’ 60 *Journal of Finance* 757, 781 (2005).

takeover premiums in tender offers are higher than in mergers. Offenberg and Pirinsky hypothesize that the faster speed of tender offers makes the transaction structure attractive to bidders, “especially when the acquisition is strategically important and the probability for a competitive bid is high.”<sup>121</sup> Given that targets are aware of the faster execution speed of tender offers, the use of the structure by the bidder “sends a positive signal to the target about its value and the target raises its reservation price. Thus, structuring the deal as a tender offer raises the takeover premium.”<sup>122</sup> Consistent with this hypothesis, in comparing a large sample of 269 tender offers and 1,033 mergers of US targets in a period from 2007 through 2012, Offenberg and Pirinsky found that even among similar deals, tender offers have higher acquisition premiums than mergers.

The empirical literature on UK takeovers is sparser than the literature addressing the US. One of the most significant studies on shareholder wealth effects of UK takeovers studied over 1,800 transactions between 1955 and 1985 and found that around the merger announcement date targets gain 25 to 30 percent and bidders earn zero or modest gains.<sup>123</sup> Other studies comparing takeovers in Continental Europe and the UK have found that returns to target shareholders in the UK are substantially higher than those in Continental European takeovers. For example, Goergen & Renneborg found that the M&A announcement effect for a sample of 158 deals covering the period 1993-2003 is substantially larger for UK target firms (12.3%) than for firms located in Continental Europe (6%).<sup>124</sup> Similarly, Martynova & Renneborg’s study of a large sample of 2419 deals involving firms from 28 European countries in the period 1993-2001 found that UK target firms experience abnormal returns of 17.64 %, significantly higher than the 10.19 % abnormal return to their Continental European peers.<sup>125</sup>

Despite the fact that over the past decade parties in the UK have moved significantly from using takeover bids to using schemes in friendly deals, to date no empirical studies address the shareholder wealth effects of these different acquisition structures. Moreover, no study exists to evaluate the differences between the UK and US structures over the last decade.

As noted above, the UK’s takeover regime is more protective on ex ante

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<sup>121</sup> Offenberg and Pirinsky, ‘How do acquirers choose between mergers and tender offers?’, 332.

<sup>122</sup> Offenberg and Pirinsky, ‘How do acquirers choose between mergers and tender offers?’, 332.

<sup>123</sup> J. Franks and R. Harris (1989) ‘Shareholder Wealth Effects of Corporate Takeovers: The UK Experience 1955-1985,’ *Journal of Financial Economics*, 23, 225-49.

<sup>124</sup> M. Goergen and L. Renneboog (2004), ‘Shareholder Wealth Effects of European Domestic and Cross-border Takeover Bids,’ *European Financial Management*, 10 (1), 9-45.

<sup>125</sup> M. Martynova and L. Renneboog (2011), ‘The Performance of the European Market for Corporate Control: Evidence from the Fifth Takeover Wave,’ *European Financial Management*, 17(2), 208-259.

shareholder rights, including more extensive shareholder approval requirements such as voting rights for bidder shareholders in certain fundamental transactions. Until recently, there was little empirical literature to explore the impact of this voting right for bidder shareholders. A recent study of a large sample of UK transactions over an 18 year period finds that the UK's mandatory voting requirement positively impacts bidder shareholders.<sup>126</sup> More specifically, the study finds that shareholders gain 8 cents per dollar at the announcement of a Class 1 deal or \$13.6 billion over 1992-2010 in aggregate, while in the US acquirers lost \$214 billion in matched deals during the same period. In the U.K. relatively smaller Class 2 transactions do not require a vote and shareholders lost \$3 billion. The authors argue that mandatory voting makes bidder management more likely to refrain from overpaying or from proposing deals that are not in the interest of shareholders. Interestingly, the study finds that the mandatory voting mechanism works as a credible threat against bad corporate acquisitions since according to their findings shareholders never voted against Class 1 transactions ex-post and deals that were poorly received by the market at announcement were often withdrawn prior to the shareholder vote.

### **B. Shareholder Wealth Effects of Squeeze-Outs**

Several empirical studies have addressed the impact of takeovers on minority shareholders, focusing primarily on squeeze-out transactions. Much of the existing empirical literature analyzing the wealth effects of squeeze-out transactions on minority shareholders uses data from the United States. With respect to the US, three studies have addressed the differences in the legal rules governing tender offers versus triangular merger squeeze-outs as a result of the divergence in judicial standards of review in shareholder fiduciary duty litigation. As noted above, until the recent *MFW* case, squeeze-out transactions were subject to different standards of judicial review as a result of the *Siliconix* decision which held that, unlike merger squeeze-outs, tender offer squeeze-outs were not subject to "entire fairness review." Several empirical studies have explored the impact of *Siliconix* on minority shareholder returns, as well as the more recent move toward convergence of legal standards over the past few years.

Using a data set from US squeeze-out transactions in 1998-2003, Bates, Lemmon, and Linck's study considered shareholder wealth effects and bid negotiations to test whether minority shareholders fare poorly in controlling shareholder transactions.<sup>127</sup> The study discriminates between two competing

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<sup>126</sup> M. Becht, A. Polo and S. Rossi, Does Mandatory Shareholder Voting Prevent Bad Acquisitions? (October 21, 2015). European Corporate Governance Institute (ECGI) - Finance Working Paper No. 422/2014; Rock Center for Corporate Governance at Stanford University Working Paper No. 188. Available at SSRN: <http://ssrn.com/abstract=2443792>

<sup>127</sup> T.W. Bates, M.L. Lemmon, and J.S. Linck, 'Shareholder Wealth Effects And Bid Negotiation In Freeze-Out Deals: Are Minority Shareholders Left Out In The Cold?', *Journal*

theories regarding such bids: (i) bid capture (where minority shareholders lack sufficient board representation or efficient legal recourse, which allows controllers to capture a disproportionate share of gains in squeeze-out acquisitions); and (ii) a minority bargaining power theory (positing that active board representation and implicit legal recourse effectively insulate minority shareholders from self-dealing by controllers).<sup>128</sup> The study found abnormal returns to controlling shareholders, and also found that on average, minority claimants in squeeze-out bids actually receive 11% more than their pro rata share of deal surplus generated at the bid announcement. The authors claim that these results refute the notion that controlling shareholders systematically undertake squeeze-outs at the expense of the minority claimants of the target firm.<sup>129</sup> The authors conclude that economic incentives and legal protections adequately protect minority shareholders from expropriation during squeeze-out bidding.<sup>130</sup>

Some scholars have argued that the findings in the Bates et al. study “cannot be ruled as a universal phenomenon given the different degree of countries’ stock market development.”<sup>131</sup> A 2009 study by Croci and Petmezas examines the relationship between target minority shareholder returns and stock market development in deals where controlling shareholders increased their ownership stakes by acquiring some (or all) of the remaining minority shares in listed companies.<sup>132</sup> In a sample of 1,174 acquisitions in 46 countries from 1989-2005, the study finds that increase-in-ownership transactions created value for target shareholders. However, when the authors examined their sample at the country level, they found that target minority shareholders gain significantly more in countries with high stock market development than their counterparts in the less-developed markets.<sup>133</sup> They argue that active and more developed stock markets favor minority shareholders, and can help discipline the behavior of large shareholders.

As discussed above, in the US, the Delaware courts have long recognized that minority shareholders can be adversely affected by controlling stockholder squeeze-outs. Thus, the courts have put forth their support for the dual protections of both a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote or tender condition. This support was in part influenced by significant scholarly work in this

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*of Financial Economics*, 81 (2006) , 681-708.

<sup>128</sup> Bates, Lemmon and Linck, ‘Shareholder Wealth Effects’, 682.

<sup>129</sup> Bates, Lemmon and Linck, ‘Shareholder Wealth Effects’, 682.

<sup>130</sup> Bates, Lemmon and Linck, ‘Shareholder Wealth Effects’, 708.

<sup>131</sup> E. Croci and D. Petmezas, ‘Minority Shareholders’ Wealth Effects And Stock Market Development: Evidence From Increase-In-Ownership M&As’, *Journal of Banking and Finance*, 34 (2010) 681.

<sup>132</sup> Croci and Petmezas, ‘Minority Shareholders’ Wealth Effects’, 681.

<sup>133</sup> Croci and Petmezas, ‘Minority Shareholders’ Wealth Effects’, 682.

area.<sup>134</sup>

In the US, several papers have focused on whether the then-different standards of judicial review for tender offer versus merger squeeze-outs affect minority shareholder gains in squeeze-out transactions post-*Siliconix*.<sup>135</sup> Subramanian's early empirical study of controlling stockholder squeeze-out transactions in a 4 year period following the *Siliconix* case found that minority shareholders obtained lower cumulative abnormal returns (CARs) in tender offer squeeze-outs relative to merger squeeze-outs in that period. In another article, Subramanian argued that minority shareholders received lower premiums in tender offers than in statutory mergers, demonstrating that the decision to tender did not substitute entire fairness in protecting the minority.<sup>136</sup> Subramanian further argued that the differences in outcome for minority shareholders in tender offer squeeze-outs were "not simply a one-time wealth transfer from minority shareholders to the controller—an idea based on the assumption that minority shareholders will simply pay less for a minority stake if they know that they can be frozen out later at a lower price. These differences create a permanent social welfare loss that requires judicial intervention."<sup>137</sup>

Subramanian's post-*Siliconix* study did not formally examine whether *Siliconix* generated a structural change in relative CARs in tender offers versus mergers, and thus whether the differences in outcomes are attributable to dissimilar standards of review. A follow-up empirical study by Restrepo further explored Subramanian's thesis. Analyzing a sample of transactions both before and after *Siliconix*, Restrepo found that the difference in outcome for minority shareholders in tender offer squeeze-outs relative to merger squeeze-outs occurred only after *Siliconix*. Using a difference-in-differences approach, Restrepo compares changes over time (before and after *Siliconix*) between CARs in tender offers (the treatment group) and CARs in statutory mergers (the control group). The study's results suggest that *Siliconix* actually had at least some negative effect on CARs in tender offers, since the estimator of difference-in-differences is consistently negative and generally significant. The 2013 study had important policy

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<sup>134</sup> See, e.g., R. J. Gilson and J. N. Gordon, *Controlling Controlling Shareholders*, 152 U. Pa. L. Rev. 785 (2003); P. V. Letsou and S. M. Haas, 'The Dilemma That Should Never Have Been: Minority Freeze-Outs in Delaware', *Bus. Law.*, 61 (2005), 25; Guhan Subramanian, *Fixing Freezeouts*, *Yale L.J.* 115 (2005), 2.

<sup>135</sup> See F. Restrepo, 'Do Different Standards Of Judicial Review Affect The Gains Of Minority Shareholders In Freeze-Out Transactions? A Re-Examination Of *Siliconix*', *Harvard Business Law Review*, 3 (2013), 321; Guhan Subramanian, 'Post-*Siliconix* Freeze-Outs: Theory And Evidence', *Journal of Legal Studies*, 36 (2007), 1.

<sup>136</sup> Guhan Subramanian, 'Fixing Freezeouts', *Yale Law Journal*, 115 (Oct. 2005), 24-25.

<sup>137</sup> F. Restrepo and G. Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes: Evidence On The Unified Approach', *Harv. Bus. L. Rev.*, 5 (2015), 205, 211.

implications for if *Siliconix* was a significant factor in differences in CARs between tender offers and statutory mergers, the case for unification/regulatory convergence (forwarded by Subramanian and others) would be supported.<sup>138</sup> On the other hand, if the reverse were true, there would be no clear reason for regulatory convergence on the basis of different transactional outcomes. The results of Restrepo's study empirically supported the case for regulatory convergence (the approach eventually adopted by the Delaware courts).<sup>139</sup>

In 2015, Restrepo and Subramanian furthered this research and jointly authored an article about the impact of more recent Delaware case law on deal outcomes, calling this period one of "doctrinal evolution" in judicial review of squeeze-outs executed as tender offers versus those structured as mergers.<sup>140</sup> The authors present empirical evidence on all squeeze-outs of Delaware targets during the shift to the "unified approach" to squeeze-outs, and find that deal outcomes have converged after the Delaware Chancery Court's decision in *In re Cox Communications*, which explicitly endorses the unified approach. The study showed that post-*Cox*, practitioners used the tender offer squeeze-out mechanism less often and, when it was used, minority shareholders received higher relative CARs compared to the pre-*Cox* period.<sup>141</sup> Restrepo and Subramanian's findings also suggested that the social welfare loss that Subramanian identified in his 2005 article seems to no longer be present. They then argue that, not only did the Delaware Supreme Court adopt the right policy by endorsing the unified approach for merger freezouts, but that the Delaware Supreme Court should explicitly endorse the unified approach in tender offer squeeze-outs to ensure adequate procedural protection to minority shareholders.<sup>142</sup> As Restrepo and Subramanian state, SC approval alone is insufficient to protect minority shareholders because SC approval and MOM conditions serve different purposes (i.e., SC is "a back-and-forth and typically hard-fought negotiation between the controller and representatives of the minority" while MOM provides a "binary check against a captured SC").<sup>143</sup> Accordingly, they

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<sup>138</sup> Restrepo, *Different Standards of Judicial Review*, 324.

<sup>139</sup> Restrepo, *Different Standards of Judicial Review*, 325.

<sup>140</sup> F. Restrepo and G. Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes: Evidence On The Unified Approach', *Harv. Bus. L. Rev.*, 5 (2015), 205.

<sup>141</sup> Restrepo and Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes', 222-223. The study also showed that half of the merger squeeze-outs in their sample did not follow the procedural template of the unified approach (specifically, absence of MOM conditions). Restrepo and Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes', 207.

<sup>142</sup> Restrepo and Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes', 224.

<sup>143</sup> Restrepo and Subramanian, 'The Effect of Delaware Doctrine On Freezeout Structure And Outcomes', 225.

endorse the unified approach to incentivize controlling shareholders and SCs to provide a MOM condition, arguing that both procedural protections should be necessary for controlling shareholders to receive the benefit of business judgment review.

### **Part V. Conclusion**

Even when deals attain similar economic ends, the regulation of a transaction may differ significantly based on the type of structure used in the transaction. Moreover, different countries regulate even similar transaction structures differently. The US and UK, for example, have used different regulatory tools for tenders offers and takeover bids, and for triangular mergers and schemes of arrangement. In the UK, for example, courts do not play a decisive role in most transactions, even in schemes which they formally must approve. In the US, on the other hand, litigation is a primary tool that drives deal structuring from front to end. Thus, in addition to securities and corporate laws, the rules emanating from the Delaware courts play an almost regulatory role in deal planning. The regulation of takeover transactions may also provide opportunities for deal arbitrage. For example, US law largely treats minority shareholders of bidders and targets differently. Thus, US, transaction planners aim to utilize this regulatory flexibility to avoid a role for bidder shareholders.

Finance and other empirical scholars have begun to address in detail the differences in the regulatory tools. A few insights are suggested by the empirical research chronicled in this paper. First, despite the differences in each jurisdiction's regime, target shareholders gain in takeover transactions in both the US and UK, and in the US regime these gains are higher in tender offers than in mergers. Second, recent research suggests that the UK's takeover rules better protect bidder shareholders in large transactions than US regulation which largely deprive bidder shareholders a role in acquisition transactions. Finally, the research on US transactions suggests that differences in regulation of different acquisition structures may make a difference to minority shareholders.

Nevertheless, here are several questions raised by this chapter that invite further inquiry. The empirical inquiry into UK M&A transactions is quite sparse. For example, no studies empirically explore whether minority shareholders in the UK gain more from schemes of arrangements than from takeover bids. Also, do bidder shareholders in the UK gain or lose more in schemes of arrangements or takeover bids? The empirical inquiry exploring the differences in regulatory approaches in the US and UK is also sparse. For example, it may be of use (although not without challenge) to explore which of the tools used in the US and UK regimes better protect minority shareholders. There is also literature on costs of regulatory framework imposed by both of these jurisdictions and whether these can be translated to

other countries, as well as further exploration into the institutions needed to implement these regulatory structures. Further inquiry into these issues can help law makers determine what features of takeover regulation could be best used by other jurisdictions contemplating takeover regulations.