

Liberating the Market for Corporate Control

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ABSTRACT

Many years ago, Henry Manne proposed a *theory of the market for corporate control* that provided a compelling argument for the existence of a vibrant hostile takeover market. He argued that “the control of corporations may constitute a valuable asset” if the acquirer takes control with the expectation of correcting managerial inefficiencies. In this way, it is the hostile takeover market and its lead actor, the hostile bidder, that acts as a *corrective mechanism* in corporate governance.

Unfortunately, while a vibrant hostile takeover market did exist in the United States during the 1960s, 70s, and 80s, this has not been the case for many years. By contrast, the United Kingdom, despite having a broadly similar capital market environment and corporate governance system to the U.S., has gone down the path of allowing its hostile takeover market to flourish. Thus, the U.K. has been able to successfully retain the hostile takeover as a corrective mechanism in corporate governance.

We find the current domestic state of affairs unacceptable. Without a vibrant hostile takeover market, a significant and efficient corrective mechanism has been lost. Therefore, with a view to redressing this inefficiency, we use as our primary authority the core principles identified in the U.K.’s regulatory legal framework, and especially its longstanding *board passivity* (or “non-frustration”) rule. More than any other element of the British framework, the board passivity rule has allowed for the creation of an enduring and successful hostile takeover market in the U.K. Accordingly, this Article recommends that domestic state corporate law statutes be amended to include a safe harbor for a hostile bidder

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when making an all-cash, all-shares tender offer that includes a guarantee of the same or higher price if a back-end or squeeze-out merger occurs.

The use of the above safe harbor would effectively disallow a board's use of takeover defenses, such as a poison pill, unless specifically provided for in the corporate charter. In this way, private ordering can always be used to trump the statutory safe harbor.

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INTRODUCTION

The COVID-19 pandemic has been a health crisis of unimaginable proportions. It has also been an economic disaster that seems never-ending. Moreover, it does not appear to be an overstatement to say that corporate America was totally unprepared for the COVID-19 pandemic, leading to the need for large federal bailouts and filing of Chapter 11 bankruptcy proceedings by many of our best-known public companies.¹

While it is undoubtedly true that top management across the board has taken drastic measures to keep their companies afloat and retain their employees, some have also taken steps to make sure they do not lose managerial control. In essence, they tried to avoid punishment for the lack of managerial acumen that the pandemic exposed, whether in preparation or in response. The facts bear this out. According to the law firm of Robinson & Cole, “[w]ithin the first seven months of 2020, there have been a total of 70 poison pills [or shareholder rights plans] adopted, compared to only a total of 35 adopted in 2019.”² Moreover, “[a]mong the 70 corporations which have adopted poison pills this year, 38 of them cited in their press releases that their boards of directors have taken note of the substantial increase in market volatility and uncertainty as a result of the global COVID-19 pandemic, as well as the pandemic’s negative impact on their stock price, which they believed did not reflect their companies’ inherent value or business performance.”³

These corporate governance actions are a blunt reminder that an inherent weakness exists in our market for corporate control, i.e., an almost non-existent hostile takeover market. This weakness means that inefficient management can retain control of a company longer than what the capital markets deem appropriate, causing great harm to all stakeholders, not just shareholders.⁴

1. For a list of public companies that filed for bankruptcy during the pandemic, see Emily Pandise, *One year into pandemic, Main Street bankruptcies continue*, NBC NEWS (May 15, 2020) <https://www.nbcnews.com/business/consumer/which-major-retail-companies-have-filed-bankruptcy-coronavirus-pandemic-hit-n1207866> (last updated Mar. 9, 2021).

2. Eric M. Kogan et al., *An Update on Poison Pills, NOL Poison Pills and the COVID-19 Pandemic*, NAT. L. REV. (Aug. 17, 2020), <https://www.natlawreview.com/article/update-poison-pills-nol-poison-pills-and-covid-19-pandemic>.

3. *Id.*

4. See *infra* note 96 (discussing the commonly (albeit by no means universally) accepted co-relation of a firm’s product and capital (i.e., stock) market performance within modern law and finance scholarship, and the corresponding general co-relation of shareholder and broader social/stakeholder welfare outcomes arising from notionally “efficient” corporate policies).

Many years ago, Henry Manne proposed a *theory of the market for corporate control*⁵ that provided a compelling argument for the existence of a vibrant hostile takeover market.⁶ He argued that “the control of corporations may constitute a valuable asset” if the acquirer takes control with the expectation of correcting managerial inefficiencies.⁷ In this way, it is the hostile takeover market and its lead actor, the hostile bidder, that acts as a *corrective mechanism* in corporate governance. A corrective mechanism is defined as a stakeholder, including shareholders, or potential stakeholders “of a public company, other than the current board of directors or executive management, which may have, from time to time, superior decision-making skills in the making of major corporate decisions.”⁸

Unfortunately, while a vibrant hostile takeover market did exist in the United States during the 1960s, 70s, and 80s,⁹ this has not been the case for many years.¹⁰ In the early 80s the use and success of the front-end loaded, two-tier, tender offer (“coercive two-tier tender offer”) to acquire the majority of voting stock of a target company despite the target board’s opposition, led to a slew of antitakeover statutes and the development of shark repellents such as the poison pill, which greatly damaged the vibrancy of this market.¹¹

While it is true that the hostile takeover market in the United States has not totally disappeared, it has been greatly diminished.¹² Moreover, when hostile tender offers do occur in the current environment, they usually occur in conjunction with a costly, difficult, and time-consuming proxy contest that does not come with a guarantee of success.¹³ In sum, the days of a straightforward hostile tender offer for a majority of or all the shares of a U.S. public company are long gone.

On the other side of the Atlantic Ocean, by contrast, there is a very different story to be told concerning the historical development of the United Kingdom’s

5. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

6. Brian Cheffins has recorded that “[e]ven prior to Manne’s 1965 identification of the market for corporate control there was awareness that the prospect of an unwelcome takeover bid was a potentially significant disciplinary mechanism for executives.” However, Manne was the first scholar to provide a comprehensive academic theorization of the phenomenon, as well as the first to coin the terminology of “the market for corporate control” itself. See BRIAN CHEFFINS, *THE PUBLIC COMPANY TRANSFORMED* 79 (2018).

7. Manne, *supra* note 5, at 112.

8. See Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 12 J. L. ECON. & POL. 251, 258 (2016).

9. See Matthew D. Cain et al., *Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeovers*, 124 J. FIN. ECON. 464, 479 (2017).

10. *Id.* at 465.

11. See *infra*, Part I.

12. Cain et al., *supra* note 9, at 479 (“As a proportion of total M&A equal-weighted volume, hostile activity peaked in 1967 at 40% immediately prior to the enactment of the Williams Act and declined to about 8.6% in 2014.”).

13. Steven Davidoff Solomon, *Hostile Takeovers Abound, but Success Is No Guarantee*, N. Y. TIMES (May 27, 2016), <https://www.nytimes.com/2016/05/28/business/dealbook/hostile-takeovers-abound-but-success-is-no-guarantee.html>.

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hostile takeover market. Despite having a broadly similar capital market environment and corporate governance system to the United States,¹⁴ the conduct and regulation of takeovers in the United Kingdom bears little resemblance to that of her New World cousin.¹⁵

For a start, the United Kingdom is traditionally acknowledged as having a much more vibrant hostile takeover market than the United States, in terms of both the percentage of overall M&A deals that are contested and the proportion of hostile deals that are successfully completed.¹⁶ Of further interest from a U.S. perspective is the fact that the British hostile takeover market developed *without* the notoriously coercive two-tier tender offer ever entering the fray. Consequently, U.K. listed target companies have never had the same need to engage poison pills or other shark repellent devices. Nor has there ever been much of an appetite in the U.K. for introducing any form of U.S.-style anti-takeover statute.

Rather, structural takeover defenses have been effectively prohibited by the U.K.'s much more pro-shareholder (by U.S. standards) regulatory framework for the past half century and beyond.¹⁷ As an offshoot of this, bidders for U.K. listed targets have seldom had reason to trigger the arduous proxy contests that have become a fixture of the U.S. acquisitions landscape, on the premise that a substantially unimpeded road to gaining control over the target is available in other less costly and time-intensive ways.

At the same time, like their U.S. counterparts, U.K. target managers have in general been at liberty to seek out competing friendly bidders (so-called “white knights”) in response to actual or threatened hostile bids, and to provide them with confidential information and deal inducements.¹⁸ This has enabled active multi-bidder contests for corporate control of U.K. targets, notwithstanding U.K. target managers’ practical incapacity to facilitate corporate auctions via the limited deployment of poison pills and other structural defenses in response to inadequate initial bids, as is generally permissible in the case of U.S. targets.¹⁹

As a practical illustration of Henry Manne’s model of the market for corporate control in action, the U.K. thus stands out as a highly pertinent comparative case in point. Moreover, the British experience with hostile takeovers demonstrates that despite what first appearances might suggest, there *is* in fact another way for the U.S. to go in this regard.

Accordingly, we find the current domestic state of affairs unacceptable. Without a vibrant hostile takeover market, a significant *corrective mechanism* in

14. Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior under Limited Regulation*, 92 MICH. L. REV. 1997, 2001-02 (1994).

15. John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1729 (2007).

16. See *infra* notes 157-158 and accompanying text.

17. See *infra* Part IV.A.2.

18. See *infra* notes 143-147 and accompanying text.

19. See *infra* notes 139-142 and accompanying text.

the corporate governance of U.S. public companies has been lost. We believe the law should give the hostile bidder the opportunity to return as a corrective mechanism in corporate governance. This would allow for a more efficient balance between the board's managerial discretion and the corrective ability that the market for corporate control can provide. Therefore, this Article recommends that state corporate law statutes be amended to include a safe harbor for hostile bidders who make all-cash, all-shares tender offers that includes a guarantee of the same or higher price if a back-end or squeeze-out merger²⁰ occurs.²¹ Thus, in the face of a non-coercive hostile bid, a board cannot use takeover defenses such as a poison pill or other statutory defenses, unless specifically provided for in the corporate charter. In this way, if the board and shareholders agree, a company can always use private ordering to trump the statutory safe harbor.

In the discussion that follows, references to state corporate law, have been pragmatically framed in the context of Delaware corporate law. Delaware is the state where the majority of the largest U.S. companies are incorporated,²² and its corporate law often serves as the authority that other states look to when developing their own statutory and case law.²³ Therefore, the primary examples here are from Delaware, but the thinking is meant to be global in nature.

This Article proceeds as follows: Part I explains the market for corporate control and the role played by hostile tender offers. Part II discusses the factors that led to the dismantling of the U.S. hostile takeover market. Part III explains how the U.S. approach to hostile takeovers is inconsistent with Henry Manne's *theory of the market for corporate control* and the *efficiency/synergy theory of tender offers*. Part IV describes the U.K.'s experience with the *board passivity rule* (a rule consistent with the theory found in Part III), which essentially prohibits target managers from deploying any form of aggressive takeover defense in response to an actual or imminently threatened hostile tender offer. Part V discusses the empirical evidence on tender offers, including hostile tender offers, in both the U.S. and U.K. Part VI provides a recommendation for how to revitalize the hostile takeover market in the U.S. Specifically, we recommend a

20. In this context, a back-end or squeeze-out merger refers to the forced sale of stock owned by minority shareholders after the hostile bidder has acquired majority control from the successful execution of the front-end of a two-tier tender offer. For a discussion of the two-tier tender offer, see *infra*, Part I.

21. Mr. Sharfman first proposed a variant of this recommendation in his article, *The Tension Between Hedge Fund Activism and Corporate Law*. See Sharfman, *supra* note 8, at 272; see also, Bernard S. Sharfman, *A Simple Plan to Liberate the Market for Corporate Control*, CLS BLUE SKY BLOG (Aug. 15, 2017), <https://clsbluesky.law.columbia.edu/2017/08/15/a-simple-plan-to-liberate-the-market-for-corporate-control/>.

22. See LEWIS S. BLACK, JR., DEL. DEPT. OF STATE. DIV. OF CORP., WHY CORPORATIONS CHOOSE DELAWARE I (2007) (stating that Delaware is the "favored state of incorporation for U.S. businesses"). According to the State of Delaware website, Delaware is the legal home to "[m]ore than 50% of all publicly-traded companies in the United States including 64% of the Fortune 500." STATE OF DELAWARE, ABOUT AGENCY, <http://corp.delaware.gov/aboutagency.shtml> (last visited Nov. 3, 2015).

23. See Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 397 (2007).

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new corporate law default rule that we argue to be the one that most companies would have adopted if they had considered the matter when going public.

I. THE MARKET FOR CORPORATE CONTROL

The market for corporate control refers to the buying and selling of shares by which acquirers gain voting control of “target” companies, whether privately held or publicly traded.²⁴ Changes in control may occur through merger, tender offer, proxy contest, or some combination thereof.²⁵ The rationale for the market’s existence is explained by B. Espen Eckbo:

In publicly held corporations²⁶ ownership of the firm’s common stock is frequently dispersed across a large number of stockholders, while control over the firm’s productive resources is left with a relatively small group of managers. . . . [T]his separation of ownership and control inevitably leads to a serious conflict of interest between self-interested managers and the owners. . . . The concern, is that in the presence of a passive body of stockholders, there is no major force ‘disciplining’ incumbent management into acting in the interest of the firm’s owners. However, as argued by Manne . . . ,²⁷ a potentially important market force originates in the possibility for the owners to trade the rights to control the corporation Competition among managerial teams for the right to manage resources limits divergence from shareholder wealth maximization by managers.²⁸

Imbedded in this explanation is Michael Jensen and Richard Ruback’s understanding that the market for corporate control is “a market in which alternative managerial teams compete for the rights to manage corporate resources.”²⁹ According to Jensen and Ruback:

The managerial competition model . . . views competing management teams as the primary activist entities, with stockholders . . . playing a relatively passive, but fundamentally important, judicial role. Arbitrageurs and takeover specialists facilitate these transactions by acting as intermediaries to value offers by competing management teams, including incumbent managers. Therefore, stockholders in this system have relatively little use for detailed knowledge about the firm or the plans of

24. Ronald J. Gilson & Andrew Schwartz, *An Efficiency Analysis of Defensive Tactics* 3 (Columbia Univ. Sch. of Law, The Center for Law & Econ. Studies, Working Paper No. 623, 2020) (“The “market for corporate control” is the market in which companies or investment vehicles such as private equity firms search for other companies to buy. The companies that search are called “acquirers”; the companies that are searched for are called “targets.””). See also, Edward B. Rock, *Antitrust and the Market for Corporate Control*, 77 CAL. L. REV. 1365, 1370, n.9 (1989) (quoting *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987)) (“[T]he very commodity that is traded in the ‘market for corporate control’ [is] the corporation . . .”). According to William Carney, the phrase “the market for corporate control” was first introduced into the corporate law literature by Henry G. Manne in his article, *Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427, 1444 (1964). See William J. Carney, *The Legacy of “The Market for Corporate Control” and the Origins of the Theory of the Firm*, 50 CASE WEST. RES. U. L. REV. 215, 234 (1999).

25. Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 6 (1983).

26. A publicly held corporation or public company can be defined as a for-profit corporation that is publicly traded on a national exchange or over the counter.

27. See *infra* Part IV.

28. B. Espen Eckbo, *Mergers and the market for corporate control: the Canadian evidence*, 19 CANADIAN J. ECON. 236, 236-37 (1986).

29. Jensen & Ruback, *supra* note 25, at 6.

competing management teams beyond that normally used for the market's price setting function. Stockholders have no loyalty to incumbent managers; they simply choose the highest dollar value offer from those presented to them in a well-functioning market for corporate control, including sale at the market price to anonymous arbitrageurs and takeover specialists. In this perspective, competition among managerial teams for the rights to manage resources limits divergence from shareholder wealth maximization by managers and provides the mechanism through which economies of scale or other synergies available from combining or reorganizing control and management of corporate resources are realized.³⁰

This understanding of the market for corporate control led Eckbo to conclude that "the existence of a well-functioning market for corporate control may explain why the separation of ownership and control observed in large, publicly held corporations in fact has survived as a competitive organizational form."³¹ This is a profound conclusion, having implications for corporate governance, the investment options available to the average investor, and the value of holding stock by small investors.³²

Within the market for corporate control exists the sub-category of hostile takeovers. Since the 1950s, the tender offer has been the primary tool for accomplishing a hostile takeover: the acquisition of a public company without the approval of the target company's board of directors.³³ According to Robert Prentice, a "tender offer may be generally defined as: a public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly held corporation at a specified price or upon specified terms for cash and/or securities."³⁴ The tender offer, which in the current environment is typically used for friendly takeovers in what are referred to as two-step mergers,³⁵ will normally be conditional, with the offeror having the right to withdraw its offer to purchase shares at the offered price if the number of shares tendered does not meet a minimum number.³⁶

30. *Id.*

31. Eckbo, *supra* note 28, at 237.

32. According to Manne, "Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders." See Manne, *supra* note 5, at 113.

33. John Armour & Brian Cheffins, *Stock Market Prices and the Market for Corporate Control*, 2016 U. ILL. L. REV. 761, 764 (2016). The tender offer is a pragmatic way to cap the offered takeover premium by using a fixed price versus trying to acquire control through open market purchases. *Id.*

34. Robert A. Prentice, *Front-End Loaded, Two-Tiered Tender Offers: An Examination of the Counterproductive Effects of a Mighty Offensive Weapon*, 39 CASE WESTERN RESERVE U. L. REV. 389, 393 (1988-89).

35. This involves the acquisition of control through a successful tender offer and then a squeeze-out merger for the rest of the shares. For Delaware corporations this is done under Del. Code Ann. 8, § 251(h). The benefits of a two-step merger versus a one-step merger include the ability to conclude the transaction quickly given that a vote of target shareholders is not required. See Piotr Korzynski, "Forcing the Offer": *Considerations for Deal Certainty and Support Agreements in Delaware Two-Step Mergers*, HARV. L. SCH. FORUM CORP. GOV. (April 2, 2018), <https://corpgov.law.harvard.edu/2018/04/02/forcing-the-offer-considerations-for-deal-certainty-and-support-agreements-in-delaware-two-step-mergers/>

36. Armour & Cheffins, *supra* note 33, at 771.

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By making its offer directly to shareholders, the offeror avoids having to deal directly with a disapproving board. Since 1968, the Williams Act, a federal statute, has governed the disclosure and process requirements of tender offers targeting public companies.³⁷ As we shall see in Part II, one of the unintended consequences of the Williams Act was to begin the process of diminishing the U.S. hostile takeover market.

II. WHY THE U.S. HOSTILE TAKEOVER MARKET HAS BEEN DIMINISHED

During the early 1980s, the hostile takeover was a major force in corporate governance.³⁸ There was also very little a board of directors and executive management could do about it. According to John Coffee, writing at the time, “[i]n most cases, there is little that the target can do to remain an independent company once a hostile bid has been made, and statistically only about twenty to twenty-five percent of target companies remain independent once there has been an initial tender offer. Realistically, the target’s choice is between ravishment by the hostile suitor or a hastily arranged shotgun wedding with the ‘white knight [a bidder for control that the target board finds acceptable].”³⁹

The statistics that Coffee refers to bear this out. For example, according to Diana Fortier, in 1981 there were 75 tender offers made to shareholders of public companies, of which 28 were hostile.⁴⁰ Thirteen of the targets were successfully acquired by the bidder.⁴¹ Nine of the 28 were acquired by a white knight.⁴² Only six of the 28 companies targeted by hostile bidders were able to remain independent.⁴³

Moreover, during that time, the hostile bidder was seen as a threat not only to an entrenched and inefficient board of directors and executive management, but also to shareholders when the bidder employed the coercive two-tier tender offer, which was a new and controversial takeover technique back then.⁴⁴

37. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2016).

38. Cain et al., *supra* note 9, at 479. Although, as Cheffins has noted, the first meaningful hostile takeover of a large company took place in the mid-1970s, while the threat to target managers of so-called corporate “raids” had been present in the United States since the 1950s. See Cheffins, *supra* note 6, at 79-80, 152-53.

39. John C. Coffee Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1149 (1984). This article, even though it was written prior to the rise of the poison pill and other antitakeover statutes, is noted for its comprehensive and thorough approach to the subject and should be considered a seminal work on the topic of hostile takeovers.

40. Diana L. Fortier, *Hostile takeovers and the market for corporate control*, 13 ECON. PERSPECTIVES 1, 3 (1989) (Table 1).

41. *Id.*

42. *Id.*

43. *Id.*

44. The front-end loaded, two-tiered tender offer did not make its appearance until 1980. See Prentice, *supra* note 34, at 397. Bruce Wasserstein, the famous investment banker, was credited with its invention. *Id.*

A. The Technique that Diminished the U.S. Hostile Takeover Market

The coercive two-tier tender offer entered the marketplace in 1980.⁴⁵ Dale Osterle provides the following description of how it works:

A begins, for example, a hostile tender offer for fifty-one percent of *B*'s stock by offering a twenty percent premium [can be more or less], and threatens to force out the remaining shareholders at a lower price in a takeout [squeeze-out] merger. . . . Thus, if *A* structures the offer correctly, *B*'s shareholders will race to tender their stock because the tardy will lose the opportunity to share in the tender offer premium.⁴⁶

As a result, the rational stockholder will always try to tender as many shares as possible into the front-end of the bid, whether or not the premium is sufficient, because of the potential of losing out on the offered premium if the acquisition bid is successful.⁴⁷ This is referred to as the "prisoner's dilemma."⁴⁸

The catalyst for the development of this unique type of tender offer was the Williams Act,⁴⁹ a federal law enacted in 1968 to provide investors with adequate disclosures and time for informed decision-making when faced with a tender offer.

According to Frank Easterbrook and Daniel Fischel, two of the most important corporate governance scholars of the last 50 years, prior to the Williams Act, hostile bidders were allowed to make tender offers that were "designed to force shareholders to decide quickly whether to sell all or part of their shares at a premium."⁵⁰ To combat this phenomenon, the SEC implemented rules under the Act that required investors to have at least 20 days to review the offering documents provided in a tender offer.⁵¹

Despite its intended purpose to help shareholders, the Williams Act had unintended consequences that led to reduced premiums for target shareholders. The Act created these consequences by making it a requirement that when more shares were tendered than the offeror wished to purchase, the offeror was required to purchase shares on a pro rata basis from all those who tendered them within ten calendar days after the offer began.⁵² Eventually, bidders realized that

45. *Id.* at 394.

46. Dale A. Osterle, *Target Managers as Negotiators in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 60-61 (1985).

47. C. Steven Bradford, *Stampeding Shareholders and Other Myths: Target Shareholders and Hostile Tender Offers*, 15 J. CORP. L. 417, 421-424 (1990).

48. *Id.* at 423.

49. 15 U.S.C. 78n(d)-(f).

50. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARVARD L. REV. 1161, 1162 (1981). According to Easterbrook and Fischel, "Before 1968 offerors could limit the time an offer would be available, require that tenders be irrevocable, or specify that if the offer should be oversubscribed the first shares to be tendered would be the first to be purchased. Offers with such terms produced considerable pressure for shareholders to tender quickly, lest they lose the opportunity to realize the favorable terms." *Id.* at 1162 n.6.

51. 17 C.F.R. § 240.14e-1(a) (2010).

52. 15 U.S.C. 78n(d)(6) (2016). *See* Prentice, *supra* note 34, at 394 (for a general discussion of this loophole).

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they could use this statutory provision to offer premium reducing coercive two-tier tender offers.⁵³

Interestingly, while these coercive tender offers were never more than 20% of all acquisition bids,⁵⁴ the responses they engendered, both statutory and judicial, have had a devastating impact on the hostile takeover market.

B. The Responses

The responses meant to inhibit the use of coercive two-tier tender offers can be divided into two categories: state antitakeover statutes and company implemented shark repellents such as the shareholder rights plan, commonly referred to as the “poison pill.”

1. Antitakeover Statutes

Antitakeover statutes in general come in many different varieties, and include the following:

- “Fair price” statutes require that shareholders who tender their shares on the back-end of a coercive two-tier tender offer receive a price that is just as high or higher than those who tender their shares on the front-end.⁵⁵
- “Business combination” or “freeze-out” statutes prohibit a corporation from engaging in any business combination with a shareholder for a certain period of time (such as three to five years) following the time that such stockholder became an owner of a certain percentage of the company’s stock (such as 15%-20%).⁵⁶
- “Control-share acquisition” statutes typically require an acquirer to obtain approval of the company’s disinterested shareholders before it can fully exercise its voting rights and truly take control of the company.⁵⁷
- “Pill Endorsement” statutes permit the use of a poison pill even when the courts of a particular state have invalidated them. These statutes essentially allow a board of directors to discriminate against a hostile bidder by not allowing it to participate in the purchase of discounted shares in a shareholder rights plan.⁵⁸ According to Michal Barzuza, 29 states have adopted such a statute.⁵⁹ Poison pills are discussed in more detail in the next section.
- “Mandatory staggered board” statutes require all corporations to have a staggered, or classified, board of directors unless the board of directors or shareholders opt out of the statute.⁶⁰ For example, having a staggered board

53. On December 15, 1982, in a move that went against the plain language of Section 14-d(6) of the Securities and Exchange Act of 1934, the SEC effectively extended the pro-rata period from ten to twenty days by implementing Rule 14d-8. *See* 47 F.R. 57680 (1982); *see also* W. Brewster Lee III, *SEC Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance*, 68 CORNELL L. REV. 914 (1983) (for a discussion of how the SEC justified the implementation of Rule 14d-8).

54. Prentice, *supra* note 34, at 397.

55. *See* MD. CORPS. & ASS’NS CODE ANN. §§ 3-601 to -603 (2019).

56. *See* DEL. CODE ANN. tit. 8, § 203 (2019).

57. *See* FLA. STAT. § 607.0902 (2020).

58. Michal Barzuza, *The State of Antitakeover Law*, 95 VA. L. REV. 1973, 1996 (2009).

59. *Id.* at 1988.

60. *See* MASS. GEN. LAWS ANN. ch. 156D, § 8.06(a)–(g) (2019).

would typically require only one-third of a company's directors to stand for reelection each year, delaying the ability of a hostile bidder to gain control of a company's board of directors even though it has obtained a majority of voting shares. This type of statute discourages all types of hostile takeovers, not just coercive two-tier tender offers.

2. *Poison Pills*

The poison pill plays an important—if not *the* most important—role in squashing coercive two-tier tender offers and hostile takeovers in general. The poison pill gives shareholders the right to purchase additional shares at a discounted price. The poison pill is triggered whenever a hostile bidder reaches a particular percentage ownership in the company, perhaps 10% to 15%.⁶¹ Moreover, at that level of share ownership, the hostile bidder is excluded from exercising its rights under the plan. The threatened radical dilution in the hostile bidder's prospective ownership discourages it from ever attempting to acquire the company without the approval of the board.

For a hostile bidder, the poison pill is a major obstacle in its desire to gain control of the target company against the wishes of the board of directors.⁶² To succeed in its quest, a hostile bidder must get the board to redeem the pill. However, without the acquiescence of the current board, this can only be done through the successful initiation of a proxy contest (the attempt by one or more shareholders to elect a competing slate of directors at an annual or special meeting of shareholders). If successful, and there are no guarantees that it will be, then the new board can redeem the pill.

Martin Lipton, the inventor of the poison pill back in the summer of 1982, succinctly describes the objective of the poison pill and its expected impact:

The pill prevents a hostile tender offer from being consummated unless and until the board of directors of the target redeems the pill. The pill does not prevent a proxy fight to remove and replace a board of directors that refuses to redeem the pill. It was and is a fundamental aspect of the pill that a proxy fight is the only way in which a raider can override a well-founded decision of the board to reject and block a takeover bid.⁶³

The problem with depending solely on proxy contests to discipline management or implement synergies, though, is that they are an ineffective means of doing so. As Park McGinty explains:

Collective action problems, however, render proxy contests generally ineffectual for disciplining management. Economic incentives make the proxy fight uneconomical for most dissidents, even if they have correctly perceived significant erosion in

61. Steven Davidoff Solomon, *Hostile Takeovers Abound, but Success Is No Guarantee*, N. Y. TIMES (May 27, 2016), <https://www.nytimes.com/2016/05/28/business/dealbook/hostile-takeovers-abound-but-success-is-no-guarantee.html>.

62. This is not to say, of course, that the introduction of the poison pill in the 1980s signaled the end of hostile tender offers by any means. See Cheffins, *supra* note 6, at 179. Nonetheless, the consequently increased uncertainty and other transaction costs for hostile bidders where pills are in play are undeniable.

63. See Martin Lipton, *Pills, Polls, and Professors Redux*, 69 UNIV. CHICAGO L. REV. 1037, 1037 (2002).

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shareholder value. In addition, the nature of a proxy fight invites rational apathy by shareholders. Unlike the tender offer, which provides a single offered share price which stands in stark contrast with the pre-takeover price, a proxy contest confronts shareholders with huge informational burdens. Shareholders must sift through competing election materials to decide which group of nominees will best run the company. The complexity of such a decision creates inertia that favors the incumbents. Knowing that one's decision will not tip the balance of the contest, most shareholders remain uninvolved and doom most proxy fights to failure.⁶⁴

The Delaware courts have been quite accommodating to a board's use of the pill. They not only approve of its use when the board has been given authority via a charter amendment, and therefore approved by the company's shareholders, but also, as decided by the Delaware Supreme Court in the pivotal case of *Moran v. Household Int'l, Inc.*,⁶⁵ when implemented by the board of directors as an ordinary business decision. In *Moran*, a board's decision to implement a poison pill was provided the protection of the business judgment rule.⁶⁶ In essence, the Court allowed the board to usurp what should have been a market-driven, shareholder approved, privately ordered corporate governance arrangement by allowing for its implementation through the board's unilateral decision.

The principal judicial constraint on a board's authority to implement poison pills and other takeover defenses is the *Unocal* test, which was created by the Delaware Supreme Court roughly contemporaneously with its abovementioned decision in *Moran*.⁶⁷ The *Unocal* test was intended to ensure boards do not implement "Draconian" measures and violate their fiduciary duties to shareholders when implementing poison pills and other takeover defenses.⁶⁸ It provides "enhanced scrutiny"⁶⁹ of board actions when issues of control exist and therefore a heightened suspicion that Board action may be a result of bad faith, a lack of reasonable investigation,⁷⁰ or for purposes of entrenchment.⁷¹ Not surprisingly, the *Unocal* test was created based on a fact pattern involving a coercive two-tier tender offer.⁷²

There are two prongs to the *Unocal* test. The first prong requires the Board to demonstrate "reasonable grounds for believing that a danger to corporate

64. Park McGinty, *Replacing Hostile Takeovers*, 144 U. PENN. L. REV. 983, 986 n.2 (1996).

65. *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) (clarifying that a board of directors of a Delaware corporation has the authority to create a poison pill without shareholder approval and that the decision is protected by the business judgment rule).

66. *Id.* at 1357.

67. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1986) (Mesa Petroleum Company engaged in a hostile, two-tier, front-loaded tender offer to take over Unocal Corporation.).

68. *Id.* at 955 ("A corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available.").

69. Enhanced scrutiny refers to an "enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." *Id.* at 954.

70. *Id.* at 955 (Directors must show "good faith and reasonable investigation.").

71. *Id.* at 954 ("Delaware corporation may deal selectively with its stockholders, provided the directors have not acted out of a sole or primary purpose to entrench themselves in office.").

72. *Id.*

policy and effectiveness existed.”⁷³ Directors satisfy this prong by demonstrating “good faith and reasonable investigation.”⁷⁴ Good faith in this context can be understood as the Board having a “sincere belief” that such a threat existed.⁷⁵ If the Board can show that it was informed, then reasonable investigation has been satisfied.⁷⁶ Becoming informed requires “direct investigation, receipt of professional advice, and personal observations.”⁷⁷ Evidence of good faith and reasonable investigation is “materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors.”⁷⁸

The second prong, “a proportionality test, [must be] satisfied by a demonstration that the . . . defensive measure was *reasonable in relation to the threat posed*.”⁷⁹ The review for proportionality is also a two-part test.⁸⁰ First, the court must determine whether the defensive measure was “draconian, by being either preclusive or coercive.”⁸¹ Second, “if the Board’s response to the threat was [determined] not [to be] draconian, the Court must then decide [if the defensive measure] fell ‘within a range of’ reason.”⁸²

Unfortunately, while enhanced scrutiny under *Unocal* sounds like it creates a serious challenge to a board’s improper use of defensive measures, it has not been very effective in monitoring a board’s use of a poison pill. The Delaware courts have been very permissive in allowing boards to maintain and implement takeover defenses for purposes that go well beyond protecting shareholders from coercive two-tier tender offers,⁸³ even allowing boards to implement defensive measures to protect against all cash offers for 100% of the company’s shares.⁸⁴

According to Bebchuk, Cohen, and Ferrell,

Delaware has a well developed body of case law, which makes the absence of some types of antitakeover statutes practically irrelevant. Delaware’s judges have played an active role in developing legal doctrines that permit the use of defensive tactics in general and the potent poison pill defense in particular. Because of the large body of Delaware judge-made law upholding the indefinite use of poison pills, there is no

73. *Id.* at 955 (citing *Cheff v. Mathes*, 199 A.2d 548, 554-55 (Del. 1964)).

74. *Id.*

75. The equivalency of “good faith” and “sincere belief” was established in *Cheff v. Mathes*, the case that provided the first prong of the *Unocal* test. See Leo E. Strine Jr. et al., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629, 670 (2010) (citing *Cheff*, 199 A.2d at 554).

76. *Moran v. Household Int’l, Inc.*, 500 A.2d at 1356.

77. *Cheff*, 199 A.2d at 556.

78. *Unocal*, 493 A.2d at 955 (citing *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964)).

79. *Third Point LLC*, 2014 WL 1922029, at *17 (quoting *Unocal*, 493 A.2d at 955).

80. *Id.*

81. *Id.* (quoting *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1367 (Del. 1995)).

82. *Id.* (quoting *Unitrin*, 651 A.2d at 1367).

83. Jonathan R. Macey, *The Politicization of American Corporate Governance*, 1 VA. L. & BUS. REV. 10, 35 (2006) (“Courts have failed to restrict the use of poison pills to their proper context—the regulation of coercive two-tiered tender offers.”).

84. *Id.* (citing *Paramount Commc’ns v. Time Inc.*, 571 A.2d 1140, 1142 (Del. 1989) (allowing Time to retain poison pill despite all-cash offer.); see Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381 (2001) (providing an excellent discussion of how the Delaware courts have incorrectly allowed the poison pill to be implemented with little restraint under *Unocal*).

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need for an antitakeover statute explicitly authorizing the use of poison pills (a poison-pill-endorsement statute)⁸⁵

As a result, according to Macey,

Thus, by judicial fiat, the Delaware courts have removed from the marketplace the hostile tender offer, which is the most powerful corporate governance device in the shareholders' corporate governance arsenal. As Baums and Scott presciently have observed, "Delaware jurisprudence seems to be willing, in substance . . . to give management something approaching an absolute veto over hostile tender offers despite overwhelming evidence that they confer large benefits on target shareholders." Again, just as courts and legislatures have undermined the vitality of credit rating agencies and accounting firms, they have undermined the market for corporate control.⁸⁶

One notable example of how the Delaware courts have emasculated the *Unocal* test and endorsed the poison pill is through the acceptance of board defensive measures that are used solely to combat the threat of "substantive coercion," which is "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value."⁸⁷

Substantive coercion occurs when shareholders do not believe the board's valuation estimate, compelling them to tender their shares.⁸⁸ The Delaware Supreme Court first referenced substantive coercion in footnote 17 of *Paramount Commc'ns v. Time Inc.*⁸⁹ In *Time*, the defensive measures under judicial scrutiny did not involve a poison pill. However, the opinion's reference to substantive coercion as a possible reasonable threat to the corporation set the stage for its future use.⁹⁰

Unitrin v. American General Corp. firmly established that substantive coercion could be used by a board to justify the implementation of defensive measures.⁹¹ The court found that if a board determines an all-cash, all-shares offer (here, a hostile merger, not a tender offer)⁹² to be of inadequate value, the bid's purportedly low value may *in itself* constitute a "legally cognizable threat" that justifies the adoption of a defensive measure.

While *Unitrin* did not involve a poison pill, it was clear that substantive coercion could be used as the rationale for its implementation. For example, in *Air Prod. and Chem. Inc. v. Airgas, Inc.*, the Chancery Court found the board's determination that the offer price in an all-cash offer with a commitment to offer

85. Lucian Arye Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1803 (2002).

86. Macey, *supra* note 83, at 35.

87. Ronald J. Gilson & Reiner Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 267 (1989) (The term "substantive coercion" was coined and defined in this article.).

88. *Id.* at 259-60.

89. *Paramount Commc'ns v. Time Inc.*, 571 A.2d at n.17.

90. Eduardo Gallardo, *Poison Pills Revisited*, HARVARD L. SCH. FORUM CORP. GOV. (Feb. 18, 2010), <https://corpgov.law.harvard.edu/2010/02/18/poison-pills-revisited/>.

91. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A. 2d 1361, 1367 (Del. 1995).

92. *Id.*

the same price in a squeeze-out merger was inadequate to be a “legally cognizable threat” and enough without more to justify the maintenance of a poison pill.⁹³

C. *Summary*

The approach taken by state legislatures and the Delaware courts has had destructive effects on the hostile takeover market. Not only have anti-takeover statutes and common law backed poison pills destroyed the coercive two-tier tender offer, they have also severely diminished the use of any type of hostile tender offer. In sum, the opportunistic use of the coercive tender offer created bad facts that allowed judges and state legislatures to create bad law.⁹⁴

III. THE MARKET FOR CORPORATE CONTROL AND THE EFFICIENCY/SYNERGY THEORY OF TENDER OFFERS

An important reason why the diminished state of the U.S. hostile takeover market is so distressing is that for over 50 years there has existed an extremely compelling theory (Henry Manne’s *theory of the market for corporate control*), explaining how the hostile takeover market, and its lead player, the hostile bidder, acts as an important corrective mechanism in corporate governance. In this Part we explain how Manne’s theory sits comfortably within the broader efficiency/synergy theory of tender offers.

A. *Manne’s Theory of the Market for Corporate Control*

Manne’s theory proceeds on the premise that there is “a high positive correlation between corporate managerial efficiency and the market price of shares of that company.”⁹⁵ Such a premise means that the price of a public

93. *Air Prod. and Chem., Inc. v. Airgas, Inc.*, 16 A.3d 48, 129 (Del. Ch. 2011).

94. In a recent article titled *The Death of Corporate Law*, Goshen and Hannes suggest that the Delaware courts’ characteristically permissive stance on poison pills over recent decades is of limited practical significance today, as the rising power of large, informed institutional investors has caused capital market dynamics increasingly to displace litigation as the principal determinant of prevailing corporate governance norms. Goshen and Hannes claim that markets have correspondingly replaced courts as the main source of regulatory power in corporate governance today, as evidenced by the marked reduction in the usage of poison pills and staggered boards within at least the largest tier of publicly traded U.S. corporations over recent years. See Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263 (2019). While Goshen and Hannes’ argument in this regard is elegantly put, we respectfully find it unconvincing. As Mr. Sharfman explains in a forthcoming article, the most powerful institutional investors today as measured by scale and concentration of equity ownership are index mutual funds, whose macro-focused investment strategies are conducive to inherent governance passivity at the individual investee firm level. In addition, the significant resource constraints and consequent monitoring limitations of proxy advisors have, in general, prevented them from acting as an effective surrogate check on micro-level corporate governance norms on anything less than a crude and unsatisfactory, “one-size-fits-all” basis. See Bernard S. Sharfman, *The Risks and Rewards of Shareholder Voting*, 73 S.M.U. LAW. REV. 849 (2020).

95. Manne, *supra* note 5, at 112.

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company's stock will in part reflect managerial performance.⁹⁶ Manne used this premise to argue that “the control of corporations may constitute a valuable asset” in and of itself; an asset that “exists independent of any interest in either economics of scale or monopoly profits,”⁹⁷ if the acquirer takes control with the expectation of correcting managerial inefficiencies.⁹⁸ Moreover, assuming the existence of a liquid stock market where potential acquirers could assess the price of the stock versus what the price could be with better management,⁹⁹ these expected gains in efficiency can be quantified by evaluating how the share price of the company changed as a result of the announced hostile takeover bid.¹⁰⁰

Manne provides the following description of how the market for corporate control operates in the context of a vibrant hostile takeover environment:

[I]f an existing corporation with publicly traded shares is poorly managed, holders of those shares will respond by selling. This will drive the price down to the point indicated by the quality of management which the corporation is receiving. As the price of securities of any corporation is thought to be low relative to the price that would be generated by more efficient managers, the stage is set for the critical functioning of the market for corporate control. Outsiders, whether we call them “raiders”¹⁰¹ or more polite names, will respond to the opportunity to make substantial

96. We fully acknowledge that this premise is by no means universally accepted, and indeed has been widely contested on both descriptive and normative grounds. Descriptively, Manne's purported correlation between share price and managerial efficiency is arguably problematic on account of its implicit reliance on the empirical accuracy of the Efficient Capital Market Hypothesis (“ECMH”) in modern finance theory, and its corresponding elision of the various real-world impediments to accurate securities price formation. At the same time, Manne's theory is arguably normatively objectionable insofar as it adopts shareholder welfare – as measured in terms of relative stock price performance – as a somewhat crude proxy for the broader social or stakeholder welfare impacts of notionally “efficient” corporate policies. Unfortunately, time and space limitations have prevented us from engaging in greater depth with these fundamental concerns in the present article. For purposes of the immediate project at hand, though, we believe that there exists a sufficiently stable nucleus of opinion within modern law and finance scholarship as to the basic (albeit highly imperfect) co-relativity of stock price/corporate performance and shareholder/stakeholder welfare, at least insofar as the latter criteria are measured in terms of material economic outcomes arising under normal market conditions. Accordingly, the present article contributes to advancing the general literature on the shareholder welfare effects of alternative corporate governance arrangements with respect to the market for corporate control, taking the above positions as commonly accepted conceptual preconditions of any such inquiry. *See, e.g.*, Marc T. Moore & Antoine Reberieux, *Revitalizing the Institutional Roots of Anglo-American Corporate Governance*, 40 *ECON. SOC.* 84, 87-90 (2011); Marc T. Moore & Antoine Reberieux, *Corporate Power in the Public Eye: Reassessing the Implications of Berle's Public Consensus Theory*, 33 *SEATTLE U. L. REV.* 1109, 1136 (2010).

97. Entering into a merger may also be done to increase market power with a resulting loss of social welfare and increased prices. *See* Fred S. McChesney, *Manne, Mergers, and the Market for Corporate Control*, 50 *CASE WESTERN U. L. REV.* 245, 248 (1999). However, for purposes of this Article, it is assumed that current U.S. antitrust laws and their enforcement are adequate to stop such a merger from being completed.

98. Manne, *supra* note 5, at 112.

99. *Id.* at 113 (“Share price, or that part reflecting managerial efficiency, also measures the potential capital gain inherent in the corporate stock.”).

100. McChesney, *supra* note 97, at 252.

101. Undoubtedly, Manne is referring here to hostile bidders. However, Manne did not limit the definition of an acquirer to a corporate raider or hostile bidder. Manne, *supra* note 5, at 117-18. The friendly acquisition is a perfectly acceptable way of gaining control for purposes of implementing efficiencies, even though Manne suggested that some sort of side payment to the target's management was usually involved in order to get their sign-off. *Id.* at 118. According to Coffee, “Manne's focus was not specifically on hostile tender offers, which were then just beginning to become highly visible, but

capital gains (not necessarily in the tax sense) by buying control, managing the company efficiently, and then perhaps disposing of the shares. It is not necessary that they remain permanently to manage the business.¹⁰²

Acquirers who participate in the market for corporate control, i.e., those who are motivated at least in part by the profits that can be earned by correcting managerial inefficiencies, can be categorized as a very special subset of what Zohar Goshen and Gideon Parchomovsky call “information traders.”¹⁰³ These traders trade in the financial markets based on non-public research and analysis and “are willing and able to devote resources to gathering and analyzing information as a basis for their investment decisions.”¹⁰⁴ Moreover, they look for differences “between value and price based on the information they possess . . . [t]hen trade to capture the value of their informational advantage.”¹⁰⁵ Information traders move security prices toward their fundamental values and are in essence “the agents who render markets efficient.”¹⁰⁶

As Mr. Sharfman has stated in a prior writing:

Paradoxically, information traders who have the necessary information, but do not participate in the market for corporate control, create the foundation for the market’s success. A critical assumption surrounding the market for corporate control is that the vast majority, or at least a significant number, of information traders would rather sell their shares than attempt to acquire control. . . . Unsurprising, since participating in the market for corporate control means “raising large amounts of capital necessary to acquire” a firm, as well as possessing the managerial expertise required to correct the inefficiencies at the target firm. “Moreover, becoming an acquirer may mean giving up the benefits of portfolio diversification as the acquisition becomes an overweighed investment in the information trader’s portfolio and therefore exposes the trader to non-systematic risk.”¹⁰⁷

Moreover, according to Manne,

The lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently. And the potential return from the successful takeover and revitalization of [a] poorly run company can be enormous.¹⁰⁸

rather on acquisitions, mergers, and control contests generally.” See Coffee, *supra* note 39, at 1153. Moreover, those entities who may be in the best position to evaluate a company’s managerial strengths and weaknesses may include competitors, customers, and suppliers. Manne, *supra* note 5, at 118. These are the kind of companies that constantly interact with the target and may have unique insights into the managerial inefficiencies that need correcting. *Id.* at 118–19.

102. Henry G. Manne, *Cash Tender Offers for Shares – A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236 (1967) (citations omitted).

103. Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 721–723 (2006).

104. *Id.*

105. *Id.* at 726 (citation omitted).

106. *Id.* at 719.

107. Bernard S. Sharfman, *A Theory of Shareholder Activism and its Place in Corporate Law*, 83 TENN. L. REV. 798–99 (2015) (citations omitted).

108. Manne, *supra* note 5, at 113. Yet, it is also possible that a less capable acquirer will make a bid, leading to an “inefficient transfer of control.” According to Coffee, “an inefficient transfer of control is one in which assets move from a more efficient user to a less efficient one. In such an instance, there is a social welfare loss in addition to possible wealth transfers between the two classes of participating shareholders.” The likelihood of this occurring increases as the takeover premium declines. As the takeover premium approaches zero, there would be more incentive for size-maximizing (opportunistic

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Finally, indirect efficiency gains should also be realized when a vibrant hostile takeover market exists. As described by Coffee, “[t]he constant search for these discounted bargains [. . .]both motivates the managements of marginal firms toward increased performance, lest they become targets, and deters conduct injurious to shareholders—all without the need for regulatory intervention.”¹⁰⁹

B. Hostile Bids Based on Private Information

Manne assumes that managerial inefficiencies in a public company are publicly known. If they are not, at least for the short term, then the stock would be overpriced and not a good takeover target. However, what if there are *no* significant managerial inefficiencies to exploit, but a potential acquirer has private information about a company,—perhaps insights into its patents or potential new products—that suggests it is significantly underpriced?¹¹⁰ Then, if the potential acquirer has the financial means and can tolerate a lack of portfolio diversification, a hostile bid may be in the cards even if there are no managerial inefficiencies to correct.

This type of information trader is to be distinguished from “quality shareholders,”¹¹¹ e.g., Warren Buffett’s Berkshire Hathaway, who perform intense up-front research using fundamental analysis to determine which companies to invest in, purchase them in a friendly acquisition, and then hold these companies in a relatively concentrated portfolio for perhaps decades at a time.¹¹²

While the correction of managerial inefficiencies is not the purpose of hostile bidders with private information, they still have a useful role to play. They allow current shareholders to reap the benefits of a takeover premium. Meanwhile, they provide the public markets with new information about the real value of the stock of the company and perhaps even its competitors. In sum, these hostile bidders are doing the job that information traders are meant to do; to move security prices

empire-building by the management of acquirer), rather than efficiency maximizing transactions to occur. Moreover, in a period of declining takeover premiums, the lower cost of acquisition simply encourages more takeover bids by those potential acquirers who may not really be sure that they have superior judgment vis-à-vis current management. That is, the cost of making a mistake has been reduced, allowing a cash-rich acquirer essentially to take a flyer. Coffee, *supra* note 39, at 1155-57.

109. Coffee, *supra* note 39, at 1155.

110. Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1032 (1982).

111. Lawrence Cunningham refers to these types of investors, such as Warren Buffett and the company he runs, Berkshire Hathaway, as “quality shareholders.” See Lawrence A. Cunningham, *The Case for Empowering Quality Shareholders*, B.Y.U. L. REV. (Oct. 29, 2020), <http://ssrn.com/abstract=3547482>.

112. *Id.* Samuel Lee refers to the investment strategy utilized by quality investors as “time-horizon arbitrage.” That is, “buying assets with long-term value underappreciated by the market.” See Samuel Lee, *Warren Buffett and Time-Horizon Arbitrage*, MORNINGSTAR (Nov. 27, 2013), <https://www.morningstar.com/articles/620888/warren-buffett-and-timehorizon-arbitrage>. See also, Michael W. Roberge et al., *Lengthening the Investment Time Horizon*, MFS (May 2014), http://shareholderforum.com/access/Library/20140500_MFS.pdf (identifying the increasing dispersion of equity returns over time as a time horizon arbitrage opportunity).

toward their fundamental values.¹¹³ That is, they are being “the agents who render markets efficient.”¹¹⁴

C. The Efficiency/Synergy Theory of Tender Offers

An alternative reason for making a hostile bid would be for purposes of synergy. If the value of two companies in combination is greater than the sum of them remaining independent, then a takeover premium can be justified. Such “synergistic gains” may be the result of “unique product complementarity between the two companies, specialized resources possessed by the target, economies of scale, cost reductions, lowered borrowing costs, or the capital market’s response to the combined enterprise.”¹¹⁵ In other words, these gains are the total of all increases in combined value that are not due to enhanced managerial efficiencies.¹¹⁶

Therefore, we can see that Manne’s theory of the market for corporate control does not provide a complete picture of how combined value is generated. Michael Jensen provides a more comprehensive view:

Takeovers generally occur because changing technology or market conditions require a *major restructuring of corporate assets*. In some cases, takeovers occur because incumbent managers are incompetent. When the internal processes for change in large corporations are too slow, costly and clumsy to bring about the required restructuring or management change in an efficient way, the capital markets are doing so through the operation of the market for corporate control. In this sense, the capital markets have been responsible for bringing about substantial changes in corporate strategy in recent times.¹¹⁷

Moreover, assuming tender offers are not being used to enhance a company’s market power (i.e., adequate antitrust laws are in place and enforced, and management is not seeking either to engage in opportunistic empire building, or to coerce shareholders to sell control of the company at a low price), we can build on Manne’s theory to see that the tender offer is being used as a means to accomplish what Michael Bradley, Anand Dsai, and E. Han Kim refer to as “corporate synergy”:

We assume that a *tender offer* is an attempt by the bidding firm to exploit a profit opportunity created by a change in economic conditions. This change may be the result of an exogenous change in supply and/or demand, technological innovations, or purposeful investments by the bidding firm. The value created by the combination may result from more *efficient management*, economies of scale, improved production techniques, the combination of complementary resources, the *redeployment of assets* to more profitable uses, . . . , or any number of value-creating mechanisms that fall under the general rubric of corporate synergy.¹¹⁸

113. Goshen & Parchomovsky, *supra* note 103, at 719.

114. *Id.*

115. Coffee, *supra* note 39, at 1166.

116. Bebchuk, *supra* note 110, at 1031.

117. Michael Jensen, *The Takeover Controversy: Analysis and Evidence*, 4 MIDLAND CORP. FIN. J. 6, 6-32 (1986).

118. Michael Bradley et al., *Synergistic Gains from Corporate Acquisitions and their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 4 (1988).

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The seeking of corporate synergy (increases in managerial efficiency and classical synergy) through the use of tender offers, without identifying whether the offer is friendly or hostile, is what Bradley, Dsai, and Kim refer to as *the synergy theory of tender offers*.¹¹⁹ To make clear that this represents Manne's *theory of the market for corporate control* and all forms of synergy, we are going to rename their theory *the efficiency/synergy theory of tender offers*. This theory posits that, through the mechanism of a tender offer, "the acquisition of control over the target enables the acquirer to redeploy the combined assets of the two firms toward higher-valued uses."¹²⁰ Moreover, when a bidder launches a tender offer without support from a target's management (i.e., attempting a hostile takeover), they are doing so in part as a means of achieving corporate synergy in the sense of a higher value use of target assets. And this can mean more than just enhanced management.

IV. TENDER OFFERS IN THE UNITED KINGDOM: A CONTRASTING PICTURE

"England and America," as an old saying goes, "are two nations divided by a common language."¹²¹ This certainly appears true in those aspects of corporate law geared to regulating the transfer of corporate control through tender offers, especially those used for hostile takeovers. Indeed, it is fair to say that, to the ears of the typical corporate lawyer in the U.K., much of the terminology of the U.S. public company acquisitions world is something of a foreign language with which, domestically at least, there has been little practical need to gain familiarity. As will be discussed, the U.K. approach is much more consistent with the *efficiency/synergy theory of tender offers*. However, before examining the operation and regulation of tender offers in the U.K., it is important to appreciate the relative significance of tender offers within the U.K.'s broader M&A landscape.

A. Key Distinguishing Features of the U.K. System

I. Tender Offers vs. Schemes of Arrangement

In the United Kingdom, as in the United States, tender offers are in effect the only legal mechanism available other than a proxy contest for acquiring outright voting control over a U.K. listed target without the initiative and ongoing support of its management.¹²² However, unlike in the U.S., mergers are not directly

119. *Id.* at 4.

120. *Id.*

121. This statement is commonly attributed to the Irish playwright George Bernard Shaw, albeit no record of the phrase exists in Shaw's published works. Irrespective of its origins, though, the saying has undeniably entered popular usage, especially in the United Kingdom. *See, e.g., Two nations divided by a common language*, TELEGRAPH (Sep. 8, 2005), <https://www.telegraph.co.uk/finance/2921790/Two-nations-divided-by-a-common-language.html>.

122. SAMER ADRA, FOUR ESSAYS ON UK TAKEOVERS: EVIDENCE FROM MATCHING ANALYSIS 79-80 (2015).

recognized in the U.K. as a formal legal mechanism for implementing non-hostile corporate amalgamations, albeit that the word “merger” continues to be used as a common term of art within British corporate law and investment banking practice. The standard, and by far most common, legal process for implementing a friendly acquisition or combination involving a U.K. target firm today is a statutory scheme of arrangement (known in practitioner shorthand as a “scheme”) under Part 26 of the U.K. Companies Act 2006.¹²³ In essence, a scheme entails the putative target company (via its management) applying to the court for a direction that formal meetings of all affected classes of target shareholder are convened,¹²⁴ with a view to attaining the approval of at least 75% in value of each class to the proposed arrangement.¹²⁵ Where, as is almost always the case in practice, such approval is duly given by target shareholders, the court will then typically sanction the bidder’s purchase of 100% of the target’s shares in return for the consideration proposed in the scheme application.¹²⁶ In this way, the approved arrangement is effectively crammed on any dissenting minorities who are averse to the deal.¹²⁷

In recent years, schemes have proved an increasingly popular option for bidders on account of their numerous practical advantages and transaction cost efficiencies relative to tender offers.¹²⁸ However, the fact remains that without the proactive involvement of cooperative target management that is willing to initiate the formal judicial approval process, it is virtually impossible for a scheme to get off the ground, let alone be implemented successfully in the bidder’s favor.¹²⁹ It follows that, whilst a tender offer does not necessarily indicate bid hostility, it at least signifies a much greater likelihood of hostility in comparison to the majority of bids for U.K. targets that are implemented by way of scheme.

2. *The Absence of Coercive Two-Tier Tender Offers*

In the specific context of hostile takeover bids, meanwhile, coercive two-tier tender offers have never been a feature of the British public company acquisitions landscape. In turn, there has traditionally been little perceived need, from a target shareholder perspective at least, for the sorts of aggressive firewall

123. See U.K. COMPANIES ACT 2006 §§ 895-901 (as supplemented by Appendix 7 of the U.K. Takeover Code, *infra* note 133); see JENNIFER PAYNE, SCHEMES OF ARRANGEMENT: THEORY, STRUCTURE AND OPERATION (2014) (providing a comprehensive and authoritative analysis of schemes of arrangement generally).

124. U.K. COMPANIES ACT § 896.

125. *Id.* at 899(1).

126. See *id.* at 900(2)(a).

127. See Payne, *supra* note 123, chapter 3 (on the mechanics of schemes as they operate in a takeover context generally).

128. See *id.* at 94 (discussing this issue).

129. *Id.* at 102.

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defense that have become such a conspicuous feature of the U.S. takeover environment in recent decades.

Coercive two-tier tender offers took U.S. public companies by storm by the early 1980s. Yet, such tender offers failed to gain any foothold in the U.K. largely because they had been effectively outlawed for the previous decade.¹³⁰ The U.K.'s influential Takeover Panel,¹³¹ which has since 1968 been the country's main regulatory authority in respect of attempted public company acquisitions, has traditionally imposed strict rules against the differential treatment of different groups of target shareholders.¹³² These rules form part of the City Code on Takeovers and Mergers (or "Takeover Code") that is promulgated, periodically revised and administratively enforced by the Takeover Panel.¹³³

In particular, by virtue of the U.K. Takeover Code's longstanding "mandatory bid" rule,¹³⁴ it has since the early 1970s been imperative for anyone seeking to acquire 30% or more of a U.K. listed target's voting shares to extend that offer on the same terms to *all* other holders of its equity securities.¹³⁵ While the mandatory bid rule's creation was geared to prevent "stealth" acquisitions by way of secretive vote-building rather than coercive bid structures,¹³⁶ its collateral impact in precluding the trans-Atlantic exportation of U.S.-style coercive two-tier bids in the 1980s is undeniable. Furthermore, the Takeover Code's 30% mandatory bid threshold is supplemented in practice by the statutory "squeeze-out" rule as set out in sections 979-982 of the U.K. Companies Act 2006.¹³⁷ Accordingly, a successful bidder who acquires 90% or more of a U.K. target's voting equity can unilaterally eliminate any outstanding minority interests by providing the remaining shareholders with equivalent consideration to that offered at the preceding mandatory bid stage of the transaction.

130. Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L.J. 422, 445-46 (2007).

131. The U.K.'s Panel on Takeovers and Mergers, which is more commonly referred to as "The Takeover Panel", is a non-governmental rulemaking and executive body. The Takeover Panel and its various supporting committees are comprised mainly of financial professionals who are broadly representative of the City of London's institutional investment and investment banking communities, with only limited representation from the legal profession. *See Panel Membership*, TAKEOVER PANEL, <http://www.thetakeoverpanel.org.uk/structure/panel-membership> (last visited Apr. 26, 2020) (for a list of current Takeover Panel members).

132. *See, e.g.*, THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE (12th ed., 2016) [hereinafter *Takeover Code*] (providing in General Principle 1 that "[a]ll holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.").

133. *See generally id.*; *see also* MARC T. MOORE, CORPORATE GOVERNANCE IN THE SHADOW OF THE STATE 168 (2013).

134. *See Takeover Code, supra* note 132 at F1 (Rule 9, "The Mandatory Offer and its Terms"); Nicholas Jennings, *Mandatory Bids Revisited*, 5 J. CORP. LAW STUD. 37 (2005).

135. Johnston, *supra* note 130, at 445.

136. *Id.* at 444.

137. U.K. COMPANIES ACT 2006 § 976.

3. *The Persistence of the Board Passivity Rule*

An additional consequence of the mandatory bid rule's success, in this regard, has been the substantial absence of any unified support for permitting poison pills and other shark repellent devices as a rearguard managerial response to the threat of predatory advances. Indeed, despite the occurrence of some controversial hostile bid activity in the United Kingdom involving so-called corporate "raiders" in the latter part of the 1980s,¹³⁸ there was no serious business call for removal or qualification of the board passivity rule¹³⁹ that has been (and remains) the centerpiece of the U.K. framework of takeover regulation since its inception in 1959.¹⁴⁰

The *board passivity*¹⁴¹ (or *non-frustration*¹⁴²) rule, which is set out today in General Principle 3¹⁴³ and Rule 21 of the Takeover Code, applies in circumstances where a bid for a U.K. listed target company is either in progress or expected to materialize imminently. Essentially, the rule requires that the target board steadfastly refrain from any unauthorized action that will have the effect of frustrating the actual or imminent bid in question, in particular (but not exclusively) by means of poison pills or other selective share allotment

138. *Takeover activity in the 1980s*, BANK OF ENGLAND QUARTERLY BULLETIN: FEBRUARY 1989, 78, 79 (1989).

139. See *infra* notes 143-146 and accompanying text.

140. The genesis of the board passivity rule, and indeed of the UK's takeover regulatory framework in general, was the *Notes on Amalgamations of British Businesses* published by the City Working Party of the (non-governmental) Issuing Houses Association of London in 1959. These Notes were later developed into the inaugural *City Code on Takeovers and Mergers* in 1968, successive editions of which have remained applicable until the present day. Following the coming into force of the European Union Takeover Directive in 2004, the United Kingdom was compelled to put its takeover regulatory regime on a statutory footing in order to ensure conformance with the Directive's requirements. See Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 [hereinafter *E.U. Directive*] (on takeover bids in the E.U.); see also U.K. COMPANIES ACT 2006 § 28 (for the implementing U.K. statutory provisions in this regard). However, rather than put the substantive Code provisions themselves directly into legislative form, the U.K. government opted to preserve the Code's non-statutory status while providing a statutory right of recourse to the courts in the event of any party's persistence non-conformance with an order or sanction issued by the Takeover Panel. This enabled the United Kingdom to comply with the terms of the relevant E.U. Directive while at the same time substantially preserving the flexibility and relative informality of the Code itself. See *Panel on Takeovers and Mergers v King* [2018] CSIH 30 (Scottish Court of Session, Inner House) (for a recent example of a case where a UK (in this instance, Scottish) court was called on to order compliance with a Code provision (in this instance, the mandatory bid requirement under Rule 9 of the Code); see also Paul Davies Q.C., *Enforcing the Takeover Panel's Decisions: Panel v King* [2018] CSIH 30, OXFORD BUS. LAW BLOG (Jun. 28, 2018), <https://www.law.ox.ac.uk/business-law-blog/blog/2018/06/enforcing-takeover-panels-decisions-panel-v-king-2018-csih-30>.

141. See Easterbrook & Fischel, *supra* note 50, at 1162 (on this notion generally within corporate governance); see also Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

142. This tends to be the more common term for the rule within UK and wider European academic usage. See, e.g., David Kershaw, *Hostile Takeovers and the Non-Frustration Rule: Time for a Re-Evaluation* (LSE Legal Studies, Working Paper No. 19/2016, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2875772.

143. General Principle 3 of the UK Takeover Code provides that "[t]he board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid." See *Takeover Code*, *supra* note 132, at B1.

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techniques geared to diluting the prospective acquirer's equity interest; "lock up" agreements with preferred bidders and other arrangements geared to putting significant assets of the target out of the prospective acquirer's reach; and "golden parachute" agreements and other extraordinary contractual arrangements designed to render future changes of control prohibitively expensive from the prospective acquirer's point of view.¹⁴⁴

Although structural takeover defenses of the above types are therefore almost absent within the U.K. market environment, one important hostile bid response that remains available to U.K. target managers is the option of seeking out a "white knight" or competing friendly bidder to challenge the unwanted approach. Additionally, or alternatively, U.K. target managers remain at liberty to instigate a formal auction for the firm geared to attracting competing bids from numerous other potential acquirers.

Moreover, it is arguable that U.K. target managers today have an even greater incentive than their U.S. counterparts to seek out prospective "white knights" in response to hostile bids. This is because, in 2011, the Takeover Panel imposed a general prohibition on inducement fee arrangements (or "break fees"), which are essentially conditional payments offered to bidders to compensate them for the sunk transaction costs involved in initiating bids that ultimately prove unsuccessful.¹⁴⁵ The only permissible exceptions to this general rule, where break fees *can* be paid up to the value of 1% of the target's overall value, are in so-called "go shop" scenarios: that is to say, where competing offerors are solicited and/or a formal auction is initiated following a hostile bidder announcing its firm intention to make an offer.¹⁴⁶ Only in those circumstances can break fees be offered by target managers with a view to engendering a more competitive bidding process.¹⁴⁷

One notable consequence of the above reform has been a heightened market expectation that targets' managers will actively "shop" their firms to other prospective bidders as an essential precondition to being able to offer enforceable deal protection. This in turn increases the likelihood of a "white knight" entering

144. *See id.* at I18 (Rule 21, "Restrictions on Frustrating Action").

145. *See id.* at I22 (Rule 21.2, "Offer-Related Arrangements").

146. *Id.* ("Notes on Rule 21.2").

147. By contrast, in the case of Delaware targets, the validity of break fees and other deal protection mechanisms is dependent on application of the target directors' general fiduciary duties, which means that such arrangements are by default subject to the normal protection offered by the business judgment rule. Accordingly, break fees are in general payable even to sole bidders in uncontested takeover scenarios, so long as the agreed fee amount is not so manifestly excessive under the circumstances as to effectively preclude the target's board from considering any potential competing bid. In practice, termination fees to bidders for Delaware targets typically range between 3% and 4% of overall target value. *See* John C. Coates IV, *M&A Break Fees: U.S. Litigation versus UK Regulation*, in REGULATION VS. LITIGATION: PERSPECTIVES FROM ECONOMICS AND LAW 239, 247 (Daniel P. Kessler ed., 2010); Lawrence A. Hamermesh & Jacob J. Fedechko, *The Role of Judicial Opinions in Shaping M&A Practice*, in ELGAR RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 245, 254 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

the fray at some stage in a typical British takeover bid scenario.¹⁴⁸ Moreover, the Takeover Code allows the target board to provide confidential corporate information to the “white knight.” However, if such information is provided, then all other bidders, including the hostile bidder, must also promptly be made privy to that information upon request.¹⁴⁹

Of further significance from a comparative viewpoint is the fact that the U.K. regulatory framework, in contrast to its U.S. (Delaware) counterpart, has consistently refused to recognize substantive coercion¹⁵⁰ as a relevant threat to target shareholders’ interests that might justify responsive defensive action. Rather, consistent with our own view on the matter, the U.K. Takeover Code regards collective shareholder mistrust of a target board’s hostile bid assessment as an *ex ante* responsible market judgment that merits the protection of the board passivity rule. While the risk of relatively uninformed shareholders tendering into a perceived “low ball”¹⁵¹ bid of course remains live in U.K. (as in U.S.) targets, tolerating such risk has, on balance, traditionally been regarded as a lesser evil than permitting inherently conflicted target boards to hold sway over a hostile tender offer’s fate.¹⁵² It follows that under no circumstances will alleged price inadequacy be a valid justification for a target board to preclude shareholders from undertaking their own prudential evaluation of the consideration on offer to them.

Notably, the board passivity rule is an *effect-* rather than intention-based doctrine,¹⁵³ which enables the United Kingdom’s non-judicial Takeover Panel to enforce the rule against target directors and other relevant parties in an administratively straightforward manner,¹⁵⁴ unencumbered by the vexing questions of factual inference and fiduciary duty conformance that typically

148. Anousha Sakoui, *UK takeover rules put targets on defensive*, FINANCIAL TIMES (Oct. 30, 2011), <https://www.ft.com/content/1f0cc66a-00b1-11e1-8590-00144feabdc0>.

149. *Takeover Code*, *supra* note 132, at I21 (Rule 21.3, “Equality of Information to Competing Offerors”).

150. *See supra* notes 85-91 and accompanying text (on this concept generally).

151. This term is attributable to Chancellor Chandler. *See* *Air Products & Chemicals Inc.*, A.3d 48 at 120.

152. *See* Chrispas Nyombi, *A Critique of Shareholder Primacy Under UK Takeover Law and the Continued Imposition of the Board Neutrality Rule*, 57 INT. J. L. MGMT. 235, 249-50 (2015) (on this difficult policy trade-off).

153. Specifically, Rule 21.1 of the U.K. Takeover Code provides that:

During the course of an offer, or even before the date of the offer if the board of the offeree company has reason to believe that a bona fide offer might be imminent, the board must not, without the approval of the shareholders in general meeting, take any action *which may result in* any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits.

Id. (emphasis added).

154. The most common informal sanctioning mechanism deployed by the Takeover Panel is public censure, whereby the Panel makes a public announcement about a particular party’s inappropriate conduct aimed at triggering adverse reputational consequences for that party in the markets within which it operates.

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confront U.S. trial and chancery courts.¹⁵⁵ The only situation where frustrative conduct of the above types may be engaged in is where the proposed course of defensive action has affirmatively been authorized by a majority of target shareholders.¹⁵⁶ And, in a widely held British (as U.S.) public company, such endorsement is unlikely to be readily given, especially in the presence of proxy advisors and other professional shareholder rights advocates.¹⁵⁷

B. Ramifications

Unsurprisingly against the above background, the U.K. has generally been recognized as a more accommodating jurisdictional setting for hostile takeovers than the U.S.¹⁵⁸ Moreover, this perception is borne out by the comparative empirical evidence of its total volume of hostile deal activity (accounting for the lesser size of the British market) and also the historical success rate of hostile bidders for British (as compared to U.S.) targets. For example, John Armour and David Skeel report that from 1990 to 2005 (inclusive), there were 187 hostile takeover attempts in the U.K. versus 312 in the U.S.¹⁵⁹ Since the U.K. economy is roughly one-sixth the size of the U.S. economy, an equivalent number of hostile takeover attempts in the U.S. would be approximately 70 attempts per year. This is an astonishingly high annual number even when compared to the hostile takeover activity that occurred in the U.S. during the 1980s. Moreover, of the 187 hostile bids that were launched in the U.K. during this time period, 81 were ultimately completed. This denotes a bidder success rate of 43% compared to a corresponding success rate of only 24% in the case of bidders for U.S. targets.¹⁶⁰

In Part V below, we will use empirical evidence to highlight the impact of those trends in enhancing the potency of the market for corporate control as a

155. On the Takeover Panel's limited right of formal recourse to the English and Scottish courts today in the event of non-conformance with Panel orders or sanctions, see *supra* note 136. See also *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815.

156. See *Takeover Code*, *supra* note 132, at 118.

157. See Marc T. Moore, "Whispering Sweet Nothings": *The Limitations of Informal Conformance in UK Corporate Governance*, 9 J. CORP. LAW STUD. 95, 122-24 (2009) (discussing the influence of proxy advisors on corporate governance norms generally in the U.K. context); see also Bernard S. Sharfman, *Enhancing the Value of Shareholder Voting Recommendations*, 86 TENN. L. REV. 691 (2019) (discussing this same issue in the U.S. context).

158. Writing from a critical stance with respect to the U.K. system, for instance, Lynn Stout has claimed that, whereas "U.S. law and practice departs substantially from the shareholder primacy ideal ... [in] contrast the United Kingdom seems a shareholder paradise." In this regard, Stout observes in particular how "[d]irectors in U.K. companies cannot reject hostile takeover bids" like their U.S. counterparts, but instead "must sit back and let the shareholders decide if the firm will be sold to the highest bidder." See LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 56 (2012).

159. Armour & Skeel, *supra* note 15, at 1738 ("Table 1").

160. Armour and Skeel conclude from this data that "an M&A transaction in the United Kingdom is more likely to be hostile, and if hostile, is more likely to succeed, than in the United States." *Id.* at 1738-39; see also James Cherowbrier, *Number of hostile M&A take-overs in Europe 1985-2018, by country*, STATISTA (Sep. 27, 2019), <https://www.statista.com/statistics/1043178/number-of-hostile-takeovers-in-europe-by-country/>.

corrective mechanism in corporate governance. For immediate purposes, though, it is curious to note that, as long ago as 1974, one of the U.K.'s most esteemed economic historians, Professor Leslie Hannah, was already reporting (in Manne-esque terms) on “the reinforcement of the disciplinary function of the stock market.”¹⁶¹ According to Hannah:

[T]he board of a public company which fails to put its assets to profitable use, or which fails to exploit favorable opportunities open to the company, risks being displaced by aggressive take-over bidders able and willing to pay to shareholders a premium price, reflecting the more efficient use of the company's assets which they believe to be possible under reformed management.¹⁶²

Making express reference¹⁶³ to Manne's then-recent article *Mergers and the Market for Corporate Control*,¹⁶⁴ moreover, Hannah remarked that “[t]he carrot of private profit for the bidder thus provides an admonitory stick for a sleepy management.”¹⁶⁵

More recently, a leading comparative corporate law scholar, Professor Christopher Bruner, has observed how “[U.S. shareholders'] interests are not prioritized with anything approaching the clarity and consistency enjoyed by their U.K. counterparts.”¹⁶⁶ Bruner claims that “[t]he practical upshot is that shareholders loom much larger in U.K. boardrooms than in U.S. boardrooms.”¹⁶⁷

Admittedly, the U.K.'s shareholder-centric board passivity rule has attracted its fair share of criticism over the past decade from both academic and political quarters.¹⁶⁸ Moreover, following controversial attempts at the European Union level to extend the reach of the board passivity rule across the E.U.'s Member States in general,¹⁶⁹ the debate on this provision has increasingly acquired an

161. Les Hannah, *Takeover Bids in Britain Before 1950: An Exercise in Business "Pre-History"*, 16 BUS. HIST. 65, 76 (1974). Furthermore, as Cheffins has noted, awareness of the disciplinary impact of takeovers in the U.K. seems to have been present since the 1950s. See BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 362 (2008).

162. *Id.* at 76-77.

163. *See id.* at 77 n.1.

164. *See* Manne, *supra* note 5, at 110.

165. Hannah, *supra* note 161, at 77.

166. CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER 37 (2013).

167. *Id.* at 6. This is not to deny, of course, that shareholders' interests have also remained of significant practical concern in U.S. boardrooms and executive suits throughout the past four decades. *See* Cheffins, *supra* note 6, at 186-188.

168. *See, e.g.,* Stout, *supra* note 158, at 56; COLIN MAYER, FIRM COMMITMENT: WHY THE CORPORATION IS FAILING US AND HOW TO RESTORE TRUST IN IT 110 (2013).

169. *See E.U. Directive, supra* note 140 (“Obligations of the board of the offeree company”). Significantly, the board neutrality requirement in Article 9 of the Directive is not universally binding on Member States, but rather is subject to “opt-out” at individual Member State level, subject in turn to the right of individual companies within any “opted-out” Member State to “opt in” to the relevant requirement via a shareholder resolution to this effect. *See* C.E.P.S., Directorate-General for the Internal Market and Services (European Commission) and Marccus Partners, *The Takeover Bids Directive Assessment report* (2013), available at <https://op.europa.eu/en/publication-detail/-/publication/67501b75-7583-4b0d-a551-33051d8e27c1>; Jennifer Payne, *Time to make the Board Neutrality Rule Mandatory in the EU*, OXFORD BUSINESS LAW BLOG (Jun. 7, 2016), available at <https://www.law.ox.ac.uk/business-law-blog/blog/2016/06/time-make-board-neutrality-rule-mandatory-eu>

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international character.¹⁷⁰ Opposition to the board passivity rule was especially vociferous following the respective Kraft-Cadbury¹⁷¹ and Melrose-GKN¹⁷² acquisitions in 2010 and 2018 respectively. In each of those well-publicized cases, critics perceived the rule as emasculating the boards of Cadbury and GKN in the face of highly leveraged bids that promised short-term shareholder wealth gains at the arguable expense of longer-term enterprise value for the target companies concerned.¹⁷³ However, while the negative public fallout from Kraft's controversial Cadbury takeover triggered reform to the U.K. regulatory framework in other important respects,¹⁷⁴ in neither instance were any changes to the Takeover Code's long-standing board passivity rule ever implemented. Rather, consistent with the general trajectory of the preceding fifty years, the board passivity rule has proved remarkably persistent in the face of outside challenge. Moreover, we expect this to remain the case for the foreseeable future at least, notwithstanding the U.K.'s recent secession from the E.U.¹⁷⁵

C. Summary

The above discussion suggests that the United Kingdom's hostile takeover market is, to a large extent, consistent with the *efficiency/synergy theory of tender offers* as an effective corrective mechanism in corporate governance.¹⁷⁶ By contrast, the corresponding features of the U.S. hostile takeover market would appear to fall well short of the ideal. We now turn to examine the available empirical research on the value of tender offers, both those of a friendly and especially hostile character, as measured by the average cumulative abnormal

170. See, e.g., Paul Davies et al., *The Takeover Directive as a Protectionist Tool?*, in COMPANY LAW AND ECONOMIC PROTECTIONISM: NEW CHALLENGES TO ECONOMIC INTEGRATION (Ulf Bernitz & Wolf-Georg Ringe eds., 2010); Klaus J. Hopt, *Takeover Defenses in Europe: A Comparative, Theoretical and Policy Analysis*, 20 COLUM. J. EUR. L. 249 (2014); Jonathan Mukwiri, *The End of History for the Board Neutrality Rule in the EU*, 21 EU. BUS. ORG. LAW. REV. 253 (2020).

171. David Jones and Brad Dorfman, *Kraft snares Cadbury for \$19.6 billion*, REUTERS (Jan. 19, 2010), <https://www.reuters.com/article/us-cadbury-kraft/kraft-snares-cadbury-for-19-6-billion-idUSTRE60H56R20100119>.

172. Ben Martin, *Melrose wins UK engineer GKN with £8 billion hostile bid*, REUTERS (Mar. 29, 2018), <https://www.reuters.com/article/uk-gkn-m-a-melrose-outcome-idUKKBN1H52AP>.

173. See, e.g., Georgina Tsagas, *A Long-Term Vision for UK Firms? Revisiting the Target Director's Advisory Role Since the Takeover of Cadbury's PLC*, 15 J. CORP. LAW STUD. 241 (2015).

174. See, e.g., THE TAKEOVER PANEL, CONSULTATION PAPER ISSUED BY THE CODE COMMITTEE OF THE PANEL: REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS (2010); THE TAKEOVER PANEL, REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS: RESPONSE STATEMENT BY THE CODE COMMITTEE OF THE PANEL FOLLOWING THE CONSULTATION ON PCP 2011/1 (2011).

175. Indeed, insofar as the board passivity rule in Article 9 of the E.U. Takeover Directive is originally adopted from the U.K. Takeover Code's (even more longstanding) non-frustration rule, it can be surmised that the impact of Brexit on the continued operation of this provision in the United Kingdom will in itself be negligible. See *supra* notes 138-142 and accompanying text. The only immediate material change to U.K. takeover regulation emanating from Brexit will be the removal of the E.U. mandate to grant the Takeover Panel a formal right of recourse to the courts in the event of non-compliance with any of its administratively imposed orders or sanctions. See *E.U. Directive, supra* note 140. However, it seems unlikely that the United Kingdom will implement any immediate changes to its domestic enforcement framework in response to this development.

176. See *supra* Part III.

returns to target shareholders that such transactions have been shown to generate in the U.S. and U.K. markets respectively.

V. EMPIRICAL EVIDENCE ON THE VALUE OF TENDER OFFERS, BOTH FRIENDLY AND HOSTILE

This Part provides an overview of the empirical evidence on tender offers, both in general and with specific regard to those used for hostile takeovers.

A. *The U.S. Experience*

Due to the diminishment of hostile takeovers over the past thirty years, empirical studies on their value primarily correspond to data sourced from the 1960s, 70s, and 80s. That said, the empirical work demonstrates that tender offers,¹⁷⁷ the offer type associated with hostile bids, consistently provided large positive average cumulative abnormal returns (“CAR”) to shareholders of target companies.¹⁷⁸ Such tender offers are also seen to provide small or no positive average CAR to bidders, and significant positive average CAR on a combined basis consistent with *the efficiency/synergy theory of tender offers* outlined above.¹⁷⁹

1. *Returns to Target Shareholders*

In the early 1980s, Michael Jensen and Richard Ruback surveyed a number of empirical studies that focused on the market for corporate control.¹⁸⁰ They synthesized the results of these studies and found that “target firms in *successful* takeovers¹⁸¹ experience statistically significant abnormal stock price changes [based on a window of a month or two surrounding the offer date] of 20% in mergers and 30% in tender offers.”¹⁸²

Interestingly, Jensen and Ruback also observed that unsuccessful takeovers exhibited similar significantly positive abnormal returns. This is probably because a short window period did not allow for a significant increase in the expectation of an unsuccessful takeover. However, Jensen and Ruback noted that when the window period included the termination announcement, these excess returns evaporated. That is, “bidders and targets suffer[ed] small negative

177. Jensen & Ruback, *supra* note 25, at 26 (“Tender offers are frequently cash offers, and mergers are usually stock and other security exchange offers.”).

178. See Moore & Reberioux, *supra* note 96, at 1136 (discussing the general co-relation of shareholder and broader social/stakeholder welfare outcomes within modern law and finance scholarship, and the ensuing adoption of shareholder return as a common (albeit highly imperfect) proxy for the purported “efficiency” of corporate policies).

179. See *supra* part III.C.

180. Jensen & Ruback, *supra* note 25, at 6.

181. *Id.* at 10 n.3 (“Generally an offer is considered successful if the bidder acquires a substantial fraction of the number of shares initially sought.”).

182. *Id.* at 8.

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abnormal stock price changes in *unsuccessful* merger and tender offer takeovers”¹⁸³

Jensen and Ruback also discussed a study by Kummer and Hoffmeister that suggested the desirability of being able to override the use of defensive measures.¹⁸⁴ Using a sample of 88 target firms receiving cash tender offers in the time period from January 1956 to June 1974, Kummer and Hoffmeister found that for 44 successful cash tender offers where the board did not oppose being taken over, target shareholders earned a positive average abnormal return of 16.45% in the announcement month. Meanwhile, in 21 tender offers where the board did contest the takeover, shareholders earned 19.80%.¹⁸⁵ Thus, at least in the short term, defensive measures appeared to be helpful to shareholders. However, in 15 of the 21 tender offers that were contested and the target was not acquired within 10 months of the initial tender offer (6 of the 21 were acquired successfully despite the resistance), the target shareholders incurred negative abnormal losses of 11.7%.¹⁸⁶

Consistent with the survey findings of Jensen and Ruback, Gregg Jarrell and Annette Poulsen, using a sample of 526 successful tender offers from 1963 to 1986, found that target shareholders earned on average a positive CAR of 28.99% (measured from 20 days before the bid to 10 days after the bid).¹⁸⁷ Michael Bradley, Anand Desai, and E. Han Kim, using a sample of 236 *successful* tender offers over the period of 1963 to 1984, found that the average positive CAR for target shareholders was 32%.¹⁸⁸ Sanjai Bhagat, Ming Dong, David Hirshleifer, and Robert Noah, using a sample of 1,018 tender offers from 1962 to 2001, found the average positive CAR for target shareholders to be 30.0%.¹⁸⁹

Finally, Gregg Jarrell, James Brickley, and Jeffrey Netter reported that “[t]he Office of the Chief Economist (OCE) of the Securities and Exchange Commission estimates that shareholders of target firms in *successful* tender offers from 1981 through 1986 received payments in excess of \$54 billion over the value of their holdings before the tender offers. Almost \$38 billion of the total was received after 1984.”¹⁹⁰

183. *Id.*

184. *Id.* (citing Donald R. Kummer and J. Ronald Hoffmeister, *Valuation Consequences of Cash Tender Offers*, 33 J. FIN. 505, 510 (1978)).

185. *Id.*

186. *Id.*

187. Gregg A. Jarrell & Annette B. Poulsen, *The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades*, 18 FIN. MGT. 12, 16 (1989).

188. Bradley et al., *supra* note 118, at 13.

189. Sanjai Bhagat et al., *Do tender offers create value? New methods and evidence*, 76 J. FIN. ECON. 3, 21 (2005).

190. Gregg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 49 (1988).

2. Returns to Bidders

By contrast, bidders have not fared as well. Jensen and Ruback reported that shareholders of successful bidding firms only realized statistically significant abnormal gains of 4% in tender offers and 0% in mergers.¹⁹¹ Jarrell and Poulsen provided similar results in their previously mentioned study.¹⁹² In a sample of 462 successful tender offers from 1963 to 1986, they found that the shareholders of bidders experienced significant positive CAR of 1.29% (measured from 20 days before the bid to 10 days after the bid), but nowhere near the 28.99% earned by target shareholders.¹⁹³ Moreover, in their data from the 1980s, returns to bidders turned negative, even though it was not statistically significant.¹⁹⁴

Bradley et al. and Bhagat et al. reported similar results. Bradley et al. found that the shareholders of acquiring firms received an average positive CAR of only 0.978%.¹⁹⁵ Moreover, in the last period of their study (January 1981 through December 1984), the average CAR became a negative 2.93%. Bhagat et al., meanwhile, reported a statistically insignificant positive average CAR of 0.18% over their 40-year sample period.¹⁹⁶

There are many explanations for these empirical results. Perhaps the most important ones have to do with the limitations of the statistical methods used in these studies. According to Bhagat, Dong, Hirshleifer, and Noah:

Attempts to estimate the value effects of takeovers face two challenges. The first is the *truncation dilemma*. Given that not all takeover bids succeed, a short event window that extends only a few days past the bid announcement date estimates only a fraction of the value effects that would be brought about by a successful transaction. A long window that extends through successful completion of the transaction can capture the market's assessment of the full effect of takeover on value. However, this comes at the cost of introducing much greater noise and return benchmark errors.

The second challenge, *the revelation bias*, is that the bidder's return on the announcement date reflects not just news about the value to be derived from combination, but also news about the stand-alone value of the bidder. For example, firms sometimes deliberately time the announcement of takeover bids to be simultaneous with unrelated announcements. More important, the very fact that a firm makes a bid will usually convey information to investors about the bidder's stand-alone value.

Jon Macey argues that the empirical evidence on the share price of bidders may be due to a substantial percentage of bidders disclosing "their plans to embark on an acquisition strategy months before they locate" suitable targets and

191. Jensen & Ruback, *supra* note 25, at 8.

192. Jarrell & Poulsen, *supra* note 187, at 12. In a review of the empirical evidence on takeovers five years after Jensen and Ruback; Jarrell, Brickley, and Netter identified an early draft of the Jarrell and Poulsen study as the only source of empirical evidence on the returns earned by bidders in the 1980s. See Jarrell et al., *supra* note 190, at 53 ("The 1980s evidence on bidders comes from Jarrell and Poulsen ...").

193. *Id.* at 12-13.

194. *Id.*

195. Bradley et al., *supra* note 118, at 13.

196. Bhagat et al., *supra* note 189, at 21.

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making successful tender offers.¹⁹⁷ This may mean a slow accretion, instead of a one-time jump, in the bidder's stock price as the bidder demonstrates the success or failure of its initially disclosed acquisition strategy.¹⁹⁸

Perhaps the most obvious explanation is that if the target is much smaller than the bidder, then the positive impact of the acquisition on the bidder's stock price should, on average, be correspondingly smaller.¹⁹⁹ Indeed, Jarrell and Poulsen found that "the relative size of the target to the acquirer has a positive and significant effect on CARs earned by acquiring firm shareholders"²⁰⁰

Another explanation is that the smaller return earned by bidders is the result of management contesting the tender offer bid by voicing its opposition to the takeover attempt.²⁰¹ This pre-poison pill era explanation infers a greater likelihood of management reaching out to a "white knight" who is willing to offer a competing bid. It follows that, if the bidder wants to continue pursuing the target, it must offer a significantly larger takeover premium.²⁰² This, in turn, will reduce the bidder's positive abnormal returns from the acquisition.

The above theory is supported by the work of Bradley, Anand, and Kim, who found that target shareholders earn greater abnormal returns and acquiring firms earned smaller abnormal returns from multiple-bidder contests.²⁰³ Similarly, Henri Servaes, who evaluated a large sample of successful takeovers that utilized both mergers and tender offers, found that bidding firms earned, on average, small negative returns, but lost an additional 4% when the takeover was hostile.²⁰⁴

Macey avers that the disclosure requirements of the Williams Act are a possible cause of abridged bidder gains from tender offers. According to Macey, other potential bidders, using disclosure information on the bidder as required by the Act, can then jump in and bid up the price, transferring gains to target shareholders.²⁰⁵

Moreover, the minimum time periods for tender offers mandated by the Williams Act arguably enable target boards to contest the bidder's takeover attempt by seeking a white knight.²⁰⁶ Accordingly, if the hostile bidder is ultimately successful in its bid despite the presence of a "white knight," this

197. John R. Macey, *Market for Corporate Control*, LIBR. ECON, & LIBERTY , <https://www.econlib.org/library/Enc/MarketforCorporateControl.html> (last visited Apr. 26, 2021).

198. Jensen & Ruback, *supra* note 25, at 18.

199. Jarrell & Poulsen, *supra* note 187, at 13.

200. *Id.* at 17; *see also* Eckbo, *supra* note 28, at 238.

201. Jarrell & Poulsen, *supra* note 187, at 15.

202. *Id.* at 18.

203. Bradley et al., *supra* note 118, at 25.

204. Henri Servaes, *Tobin's Q and the Gains from Takeovers*, 66 J. FIN. 409, 412 (1991).

205. Macey, *supra* note 197, at 2 (the Act requires bidders "to disclose information about themselves, their sources of financing, and their plans for other companies.").

206. Coffee, *supra* note 39, at 1178 n.95.

would likely have the effect of transferring gains from the bidder's shareholders to the target's.²⁰⁷

Finally, it is possible that if the bidder has acquired private information about the target that makes a bid worthwhile, it could be problematic for the marketplace. Market participants will not be privy to this information and therefore will not be able to determine if the bidder is making a bid that will benefit its shareholders. Based only on public information, the marketplace may determine that the bidder is making an unreasonably high bid and therefore will punish the price of the bidder's shares. This is likely to weigh especially heavily on a bidder's recorded return if the window periods being tested are relatively short.

3. *Combined Value of Target and Acquirer*

In contrast to bidder value, it is very clear that the *combined value* of a target and acquirer is increased relative to their stand-alone values. This is consistent with the *efficiency/synergy theory of tender offers*.

According to Bradley, Anand, and Kim, a successful tender offer increased the combined value of the target and acquiring firm by an average of "7.43% with 75% of the combined revaluations being positive."²⁰⁸ This increase in combined value represents "the sum of the change in the wealth of the stockholders of the target and acquiring firms."²⁰⁹

Bhagat et al., using the same methodology over a comparable time period, generated results that were strikingly similar.²¹⁰ Over their entire 40-year time period, they found an increase in combined value of 5.3%.²¹¹ However, the combined value increased to 7.3% when they used a novel statistical technique to deal with the previously discussed *truncation dilemma*.²¹² Bhagat et al. also found that combined returns were significantly higher for hostile versus friendly takeovers.²¹³ Based on the traditional methodology, they found the increase in combined value to be 8.43% for hostile offers versus 4.38% for friendly offers.²¹⁴ However, using their novel approach to adjust for truncation, they found combined returns to be significantly higher: that is, 16.34% for hostile offers versus 4.75% for friendly offers.²¹⁵

207. *Id.*

208. Bradley et al., *supra* note 118, at 10.

209. *Id.* at 4.

210. *Id.* at 25.

211. Bhagat et al., *supra* note 189, at 5, 30.

212. *Id.* at 5 and 30.

213. *Id.* at 33.

214. *Id.*

215. *Id.*

4. *The Significance of Hostile Tender Offers*

Finally, it needs to be noted that tender offers, let alone hostile tender offers, are a very small part of the market for corporate control. According to Fortier, over the ten-year period covering 1978 through 1987, there were a total of 24,309 mergers and acquisitions.²¹⁶ These included both private and public companies.²¹⁷ During that time there were only 858 tender offers.²¹⁸ Out of those 858, only 254 or 30% were hostile bids.²¹⁹ Out of those 254, 184 or 73% were acquired by the hostile bidder or a white knight.²²⁰

Fortier's descriptive statistics are consistent with what was observed in the studies previously discussed. Jarrell and Poulsen noted that management opposition (if the board at any time publicly opposed the takeover) was identified in well over 30% of successful tender offers: 32% in the 1960s, 35% in the 1970s, and 39% in the 1980s.²²¹

Bhagat et al. found that out of 1,018 tender offers, 221 were considered hostile by the target management.²²² A second bidder entered the contest in 147 tender offers.²²³ Target management litigated in 232 cases.²²⁴ They also found that 731 of the 1,018 tender offers were all-cash offers.²²⁵ Finally, based on the criterion that the bidder acquires at least 15% of target shares in the tender offer, 690 or 68% of these offers were successful.²²⁶

Given the small number of hostile bids relative to the total number of mergers and acquisitions and the predominance of cash offers (thereby minimizing their coercive nature), it might be asked why hostile tender offers are so controversial and such a common target of both regulation and court scrutiny. Back in 1989, Fortier sought to answer that question by observing that:

Although contested tender offers—hostile takeovers—only account for a small fraction of all merger and acquisition activity, they involve large publicly traded companies with substantial market values across many industries. The \$12.8 billion aggregate dollar value of 15 successful takeovers in 1987 accounted for 7.7 percent of the total dollar value of the 972 mergers and acquisitions for which such data were disclosed. Moreover, the number of unfriendly takeovers was higher in each of the past three years than in any of the previous eleven years.²²⁷

216. Fortier, *supra* note 40, at 3, Table 1.

217. *Id.*

218. *Id.*

219. *Id.*

220. *Id.*

221. Jarrell & Poulsen, *supra* note 187, at 15.

222. Bhagat et al., *supra* note 189, at 18.

223. *Id.*

224. *Id.*

225. *Id.*

226. *Id.*

227. Fortier, *supra* note 40, at 1.

During the 1980s, hostile tender offers, even though small in number, targeted the largest and most powerful companies.²²⁸ Given that no public company was exempt from a possible hostile takeover, this could reasonably be said to have unified more or less all public companies against such takeovers, creating significant pressure on state legislatures and the courts to find ways to make them go away.²²⁹

B. *The U.K. Experience*

The most extensive and influential empirical study of U.K. takeover activity was published by Julian Franks and Robert Harris at the end of the 1980s. Franks and Harris undertook an extensive study of a sample of 1,898 U.K.-listed target firms and 1,058 bidder firms over the three-decade period from 1955 through 1985.²³⁰ From the standpoint of identifying statistically significant abnormal returns to shareholders (and especially target shareholders) from corporate control shifts, the statistical findings from Franks and Harris' study are of comparable importance to the U.K. as the abovementioned Jensen/Ruback observations²³¹ are in a U.S. context.

As regards corporate control ("mergers") activity on the whole (both hostile and friendly in nature), Franks and Harris found that target shareholders achieved positive average CAR of 29.7%²³² whereas bidder shareholders achieved a positive average CAR of 7.9%.²³³ They concluded from this data that "mergers have, on average, been value-creating for shareholders as measured by equity market prices around the merger announcement date" insofar as "shareholders of targets gain, and bidder shareholders gain or do not lose."²³⁴ Furthermore, the

228. Cheffins records that, "[i]n the 1980s, nearly 30% of companies in the *Fortune* 500 received tender offers where control was sought, with a substantial proportion clearly being hostile." Cheffins, *supra* note 6, at 163-64.

229. Such mutual resistance on the part of public companies and state legislatures to hostile takeovers is arguably manifested most conspicuously in the form of state nonshareholder constituency statutes. Such provisions, which are present today in broadly similar format within a majority of state corporation law frameworks, give target boards substantially unbridled fiduciary license to implement aggressive antitakeover measures by permitting such action to be justified by reference to virtually *any* conceivable stakeholder interest group including (inter alia) shareholders, employees, suppliers, customers, creditors and local communities. See Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227 (1994).

230. Julian R. Franks & Robert S. Harris, *Shareholder Wealth Effects of Corporate Takeovers: The U.K. Experience 1955 – 1985*, 23 J. OF FIN. ECON. 225 (1989).

231. See *supra* notes 178-181 and accompanying text.

232. Franks & Harris, *supra* note 230, at 232.

233. *Id.* at 233.

234. *Id.* at 247. These findings affirm an earlier and smaller scope study conducted by Franks, Broyles and Hecht into abnormal shareholder returns from acquisitions of U.K.-listed brewery and distillery companies over the period from 1955 through 1972. The authors found that target shareholders enjoyed an average equity premium of 26% over the four-month pre-merger period when the market began incorporating information relating to the anticipated acquisition, with bidder firms' shareholders on average generating smaller but nonetheless positive abnormal returns over the same period, resulting in a net shareholder gain from M&A activity on the whole. See J.R. Franks et al., *An Industry Study of the Profitability of Mergers in the United Kingdom*, 32 J. FIN. 1513 (1977).

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comparatively modest recorded gains to bidder shareholders are potentially understated by the fact that, in Franks and Harris' sample, bidder firms were on average eight times larger than target firms.²³⁵ As with the U.S. data discussed above,²³⁶ it can be surmised that, under these circumstances, any ensuing wealth gains to bidder shareholders will likely have a lower proportionate price impact relative to those accruing to shareholders of the (smaller) target firm.²³⁷

Whilst, in general, Franks and Harris did not directly discriminate in their study between the respective impacts of hostile and friendly takeovers, they did distinguish the differing wealth outcomes for shareholders of tender offers as compared to schemes, which (for reasons outlined above²³⁸) could be said to crudely approximate the basic hostile/friendly bid distinction in a U.K. context.²³⁹ Based on a comparison of CAR accruing to shareholders in tender offers as against schemes, Franks and Harris found that the former type of bid came out significantly favorable for target shareholders and moderately so for bidder shareholders.²⁴⁰ In the case of target shareholders, positive CARs averaged 24% from tender offers in the month of the bid announcement compared to 14.8% for schemes, and 30.1% for tender offers over the course of the whole (five-month) acquisition period as against 20% in the case of schemes.²⁴¹

As regards bidder shareholders, meanwhile, the corresponding abnormal returns were positive 1.2% in the bid announcement month for tender offers versus negative 3.6% for schemes, and positive 8% over the whole acquisition period for tender offers versus positive 5.2% for schemes.²⁴² The latter figures are even more remarkable when placed in comparison with contemporaneous bids for U.S. listed targets: positive CAR to bidder shareholders was recorded at

235. Franks & Harris, *supra* note 230, at 227.

236. See *supra* notes 197-198 and accompanying text.

237. There is also a noteworthy non-performance-related factor that has been recorded as a cause of reduced wealth gains for bidder firm shareholders in takeovers involving listed U.K. targets, which is the widely perceived effect of stock-for-stock transactions in diluting the proportionate pre-bid holdings of the bidder's incumbent shareholders. However, this adverse buy-side price impact is typically not present in the case of all-cash, all-shares acquisitions, given the absence of any consequent dilutive effect in such instances. See Paul Draper & Krishna Paudyal, *Acquisitions: Private versus Public*, 12 EUR. FINANCIAL MANAG. 57, 73 (2006); see also Andrey Golubov et al., *Do Stock-Financed Acquisitions Destroy Value? New Methods and Evidence*, 20 REV. FIN. 161 (2016) (on this phenomenon generally).

238. See *supra* Part IV.A.1.

239. See Franks & Harris, *supra* note 230, at 237 ("Table 4").

240. *Id.* at 237-38.

241. *Id.* at 237 ("Table 4"). Whilst a more recent study by Adra would appear to show that tender offers are conducive to lower average premiums for target shareholders and no statistically significant difference in announcement period abnormal returns for acquirers vis-à-vis schemes, the materiality of these findings is tempered by the fact that schemes are more likely to be used today for acquisitions or combinations involving larger targets, where the ensuing tax savings and other transaction cost economies of scale for acquirers will tend to outweigh the correspondingly greater legal fees that schemes entail in comparison to offers. In the case of acquisitions or combination involving smaller targets, by contrast, the transaction cost calculus is more likely to weigh in the opposite direction thereby making an offer the favorable option. See Adra, *supra* note 122, at 91, 101, 104.

242. Franks & Harris, *supra* note 230, at 237.

just 0.7% in tender offers and 1.5% in other bid types.²⁴³ Arguably the most striking statistic in terms of the hostile/friendly bid dichotomy, though, was the finding from a subsequent 1996 study conducted by Julian Franks and Colin Mayer that positive average CAR post-announcement was almost 30% in the bid month for hostile bids as compared with only 18% for accepted (i.e. friendly) bids.²⁴⁴

Franks and Harris' findings have largely been confirmed by the results of less extensive studies carried out around the same general time period. For instance, Parkinson and Dobbins examined the sustained share price impact of hostile bid activity on U.K. publicly traded companies over the period 1975 through 1984. They found that "the large, significant positive abnormal returns obtained by target firms in the month of the bid are largely maintained in the 24 month period following the month of the bid."²⁴⁵ With respect to bidder firms, meanwhile, the authors found that "insignificant positive returns are reported throughout the 24 month post-bid period."²⁴⁶ This led the authors to conclude, in a similar vein to Henry Manne,²⁴⁷ that in the U.K. "it is the merger [i.e. hostile takeover] *process* that yields the most benefit to shareholders in both target and bidder firms" and that, on the whole, "shareholder wealth is increased by merger [hostile takeover] activity."²⁴⁸

Franks and Mayer²⁴⁹ studied the U.K. public company takeover market over the period in 1985 and 1986, which comprised a total of 80 hostile bids, 35 of

243. *Id.*

244. Julian Franks & Colin Mayer, *Do Hostile Takeovers Improve Corporate Performance?*, 7 BUS. STRATEGY REV. 1, 169, 170 (1996) ("Table 3").

245. Christine Parkinson & Richard Dobbins, *Returns to Shareholders in Successfully Defended Takeover Bids: UK Evidence 1975 – 1984*, 20 J. BUS. FIN. & ACCT. 514 (1993). Parkinson and Dobbins' findings on the significant positive wealth effects of bid activity conducted within a shareholder-protectionist regulatory framework have been reaffirmed more recently at the broader European level by Wang and Lahr, based on a study of takeover bids involving publicly traded E.U. targets carried out between 1986 and 2010. The latter authors found that cumulative abnormal returns accruing to target shareholders in the pre-bid period averaged 17.3% over this time, resulting in a mean combined announcement-related wealth gain to the parties of 2.4%. See Ying Wang & Henry Lahr, *Takeover Law to Protect Shareholders: Increasing Efficiency or Merely Redistributing Gains?* 43 J. CORP. FIN. 288, 295-97 (2017). Wang and Lahr additionally found from their extensive data sample that "stricter takeover law increases the combined expected gains from takeover for bidders and targets" but "does not reduce the announcement returns to the bidders", thereby producing an aggregate "positive wealth effect". *Id.* at 311.

246. *Id.* at 515. Moreover, based on a sample of 376 successful acquisitions of U.K. target firms over the period 1977 through 1986, Limmack highlighted a positive relationship between the level of bid premium paid to target shareholders and the corresponding returns to bidders over the two-year post-bid period. See Robin J. Limmack, *Takeover Activity and Differential Returns to Shareholders of Bidding Companies*, HUME OCCASIONAL PAPER No. 19, 22 (1990). Subsequent research conducted by Powell and Stark over the period from January 1985 through July 1993 suggests that reported positive returns to U.K. bidders are at least partially attributable to post-acquisition improvements in operating performance, especially in those instances where acquisition is followed by removal of the target firm's CEO. See Ronan G. Powell & Andrew W. Stark, *Does Operating Performance Increase Post-Takeover for UK Takeovers? A Comparison of Performance Measures and Benchmarks*, 11 J. CORP. FIN. 293 (2005).

247. See *supra* Part IV.

248. Parkinson & Dobbins, *supra* note 245, at 515.

249. Franks & Mayer, *supra* note 244, at 170.

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which were successful. The authors found that successful hostile bids resulted in managerial change within the target firm in 88% of cases, compared to only 60% of friendly combinations.²⁵⁰ In the same vein, successful hostile takeovers on average resulted in 90% of board resignations versus 50% in friendly control shifts.²⁵¹ Meanwhile, asset sales exceeding 10% of the merged firms' total tangible fixed assets occurred following 53% of successful hostile takeovers but in only 26% of friendly deals,²⁵² while bid premiums in the month of the bid averaged 30% in the case of the former transactions as against only 18% for the latter.²⁵³

Except for targets having sub-optimal financial performance results in terms of Tobin's Q, Franks and Mayer found "little evidence that hostile takeovers are motivated by poor [financial] performance prior to bids ["managerial failure"]... Instead, we argue [they argued] that opposition to bids by incumbent management reflects disagreement over the price the bidder is willing to pay and its intentions to restructure the company."²⁵⁴

The argument made by Franks and Mayer, and the findings in support of that argument, are consistent with the redeployment of assets component of the *efficiency/synergy theory of tender offers*. Whilst Franks and Mayer's findings in this regard initially appear to rebut Manne's theory of the market for corporate control by finding no evidence of "managerial failure", upon closer examination this is not necessarily the case. Rather, Manne would arguably reject at least part of Franks and Mayer's interpretation of their statistical analysis by arguing that the refusal of target management to redeploy assets is itself evidence of managerial failure or inefficiency.

Cosh and Guest, meanwhile, examined the long-term pre- and post-acquisition performance of U.K. hostile takeover targets over the 11-year period from 1985 through 1996, covering 64 successful hostile takeover bids for U.K. listed targets carried out during this time.²⁵⁵ They found that, whereas hostile takeover targets showed marked underperformance in the one-year pre-acquisition period in terms of both profitability and share price, there was strong evidence of improved profitability and share price performance in the post-acquisition period, relative to non-merging firms in the sample.²⁵⁶ This was in notable contrast to friendly takeover targets, which exhibited no enhancements in profitability after acquisition and, moreover, negative share price performance in the longer term.²⁵⁷ The authors attributed the relative success of hostile

250. *Id.* at 169.

251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.* at 164.

255. Andy Cosh & Paul Guest, *The Long-Run Performance of Hostile Takeovers: U.K. Evidence 7* (ESRC Centre for Business Research, University of Cambridge, Working Paper No. 215, 2001).

256. *Id.* at 5.

257. *Id.*

takeovers in the above respects principally to the tendency of successful bidders to undertake value-adding asset disposals in target firms following acquisition, rather than to job cuts or reduction of investment therein.²⁵⁸

In a similar vein, Raj and Forsyth analyzed pre- and post-acquisition performance of hostile versus friendly bidders and bid targets in the 31 successful hostile takeovers involving U.K. listed bidders from 1990 through 1998, as measured in terms of the level of abnormal returns accruing to the merging firms' shareholders.²⁵⁹ The authors found that, in the 18-month period preceding bid announcement, target firms suffered an average drop of approximately 20% in their share price performance, which they regarded as "lending support to the disciplinary hypothesis."²⁶⁰ Furthermore, whereas hostile bidder firms in the sample on average demonstrated relatively positive performance in the post-acquisition period, friendly bidders by contrast exhibited significant negative performance.²⁶¹ The authors surmised from the above findings that "perhaps hostile bidders are prepared to take necessary steps to ensure better post-acquisition performance."²⁶²

As we similarly encountered in examining the corresponding U.S. picture discussed above, empirical data on the impact of U.K. public M&A (and especially hostile takeover) activity over the 2000s and 2010s is not as extensive as those in the previous decades. However, although the volume of hostile takeover activity in the U.K. has undoubtedly tailed off in the past two decades relative to preceding time periods, this trend would appear to be attributable to factors other than the applicable regulatory framework. It is undeniable that both the U.K. Takeover Code and the U.K. corporate law system more broadly, have remained firmly shareholder-friendly throughout the above time period.²⁶³ Accordingly, it can be surmised that other contextual variables are most likely responsible in this regard. Not least amongst these is the significant increase in the general cost of public equity capital that has occurred since the burst of the dot.com bubble in 2001, a trend which neither the 2008 global financial crisis

258. *Id.* at 31.

259. Mahendra Raj & Michael Forsyth, *Hostile Bidders, Long-Term Performance, and Restructuring Methods: Evidence from the UK*, 20 AMER. BUS. REV. 71 (2002).

260. *Id.*, at 80. In a similar vein, a slightly earlier study of 94 successful acquisitions of UK publicly traded companies between 1990 and 1993 (set against a control group of comparable non-merged firms) found a strong positive correlation between corporate underperformance and the corresponding likelihood of the relevant firm becoming a takeover target. See Charlie Weir, *Corporate Governance, Performance and Take-overs: An Empirical Analysis of UK Mergers*, 29 APPL. ECON. 1465, 1473 (1997).

261. *Id.*

262. *Id.*

263. Moreover, if anything the U.K.'s general system of company law has become *even more* overtly shareholder-centric in recent decades, especially following the introduction of section 172 of the U.K. Companies Act 2006, which provides the first ever express statutory endorsement of the precept that "[a] director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members [i.e. shareholders] as a whole." See U.K. COMPANIES ACT 2006 § 172(1); see also Marc T. Moore, *Shareholder Primacy, Labour and the Historic Ambivalence of UK Company Law*, in ELGAR RESEARCH HANDBOOK ON THE HISTORY OF CORPORATE AND COMPANY LAW (Harwell Wells ed., 2018).

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nor (at least at the time of writing) the 2020 global COVID-19 pandemic have offset in any materially significant way.²⁶⁴

Notwithstanding the lower frequency of hostile bids for U.K. targets in recent times, the available evidence would suggest that, consistent with earlier periods, acquisitions of publicly traded U.K. firms have continued to generate significant abnormal positive returns on the target shareholder side at least.²⁶⁵ Based on an extensive study covering the 27-year period from 1990 through 2017, Alexandridis et al. calculated the mean takeover premium paid to U.K. target shareholders at just over 42%.²⁶⁶ Meanwhile, Andra used a sample of 552 deals in excess of £1 million in value from between 2002 and 2011, and calculated the corresponding average takeover premium for U.K. target shareholders just under 35%.²⁶⁷

Regarding *hostile* deal activity, based on a study of successfully completed hostile takeovers of public U.K. targets recorded in the *Lexis PSL Market Tracker* database²⁶⁸ for the period 2007 through (May) 2020, Professor Moore has estimated the average premium paid to target shareholders at approximately 36%, and the mean premium at approximately 40%.

As for individual hostile deal values, these range from a low of approximately 8% in the controversial re-acquisition of Kazakhstan's formerly London-listed Eurasian Natural Resources Corporation by its founders in 2013,²⁶⁹ to a high of approximately 64% in Cable & Wireless' 2008 capture of its former telecommunications industry rival Thus Group.²⁷⁰ Moreover, in the two biggest U.K. hostile takeovers (as measured by aggregated deal value)

264. See *FTSE All Share Index (2016-2020)*, FINANCIAL TIMES, <https://markets.ft.com/data/indices/tearsheet/summary?s=FTAL:FSI> (last visited Apr. 21, 2021); Judith Evans, *Chart that tells a story – the FTSE since 1999*, FINANCIAL TIMES (Feb. 27, 2015), <https://www.ft.com/content/a3b1186a-bdde-11e4-8cf3-00144feab7de>.

265. Whilst looking at abnormal acquisition-related returns to target shareholders of course provides only a partial picture of the net wealth outcomes of M&A activity, there is contemporaneous evidence which infers that bidder shareholders may also have captured long-term wealth gains from public company acquisitions in many recent instances. For instance, a study by Andriosopoulos *et al* of short-term market reaction to U.K. publicly traded bidders' M&A announcements from 2000 through 2010 demonstrates that so-called "value" acquirers, which the authors define as those firms with a low price-to-earnings ratio prior to acquisition, systematically outperform "glamour" acquirers that exhibit high pre-bid price-to-earnings ratios. See Dimitris Andriosopoulos et al., *The Market Valuation of M&A Announcements in the United Kingdom*, 48 INT. REV. FINANC. ANAL. 350, 364 (2016). This finding purportedly challenges the validity, at least in the U.K. market context, of Michael Jensen's influential notion of the agency costs of overvalue equity, which essentially avers that managers of firms with excessively high equity valuations will tend to use their firms' overvalued equity as inflated consideration for value-reducing acquisitions, such that any ensuing gains to target shareholders come directly at the long-term expense of bidder shareholders. See Michael C. Jensen, *Agency Costs of Overvalued Equity*, 34 FINANC. MANAG. 5 (2005).

266. Specifically, 42.02%. See George Alexandridis et al., *Gains from Mergers and Acquisitions Around the World: New Evidence*, 39 FINANC. MANAG. 1671, 1672 (2010).

267. Specifically, 34.65%. See ADRA, *supra* note 122, at 91.

268. See LEXISNEXIS, <https://lexismarkettracker.lexisnexis.com/> (last visited Apr. 20, 2021).

269. Mark Scott, *Founders of ENRC Offer \$4.7 Billion in Takeover Bid*, N.Y. TIMES (Jun. 23, 2013), <https://dealbook.nytimes.com/2013/06/23/founders-of-enrc-to-make-4-7-billion-takeover-bid/>.

270. Gwen Robinson, *UK's Thus investors signal takeover*, FINANCIAL TIMES (Jul. 1, 2008), <https://www.ft.com/content/d1dfdc57-11b8-3bd8-a491-80ca9d4ec94e>.

successfully concluded over the past two years (at time of writing), namely Melrose Industries' \$10.6 billion acquisition of the engineering and aerospace manufacturer GKN in April 2018²⁷¹ and DNO's \$821 million acquisition of Aberdeen-based Faroe Petroleum in January 2019,²⁷² the purported premiums paid to target shareholders were estimated at 43%²⁷³ and 52%²⁷⁴ respectively.

It remains to be seen precisely how the U.K.'s hostile takeover market responds to the global economic turmoil wreaked by the ongoing COVID-19 pandemic. However, recent events would suggest that, if anything, current market instabilities will potentially intensify bid hostility in the U.K. by providing fresh arbitrage opportunities for prospective industry and private equity acquirers over the next few years.²⁷⁵

C. Summary

Empirical evidence on the aggregate wealth impact of change in control transactions would appear broadly consistent across the U.S. and the U.K. In both countries the market for corporate control has tended to produce statistically significant abnormal positive returns for target shareholders, which in general have not been offset by corresponding losses to bidder shareholders. In sum, even though we noted some evidence above which suggests that target and bidder shareholders have historically fared better under the U.K. system than under its U.S. counterpart, it is clear that in both countries takeovers have been significantly beneficial to the shareholders of target companies.

However, unsuccessful tender offers, like mergers, did not yield positive abnormal returns. When the window period is extended to include the termination announcement, the returns turned slightly negative. Moreover, when unsuccessful tender offers did not ultimately result in a change in control, target shareholders suffered *significant* losses. This implies that the use of aggressive defensive measures is inconsistent with shareholder welfare.

By contrast, empirical studies show that the shareholders of bidders have not fared as well. In general, their returns from acquisitions appear to have been negligible even where the corresponding returns to target shareholders have been

271. Peggy Hollinger et al., *Melrose victorious in hostile bid for GKN*, FINANCIAL TIMES (Mar. 29, 2018), <https://www.ft.com/content/c6afe24c-3356-11e8-b5bf-23cb17fd1498>.

272. Nathalie Thomas & Myles McCormick, *Faroe concedes defeat as DNO raises stake to 52%*, FINANCIAL TIMES (Jan. 9, 2019), <https://www.ft.com/content/cd47fbda-13ed-11e9-a581-4ff78404524e>.

273. MELROSE INDUSTRIES PLC, INCREASED AND FINAL OFFER FOR GKN PLC BY MELROSE INDUSTRIES PLC 4 (2018).

274. DNO ASA, INCREASED AND FINAL CASH OFFER BY DNO ASA FOR FAROE PETROLEUM PLC 7 (2019).

275. See e.g., Simon Clark & Ben Dummett, *Coronavirus Accelerates European Efforts to Block Foreign Takeovers*, WALL ST. J. (Apr. 10, 2020), <https://www.wsj.com/articles/coronavirus-accelerates-european-efforts-to-block-foreign-takeovers-11586516403>; Mark Chivers et al., *Preparing for takeovers in the light of coronavirus* (Apr. 30, 2020), <https://www.dlapiper.com/en/uk/insights/publications/2020/04/preparing-for-takeovers-in-the-light-of-coronavirus/>.

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significantly positive. Many reasons have been given for this. But perhaps more than anything these results reflect the limitations of traditional statistical methods.

In contrast to the experience of bidder shareholders, though, it is very clear that the combined value of a target and acquirer increased relative to their stand-alone values. This is consistent with the efficiency/synergy theory of tender offers.

VI. SHARFMAN RECOMMENDATION: REINTRODUCING THE HOSTILE TENDER OFFER INTO THE U.S. CAPITAL MARKETS

The efficiency/synergy theory of tender offers and the empirical evidence based on both U.S. and U.K. experience supports the return of the hostile tender offer to U.S. shores. The question then becomes, in what form?

A. Parameters

Both the U.S. and U.K. experiences have provided valuable lessons on how the hostile tender offer needs to be structured to make it a viable corrective mechanism in the U.S. capital markets. We believe the hostile tender offer can be reintroduced given the following parameters.

1. The Hostile Tender Offer Must Not Be Coercive

The use of the coercive two-tier tender offer led to the introduction of antitakeover statutes, poison pills, and other shark repellents. This, in turn, led to the diminishment of the U.S. hostile takeover market. Not only are coercive tender offers, in whatever form, unfair to shareholders, they are truly a threat to the efficient management of the target company. Coercion should not be the basis on which shareholders decide who is going to efficiently manage a target company's bundle of assets worth perhaps billions or tens of billions of dollars. Coercion is not consistent with the objectives of enhanced managerial efficiency and synergy. Therefore, the coercive tender offer should not be allowed to return.

How then can a tender offer be structured so that it is not coercive? According to Gilson and Kraakman, "any bid, apart from an any-or-all cash bid with a commitment to freeze out non-tendering shareholders at the bid price, may have *some* coercive effect on target shareholders."²⁷⁶ Gilson and Kraakman use the following example to explain why this is so:

Consider an offer that may seem non-coercive on its face: a 100% cash offer at a significant premium, but without any commitment to buy out non-tendering shareholders at a fixed price. A shareholder who believes that the stock is worth more than the offer, perhaps because he expects a higher offer in the future, would prefer not to tender. However, if he does not tender while other shareholders do tender, he will be left holding minority shares in a controlled corporation with a market value

276. Gilson & Kraakman, *supra* note 87 at 254.

that is likely to be well below the tender offer price. Thus any partial offer, including an any-or-all offer without a freezeout commitment, is potentially coercive.²⁷⁷

It follows that a non-coercive tender offer can be understood to be an all-shares, all-cash tender offer with a commitment to freeze out non-tendering shareholders at the bid price or higher. However, this approach is nothing new. In the U.K., it has been used successfully for decades by virtue of the Takeover Code's mandatory bid rule, operating in conjunction with the squeeze-out rule's equivalent consideration requirement under the U.K. Companies Act.²⁷⁸ The combined effect of both these provisions has been the substantial elimination of inter-shareholder discrimination in the U.K.'s public company M&A environment, without the need for recourse to aggressive managerial takeover defenses.

2. *Poison Pills and Private Ordering*

We agree with Julian Velasco's view that "[w]hile the poison pill does provide much-needed protection against coercive offers, its continued use in the face of non-coercive offers is indefensible."²⁷⁹ Unfortunately, current law does not take that approach. It treats a target board's maintenance of a poison pill in the face of a non-coercive tender offer as an *ordinary* business decision protected by the business judgment rule. This has been the Delaware approach to the poison pill in a long series of cases starting with *Moran* and *Unocal* and culminating in *Airgas*. In *Airgas*, all the target board had to do to maintain its poison pill was to make a determination, utilizing good faith and being informed, that the offer was inadequate. Yet, while we disagree with the decision, it was no fault of Chancellor Chandler. He was simply following a long line of precedent that logically led him to decide in favor of the target board.²⁸⁰

What the facts of *Airgas* deal with, of course, is what Gilson and Kraakman refer to as *substantive coercion*, a badly named term as it doesn't really involve coercion of shareholders as such.²⁸¹ In actual fact, so-called "substantive

277. *Id.* at 254 n.29.

278. *See supra* Part IV.A.2.

279. Velasco, *supra* note 84, at 415.

280. Robert Rhee has a different interpretation of *Airgas*. *See* Robert J. Rhee, *Corporate Short-Termism and Intertemporal Choice*, 96 WASH. U. L. REV. 495, 518-542 (2018). He makes a financial argument that it was a successful example of how shareholders profited from the board's defensive measures. His argument is based on Air Products making its "best and final" offer of \$70 per share on Dec. 9, 2010, which was not accepted by the board, and then ultimately being acquired by Air Liquide in May 2016 for \$143 per share. However, we do not find Professor Rhee's financial argument compelling. While shareholders ended up doubling the value of their investment as a result of the board's defensive measures, it appears they could have done almost as well by investing in the S&P 500 index in December 2010, a much safer investment given its diversification, and then selling the index in May 2016 (85.6% return including reinvested dividends), *S&P 500 Return Calculator*, DQYDJ, <https://dqydj.com/sp-500-return-calculator/> (last visited Apr. 24, 2021).

281. Velasco, *supra* note 84, at 417 (The term was not intended to suggest that substantive coercion was coercive in the ordinary sense of the word.)

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coercion” principally represents the high level of *mistrust* that exists between shareholders and management.²⁸²

This mistrust in the board of directors, either because of its abilities or suspected motivations,²⁸³ is important information that a corporation as a whole should be able to utilize when considering the merits of a non-coercive tender offer. Such mistrust calls for shareholders to seek out new management, not the endorsement of a defensive measure to keep the current management team in power. Unfortunately, in applying the substantive coercion theory when evaluating the validity of aggressive managerial defenses to all-shares, all-cash tender offers, courts are condoning inefficient decision-making at a critical juncture in a corporation’s life.

We believe that the judicial denial of the ability of the corporation to use this information in considering a change of control transaction was the result of the court ignoring the private ordering nature of corporate law. According to the Delaware Supreme Court in *Williams v. Geier*, “[a]t its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial *private ordering*, provided the statutory parameters and judicially imposed principles of fiduciary duty are honored.”²⁸⁴ Private ordering arrangements are implemented through agreements made primarily between the board and shareholders, even though other stakeholders, such as creditors and vendors, may participate when they have the appropriate leverage to be involved.

In *Airgas*, no charter amendment was required to establish that the board had the authority to implement a poison pill. We find that objectionable and disagree that the board of directors should have the power to unilaterally implement a poison pill solely under its statutorily provided default authority.²⁸⁵ A grant of such unilateral authority by the courts is inconsistent with the private ordering nature of corporate law. Moreover, implementing a poison pill is an extraordinary decision, not unlike entering into a merger or acquisition agreement; a decision that should not be made without the approval of shareholders. Therefore, if the board is to use a poison pill, the authority for its use should come from a private ordering arrangement approved by *both* the board *and* shareholders.

This private ordering approach to defensive measures is supported by the efficiency argument made by Luca Enriques, Ronald Gilson, and Alessio Paces:

While takeovers may be efficient in the aggregate, the efficiency of individual takeovers and individual companies’ exposure thereto depends on a variety of factors. These factors include the production functions of companies, conditions in the relevant industry, the problems confronting the corporation, and the best response to those problems. Because all of these factors may differ from company to company and over time, the appropriate stance to takeovers in each case may also differ.

282. Gilson & Kraakman, *supra* note 87, at 262-64.

283. *Id.*, at 263.

284. 671 A.2d 1368, 1381 (Del. 1996).

285. *See e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2019).

Consequently, we posit that takeover regulation should sanction individual company efforts to devise a takeover regime appropriate to their own, mutable circumstances.²⁸⁶

Therefore, while we strongly disagree with how the *Unocal* test has been applied over the years, it is important to understand that the principles of private ordering do not allow us to recommend that this line of decisions be wiped out by statutory fiat. If the board and shareholders agree that the use of a poison pill or any other defensive measure is in the best interests of all parties, even in the face of a non-coercive tender offer, *as evidenced by its endorsement in the corporate charter*, then all the court decisions decided under the *Unocal* test, including *Airgas*, must apply to those defensive measures.

Of course, we do not foresee the Delaware courts changing direction on this issue any time soon. Therefore, it is clear that a statutory override is required to allow for the non-coercive tender offer to take its place as a corrective mechanism in the corporate governance of U.S. public companies. However, that override must not interfere with a private ordering arrangement that allows the board to use a poison pill or any other defensive measure. Accordingly, our proposed reform would allow for the *Unocal* test and *Airgas* to remain good law, albeit just not in the relatively small number of fact patterns where the statutory override applies.²⁸⁷

3. “White Knights”

Many years ago, there was a very important debate pitting Frank Easterbrook and Daniel Fischel,²⁸⁸ who believed in total board passivity in the face of a hostile tender offer, against Lucian Bebchuk,²⁸⁹ who argued that the target board should have the opportunity to seek a “white knight.”

Easterbrook and Fischel argued that allowing the target board to actively solicit the participation of “white knights” in the bidding process, with the possible result of a bidding war, would raise the expected purchase price of an acquisition and have a counterintuitive, but harmful impact on the hostile takeover market.²⁹⁰ They reasoned that an increase in the expected purchase price of an acquisition would eat into a hostile bidder’s expected return on its

286. Luca Enriques et al., *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, 4 HARV. BUS. L.R. 85, 87 (2014).

287. It may be objected that, in response to our recommended reform, prospective public issuers will simply include a poison pill and/or other defensive measure(s) in their charters at the initial public offering stage, or take some other measure(s) to insulate themselves pre-emptively against any such statutory provision. In our belief, though, the pervasive presence of proxy advisors and other highly influential shareholder rights activists within the contemporary capital market environment is likely to provide a significant practical counterpressure to any such trend. Moreover, even to the extent that such whitewashing practices are permitted in the case of new public issuers, they are likely to encounter much greater investor resistance when attempted on a midstream basis within incumbent issuers.

288. Easterbrook & Fischel, *supra* note 50, at 1162.

289. Bebchuk, *supra* note 110, at 1032.

290. Easterbrook & Fischel, *supra* note 50, at 1162.

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investment in the target search process and thus discourage its overall willingness to participate in the hostile takeover market.²⁹¹

According to Easterbrook and Fischel,

Any approach that looks only at the way in which managers can augment the tender offeror's bid, given that a tender offer has already been made, but disregards the effect of a defensive strategy on the number of offers that will be made in the future and the way in which the number of offers affects the efficiency with which corporations are managed, ignores much that is relevant to shareholders' welfare."²⁹²

Bebchuk, on the other hand, argued that target boards should have the ability to seek out "white knights." Moreover, in Bebchuk's view, target boards should be allowed to entice the entry of a white knight into the bidding process by providing the latter with confidential corporate information.²⁹³ While Bebchuk conceded that the potential entry of "white knights" would reduce the financial return on a hostile bidder's investment in search, he believed that the latter's prospective return would likely still be sufficiently large to allow for a significant amount of search.²⁹⁴

As regards a hostile bidder that loses out in a bidding war with a white knight, meanwhile, Bebchuk believed that the former party would still be positioned to earn significant capital gains on the shares it purchases prior to the making of a tender offer.²⁹⁵ Bebchuk noted that under Section 13(d) of the Williams Act, an investor is not required to disclose its stock holdings in a public company until it has beneficial ownership of more than five percent of a class of that company's stock.²⁹⁶ Therefore, similarly to a modern day hedge fund activist who takes a significant position in a public company (e.g., 5%-10%) and then advocates for the target board to prepare the company for sale, the hostile bidder could make large gains if it were to make significant "pre-offer purchases of the target's stock."²⁹⁷

Bebchuk also noted that the hostile bidder may be using its search to identify a target that "will bring greater synergistic or managerial gains to the searcher than to any other potential acquirers."²⁹⁸ This should mean that the hostile bidder will have the greatest incentive to win the bid and reduce the uncertainty of the bid failing.

In addition, Bebchuk observed that since the time period for making bids is necessarily limited, the hostile bidder will have an advantage by having the most up-front time to gather information on the target.²⁹⁹ Finally, Bebchuk argued that

291. *Id.*

292. *Id.* at 1164.

293. Bebchuk, *supra* note 110, at 1030.

294. *Id.* at 1035.

295. *Id.*

296. *Id.*

297. *Id.*

298. *Id.* at 1036.

299. *Id.*

a hostile bidder's search costs will necessarily be limited if they are based on public information.³⁰⁰

The above debate between living legends in corporate governance scholarship occurred almost four decades ago. However, if we can generalize from the U.K. experience at least, it would appear that Bebchuk has won the debate. Indeed, as highlighted above, the U.K. has been able to maintain a vibrant hostile takeover market while continuing to permit U.K. target boards to seek the assistance of white knights in response to hostile bid announcements.³⁰¹

B. Recommendation

Accordingly, we recommend that state corporate law statutes be amended to include a safe harbor for a hostile bidder when making an all-cash, all-shares tender offer that includes a guarantee of the same or higher price if a squeeze-out merger occurs ("non-coercive tender offer"). The use of this safe harbor would disallow both a board's use of the poison pill as a takeover defense and statutory takeover defenses. However, if the use of a specific takeover defense, such as a poison pill, or a specific statutory takeover defense, is provided for in the corporate charter, then the target board will be given the discretion to utilize those defenses. In this way, private ordering can always be used to trump the proposed statutory safe harbor.

During the time when the non-coercive tender offer is outstanding, the target's management must be allowed to make ordinary business decisions but cannot, in general, interfere with the tender offer. The board's activities would be limited in a manner similar to what Easterbrook and Fischel describe:

[M]anagement should be able to issue a press release urging shareholders to accept or reject the offer. The offeror also will convey its views to the shareholders, who can act on these messages in light of the self-interest of both the management and the offeror. But almost any other defensive actions expend the target's resources and produce no gain to investors. Thus, management should not propose antitakeover charter or bylaw amendments, file suits against the offeror, acquire a competitor of the offeror in order to create an antitrust obstacle to the tender offer, buy or sell shares in order to make the offer more costly, ..., or initiate any other defensive tactic to defeat a tender offer.³⁰²

Finally, consistent with U.K. practice, target boards will always have the right to seek the support of a "white knight." This is an exception to the Easterbrook and Fischel approach. Moreover, and again consistent with U.K. practice, if confidential corporate information is provided to the "white knight," it must also be provided to all bidders, including the initial hostile bidder.

In sum, what we are recommending is a new default rule for corporate law. According to Brett McDonnell:

300. *Id.* at 1036-37.

301. See *supra* notes 143-147 and accompanying text.

302. Easterbrook & Fischel, *supra* note 50, at 1201.

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A default rule is one that applies only in the absence of an agreement by the relevant parties to be governed by a different rule.... [C]orporate law provides a series of convenient, off-the-rack default rules that most corporations will find useful to follow most of the time.... However, if the parties who have formed a particular corporation find that some of the default rules in their state do not work well for them, they should be able to choose to be governed by a different rule.³⁰³

If correctly structured, off-the-rack corporate law default rules enhance the efficiency of entering into corporate governance arrangements by reducing the need for management and shareholders of new corporations to negotiate over every possible corporate governance arrangement. Most importantly, by providing generally optimal solutions for key corporate governance arrangements, default rules help mitigate the potential cost of a negotiating lawyer overlooking an important governance issue that should have been negotiated.

We argue that our proposed default rule is the one that most companies would have adopted if they had considered the matter when going public. We base this argument on the common assumption that a desirable corporate law default rule is one that maximizes shareholder value.³⁰⁴ Our review of the statistical research on hostile takeovers here and in the U.K. demonstrates that our proposed default rule would be optimal in achieving such an objective.

CONCLUSION

Periodic crises have a habit of exposing certain managerial weaknesses. The COVID-19 pandemic revealed particular weaknesses in managerial preparedness and response. A vibrant hostile takeover market is one way for the market to correct these weaknesses as quickly and efficiently as possible.

Unfortunately, the unintended consequence of the front-end loaded, two-tier, tender offer was to lead the U.S. capital markets down a decades-long legal path that severely diminished the vibrancy of its hostile takeover market. The U.K.'s successful experience with the non-coercive tender offer shows us that there is another way. This approach has allowed a vibrant hostile takeover market to continue over the same time period within a not-dissimilar legal culture and capital market environment.

We acknowledge that there are many out there, including some highly regarded corporate law commentators, who are simply satisfied with the status quo and do not wish to rock the boat.³⁰⁵ While that type of protectionist sentiment

303. Brett McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 384 (2007).

304. Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489 (2002).

305. See, e.g., Stephen Bainbridge, *Were Easterbrook and Fischel right that target company boards should remain passive in the face of a hostile takeover bid? A comment on Sharfman and Moore*, PROFESSOR BAINBRIDGE (Sept. 9, 2020), <https://www.professorbainbridge.com/professorbainbridgecom/2020/09/were-easterbrook-and-fischel-right-that-target-company-boards-should-remain-passive-in-the-face-of-a.html>.

(the protection of current management from removal) does help to enhance short-term political and economic stability, it also has the effect of perpetuating managerial inefficiency and, as a result, creates one more impediment for our economy as it struggles to move out of a decades long slow growth trajectory and tries to protect itself from the next pandemic or any other such exogenous shock.

As a result, it may take a number of years before our recommendation gains momentum with state lawmakers. But at the very least, this article plants the seed for the development of something our economy can definitely use, a vibrant hostile takeover market. Hopefully, that seed will take root sooner than later.