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The Transactional Scope of Takeover Law in Comparative Perspective

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March 2016

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Abstract

The core activity regulated by takeover codes is the voluntary offer by a bidder addressed to all the shareholders of a target company (other than the bidder) to acquire their shares in order to give the bidder control of the company. Around this core transaction, however, takeover codes regulate a range of other transactions. This paper explores four such transactions. Two of them are offers by persons already in control of the company: first, where the offer is made by the controller voluntarily (the 'consolidating' offer) and, second, where the offer is required by regulation (the mandatory bid rule). The third transaction is where shares move into the hands of an acquirer, not by reason of a contract between acquirer and shareholders, but by reason of powers conferred by statute. The clearest examples are statutory merger provisions and schemes of arrangement. The fourth transaction is a control shift produced by contract between company and shareholders or investors without any contracting between acquirer and existing shareholders. The example examined in detail is the share buy-back.

The purpose of the analysis is to determine the rationale for applying rules formulated for general, voluntary offers to acquire control to these peripheral transactions – either in full or in part. The focus of the analysis is on the UK Takeover Code and the variants of it which have been adopted in various Far East jurisdictions. To some extent the drafters of the UK Code faced the same problems as those in the other jurisdictions and the resulting rules have a high degree of commonality across the codes. However, the dominant shareholder structure of public companies in the other jurisdictions is very different from the dispersed UK pattern. The drafters of the non-UK codes have thus faced difficult issues about how to shape relations between controlling and non-controlling shareholders which the UK code is able to ignore or downplay. Some reference is also made to the law of Delaware, which, whilst not a Code jurisdiction, has an innovative approach to protection of minorities against controlling shareholders.

Keywords: Takeovers, Tender Offers, Mergers, Schemes of Arrangement, Mandatory Bid Rule, Share Buy-backs, Transactional Arbitrage

JEL Classifications: K12, K22

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Abstract

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Defining the transactional scope of takeover law might seem simple. Takeover law regulates takeovers. We have, it may be said, a widely accepted view of what a takeover is. It occurs when a person (normally a company) decides to make a general offer to the shareholders of a target company to contract with them to acquire some or all of their shares, but in any event sufficient shares to give the offeror control of the company.[1] So, takeover law is the law which regulates such transactions. However, even a cursory look at the scope of takeover rules in different countries shows that this definition of the transactional scope of takeover law is inadequate. This chapter examines four situations where takeover regulation is commonly found but which fall outside the definition just given. The first two situations fall outside the core definition because they are offers by persons already in control of the company. They are thus situations in which a person with control of the company (or at least one who is treated as having control) offers to acquire further shares in the company. However, the two situations are in one respect very different from one another. In the first situation the person with actual control desires to increase their level of ownership (which I term a 'consolidating offer' – discussed in Section I), whereas in the second case the rules require the person who has crossed a control threshold to make an offer for all the outstanding shares of the company, whether that person wishes to or not. This latter, of course, is the mandatory bid rule – discussed in Section II.

The third case raises the issue of whether takeover regulation is confined to offers to contract for shares (which is the case in the first and second situations) or whether it extends to situations where control of a company is shifted to the acquirer through the exercise of statutory powers conferred on the corporation which bypass the need for contracts between transferor and transferee shareholders. The central example is the statutory merger. In principle, the rules governing control shifts by contract could be the sole form of regulation of statutory mergers; they could be excluded entirely from the regulation of statutory mergers which could be regulated under a separate set of rules; or the rules regulating contractual acquisitions could supplement in a subordinate way the separate rules for mergers. In practice, the first approach is never found, probably because of the inaptness of the contractual rules, but some jurisdictions opt for the second and some for the third approach. The central sections of the paper (III to V) analyse this situation.

Finally, we look at hybrid situations, where control shifts as a result of a corporate decision, but that decision is implemented by way of contract between company and shareholders. The central case here is the buy-back. We discuss this in Section VI.

The purpose of this paper is not simply to identify the possible approaches to regulation of these four situations, but also to seek to explain the advantages and disadvantages of using contractual regulation outside the core case of a general offer to acquire control. In this context "contractual regulation" means regulation of the contractual mechanism for the acquisition of shares, not regulation through the law of contract.

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[1] Even this simple definition raises one technical issue. In contractual doctrine the 'offer' from the acquirer is often framed as an invitation to treat and the contractual offer is made by the shareholders who respond to that invitation, which offer the acquirer then accepts. However, in this paper the term 'offer' is used to embrace both contractual offers and invitations to treat.

The focus of the paper is on jurisdictions which have adopted explicit takeover codes, often, but not always, following the UK Takeover Code model. In particular, there is some reference to Asian jurisdictions, many of which have adopted UK-style codes, but in the context of very different typical shareholder structures, ie concentrated rather than dispersed. However, we make some reference to the law of Delaware especially in relation to its mechanisms for protecting non-controlling against controlling shareholders in control shifts.

I. Consolidating offers

A contractual offer by a shareholder already in actual control of the company for the outstanding shares clearly does not fall with the core definition of a takeover offer given above. The offeror already has control before the offer is made. Nevertheless, there may be good reasons for the controller's desire to move to greater or complete control. The controller may be willing to put additional financing into the company only on the basis that it has 100% control or it may wish to be able to implement business plans without the threat of minority shareholder litigation. On the other hand, the risk of opportunistic conduct on the part of the controller is high, especially as to the financial terms and timing of the offer, since the controller may time the offer for a period when the share price is at a low level and may have a better understanding of the future prospects of the company than the outside shareholders.

Bringing consolidating offers within the scope of takeover regulation facilitates solutions to both aspects of the consolidating offer. The business case for moving to complete ownership ('going private') is recognised by giving the consolidating offeror access to the squeeze-out mechanism which is now routinely made available to offerors whose offers receive a high level of acceptance from the offerees. The EU Takeover Directive[2] requires Member States to provide post-bid a compulsory acquisition right but at a high level of acceptances (ie where 90% of the shares *offered for* have accepted the bid, a percentage which member states may increase to 95%). Independently of the Directive, UK law has contained a squeeze-out right at this level since the enactment of the Companies Act 1929 and jurisdictions following the UK model also typically have such squeeze-out rights. Of course, the higher the percentage of the shares the consolidating offeror holds before making the offer, the less likely it is that this threshold will be reached, since the number of non-accepting shares needed to constitute a blocking percentage reduces as the consolidating offeror's pre-bid percentage holding increases.

Some jurisdictions provide squeeze-out at around the 90 per cent level no matter how that percentage ownership was achieved.[3] Germany is such a country, though, as a result of the

[2] [2004] OJ L 142/12, art. 15. In fact, it is not clear whether the Directive catches consolidating offers. The Directive applies to a "public offer . . . which follows or has as its objective the acquisition of control of the offeree company" (Art.1(a)), suggesting that only consolidating offers following within some reasonably short period the acquisition of control are covered – the wording was probably intended to embrace the mandatory bid rule. However, the Directive does not inhibit Member States from applying their rules more broadly, as most do. S.974 of the Companies Act 2006 (UK) makes it clear that consolidating offers are within the definition of a 'takeover offer'. The size of the offeror's pre-bid holding is not an element in that definition.

[3] The controller may have acquired its controlling position through a takeover long in the past or its controlling position may not be due to a takeover at all, for example, where a founder has kept a controlling interest on the flotation of the company but now wishes to take the company private again.

Directive, it now has a post-bid squeeze out mechanism as well.[4] Delaware also provides for a squeeze out via a merger between a controlling and a controlled company, where the former holds 90 per cent of voting rights in the latter, without the consent of the shareholders in the controlled company being required – the so-called 'short-form' merger.[5] This is a mechanism for potential use by a consolidating offeror who wishes to reach complete control, even if a prior offer to acquire control is not formally part of the squeeze-out mechanism. To be sure, the squeeze-out mechanism is the implementation of a merger agreement in a simplified manner, rather than a straightforward share acquisition right, so that the consent of the controlled company's board to the merger agreement is required, but this is likely to be easily obtainable by the controller. (We discuss below the fiduciary constraints on the controlled company's board.) As a result of amendments made in 2014, Delaware made the short-form merger available to consolidating offerors in a second situation. This is where, after a tender offer for all the outstanding shares, the offeror holds 50 per cent of all the shares entitled to vote on a merger.[6] Here a prior general offer is a formal part of the squeeze-out process. It need not come from an existing controller, though the purpose of the 2014 reforms was to make it available to consolidating offerors.[7] Unlike with the UK and EU squeeze-out provisions, the shares held by the offeror before the bid count towards the threshold – which the consolidating offeror may in fact already exceed in advance of the offer. The role of the tender offer is thus to enable the offerees to exit the company without waiting for the formal merger[8] and to enable controllers to squeeze-out the minority without incurring the costs of a shareholder vote.

Moving to the second aspect of consolidating offers, there are a number of reasons for supposing that, in the absence of regulation, the quality of the offerees' decision to accept or not will be low. The offerees may fear that the controller will conduct the company in a way unfavourable to the minority in the future. For example, the controller may propose to de-list the company if the offer is successful, thus generating a form of pressure to tender. The offeree will not wish to remain in the company after de-listing and so will take the exit opportunity the offer extends, even though the offeree does not think the price offered reflects the full value of the minority stake. That is, in order to avoid the loss of liquidity that de-listing would involve, the offerees may accept the offer even though they do not think it is an attractive one. Alternatively, offerees may not be well placed to evaluate the offer because of their information asymmetry with the offeror. Since controlling shareholder and minority

[4] Germany provides for unconnected squeeze out at the 95 per cent level in §§327a-f of the Aktiengesetz but provides safeguards as to the terms of the deal by requiring independent expert assessment of their fairness ex ante and providing for ex post appeal on the grounds of inadequate compensation to a court. The general assessment is that these and other safeguards make the procedure not easy to invoke. Thus, following the European Directive, the introduction into Germany of a post-bid squeeze-out mechanism with fewer procedural embellishments was a significant event for that country, despite the fact that the two squeeze-out mechanisms operate that the same percentage level. See T. Stohlmeier, *German Public Takeover Law*, 2nd ed. (Alphen aan den Rijn: Kluwer Law International, 2007) 3.3.

[5] Delaware General Corporation Law (DGCL) §253.

[6] DGCL §251(h). Fifty per cent of the outstanding shares is the standard approval requirement for mergers in Delaware. Naturally, the proposed merger must be revealed in the offer. The mechanism is a default one (ie the certificate of incorporation of the controlled company may opt out of it) and it is in any event available only to publicly traded companies or those with at least 2000 holders of record.

[7] This facility was previously available only to 'third-party' offerors, ie it excluded those holding 15 per cent of more of the shares in the company subject to the offer.

[8] The squeeze-out in the merger must be on the same terms as the offer.

shareholders are on opposite sides of the share sale, the controller clearly has an incentive to exploit whatever incapacities the minority suffers from. Finally, where the controller extracts private benefits of control, the price of the public shares will not reflect the value of those benefits. As Gilson and Gordon put it, 'a freeze-out at the discounted price allows the controlling shareholder to capture the capitalized value of future private benefits",[9] and the same point can be made about a voluntary offer if the offerees are subject to pressure to tender or suffer from information asymmetry.

A case for regulation of offers to consolidate control can thus be made, but it is not obvious that the regulation should take the form of extending the rules applicable to offers to acquire control to offers to consolidate control. It might be, for example, that the principles of commercial contract or general corporate law could be deployed to address the issues in consolidating offers. To some extent, this does occur. In English common law systems directors' duties may require disclosure of information to the recipients of an offer to consolidate control or require that any advice given by directors to shareholders be given in their interests.[10]

In fact, a number of jurisdictions explicitly extend the regulation of general offers to acquire control to general offers to consolidate control. The UK Code applies to offers to minority shareholders where the object is to consolidate control,[11] and this approach has been followed, for example, in Singapore[12] and Hong Kong,[13] where, given the concentrated shareholding structure, one may guess the extension is even more important than in the UK. Extending takeover regulation to offers which aim at consolidating control is a potentially appropriate way of both facilitating going private transactions through the post-bid squeeze-out mechanism and providing protection to minority shareholders because the acquisition technique at the core of both control acquisition and consolidating offers is the contractual offer. As far as the protective function is concerned, the main gains from extending takeover regulation to offers by existing controllers are three-fold. First, the information disclosure

[9] R. Gilson and J. Gordon, 'Controlling Controlling Shareholders' *University of Pennsylvania Law Review*, 152 (2003-4), 787. The point is that, although private benefits of control (pbc) will cease to be available once the offeror holds all the shares in the company, acquisition of the outstanding shares at a price which does not reflect existing pbc allows the offeror to capture the future value of those pbc through the price discount (ie the discount from the price the shares would have in absence of pbc).

[10] *Coleman v Myers* [1977] 2 NZLR 225 (NZCA); *Re A Company* [1986] BCLC 382. These exceptions to the rule that directors' duties are owed only to the company are based on the fact that the directors are here treating with the shareholders in relation to their shares. Even so, it appears that these common law duties will not be triggered in the absence of gross information asymmetries or the directors' choosing to advise the shareholders how to respond to an offer. See *Peskin v Anderson* [2001] 1 BCLC 372, EWCA at 379: the fiduciary duties arise "especially in those cases in whch the directors, for their own benefit, seek to use their position and special inside knowledge acquired by them to take improper or unfair advantage of the shareholders." (*per* Mummery LJ).

[11] Panel on Takeovers and Mergers, *The Takeover Code*, (11th ed, 2013), Introduction, §3(b) (UK).

[12] The Singapore Takeover Code defines an 'offer' so as to include an offer by a parent company for shares in its subsidiary, so that the common case, where the controlling shareholder holds its shareholding through a corporate vehicle, is clearly covered. See Monetary Authority of Singapore, *The Singapore Code on Take-Overs And Mergers*, 2012, Definitions.

[13] Securities and Futures Commission, *The Codes on Takeovers and Mergers and Share Buy-backs*, 2104, Introduction, §4.3: Takeovers include "offers by a parent company for shares in its subsidiary and certain other transactions where control (as defined) of a company is to be obtained or consolidated." General Principle 2 states: "If control of a company changes or is acquired or is consolidated, a general offer to all other shareholders is normally required."

requirements of the takeover rules are triggered, including the duty to provide independent advice on the offer, thus helping to reduce the information asymmetry between controlling and non-controlling shareholders.

Second, developed takeover rules typically require the price in the offer to reflect the price paid by the offeror outside the offer, both during the offer period and in the period leading up to the offer. These equality rules help to reduce pressure to tender, both on the part of those who receive an offer outside the bid and on the part of those subject to the offer. Those receiving an unattractive offer before the bid is launched will know they have little to lose by waiting for the formal offer, whilst those receiving the consolidating offer will know that none of the minority have been bought out on better terms (which might indicate that the offer is too low), at least in the period leading up to the consolidating offer.[14]

Third, where the offeror wishes to obtain complete control of the target and the relevant jurisdiction operates an EU-style, post-bid squeeze-out mechanism, the fact that a high percentage of the offerees accept the offer can be taken as some measure of the fairness of the offer. This is in contrast to Delaware-style rules where squeeze-out is predicated on the proportion of the relevant shares held post-bid by the offeror, who may need few, or even no, acceptances to cross the applicable threshold.

However, it would be wrong to overestimate the gains to target shareholders from the application of general takeover rules. The controller still has control over the timing of the offer and is likely to choose a time when the market undervalues the company (as compared with the controller's valuation based on 'soft' non-disclosable information and insights). Even if the shareholders think the offer does not reflect the full value of the company, they may tend, if dispersed and unable to coordinate their responses at low cost, to accept the offer in order to avoid the drop in value of the shares likely to occur if the offer is sufficiently accepted to enable the controller to implement its plan (for example, to delist the company).[15]

These risks to the minority shareholders are more explicitly addressed in Delaware. This is partly because the Delaware courts have traditionally been suspicious of controlling shareholders, partly because the issue of presents itself in terms of legal techniques rather differently in Delaware than in takeover code jurisdictions. In Delaware there is no code of rules specific to takeovers.[16] Rather, squeeze-outs are effected via the simplified statutory merger provisions mentioned above, coupled with fiduciary duty constraints on the board of the controlled company and its controlling shareholder. The focus of minority protection is thus on court review of the consolidating offer under the applicable fiduciary standards. For pure mergers initiated by controlling shareholders the traditional review standard has been the demanding one of 'entire fairness'.[17] Where, however, the squeeze-out merger is preceded by a tender offer, a controlling shareholder making a consolidating offer can avoid invasive

[14] However, these rules do not fully prevent the offeror from capitalising the value of private benefits of control.

[15] For example, if the market price of the share at the time of the offer is x, the offer is at x + 2, the offeree considers the true value of the share is x + 4, the likely market price if the bid succeeds is x – 2, an offeree is likely to accept the offer and obtain the lower gain of 2 than risk the loss of 2 which non-acceptance would imply, unless the offerees are able to coordinate their responses effectively. See also Section IV.1.

[16] There are federal rules specific to takeovers but these are of limited scope. See Section IV.1.1.

[17] *Kahn v Lynch Communication Systems Inc*, 638 A.2d 1110 (Del. Sup. Ct. 1994). For recent modification of this traditional position see n 63.

court review of the fairness of the offer under the 'entire fairness' standard and instead benefit from the highly deferential 'business judgment' standard, provided its offer is not coercive. Non-coerciveness is assessed by focussing on the process through which the offer was formulated by or on behalf of the controller as well as on the reaction of the offerees to it. A non-coercive offer is one which (a) is recommended by an independent committee of the controlled company's board and (b) is subject to majority of the minority shareholder approval. In addition, the offeror must commit to implement a short-form merger[18] (in order that no non-accepting minority shareholder is left stranded in the company) and must not make threats about the course it will follow if the offer is rejected.[19]

Because fiduciary standards are of general application, applying across the board to directors' and controllers' conduct of the company's business, the issue of how to regulate consolidating acquisitions is not presented to the rule-maker (the court in Delaware) in the dichotomous way that faces the drafter of a takeover code. For those drafting takeover codes the question is, should offers to consolidate control be brought within the code or not? For the Delaware courts, the question is, how should fiduciary duties be shaped in relation to consolidating offers? That question can be answered without committing the court to applying precisely the same rules as those applicable to general offers to acquire control or to a statutory merger initiated by a non-controlling shareholder. It is arguable that, given the existence of an expert court, the Delaware approach produces a set of standards better tailored to the specifics of the offer to consolidate control. The Delaware requirement for an independent special board, whose independence is rigorously examined by the court and which is charged with examining the offer and negotiating with the controller on behalf of the dispersed non-controlling shareholders, who are insulated from threats of retaliatory action, is likely to be a more effective device for minority protection than mere disclosure of information and independent advice rules which takeover codes contain. The number of consolidating offers is likely fewer than in the absence of the fiduciary review, but predominantly the deterred offers will be opportunistic ones. In concentrated shareholding jurisdictions there might be a case for building in elements of the Delaware approach into the takeover code.[20]

II. The mandatory bid rule

The mandatory bid rule (MBR) presents an analogous, but bigger, challenge to the 'control acquisition' theory of the transactional scope of takeover regulation than the

[18] See n 5 above.

[19] *In re Siliconix Inc* 2001 WL 71687 (Del Ch 2001); *In re Pure Resources Inc* 808 A.2d 421 (Del. Ch. 2002); *In re CNX Gas Corp* 4 A.3d 397 (Del. Ch. 2010). Although these were all cases involving 'two step' consolidations at the 90% level under (DGCL) §253 (see text attached to n 5 above), presumably the same approach will apply to short-form mergers under DGCL §251(h) (see text attached to n. 6 above). The focus of the fairness evaluation is on the terms of the tender offer (the first stage), not on the stage two squeeze-out. Indeed, the second-stage squeeze out is seen as a protection for the offeree shareholders.

[20] The Hong Kong Code (r 2.1) requires the establishment of an independent committee of the board to consider a bid (to whom the independent financial adviser reports), in contrast to the UK Code which envisages the task of formulating the target's response being discharged by the board as a whole (r 3.1) – though fiduciary duties might cause individual members of the board to recuse themselves. However, even the HK Code does not apparently assign to the committee the role of negotiating with the controlling shareholder on behalf of the non-controlling shareholders or impose the rigorous scrutiny of committee independence which Delaware courts require.

consolidating offer does. Here, also, the person subject to the MBR has at least de facto control of the company but that person, unlike in the situation discussed in section I, has no wish to make an offer for the outstanding shares. In other words, the MBR turns a person into an offeror who would otherwise not wish to offer – or at least not on the terms required under the MBR. Under the MBR a person who acquires a certain percentage of the voting rights, which is thought typically to give de facto control of the company, is required to make a general offer to acquire the outstanding shares, usually at the highest price it has paid for the controlling shares. By definition, this rule has significance only in situations where the new controller would otherwise not wish to make a general offer at that price.[21] It follows that under the MBR it is not the existence of a consolidating offer to acquire shares which is thought to generate the need for regulation, but the absence of such an offer. A general offer to acquire shares is required by the rules, in order to address a problem which exists outside that offer. If the problem were thought to lie within the general contractual offer, there would be no point in the law requiring the very transaction which generates the regulatory problem. As we shall see in more detail below, the problem which is perceived to require regulatory attention is the acquisition itself of de facto control of the target rather than the technique by which it was acquired.

The MBR features large in many of the jurisdictions considered which have adopted the UK Code, because of the concentrated nature of shareholdings in those jurisdictions. Depending on the structure of the concentrated shareholdings,[22] a hostile bid may not to be an available technique for obtaining control and instead a deal has to be done with the existing controllers, if a deal is to be done at all. But such a deal is likely to trigger the MBR. Thus, the MBR – and possible ways of avoiding it - constitute the core of takeover regulation in those juriscitions, at least as it applies in practice. For example, Varottil reports that, "substantial attention in India is focused on the mandatory bid rule (MBR)" and that "while the Indian markets have witnessed a constant stream of takeovers, they are almost entirely organized changes of control in a friendly manner that trigger the MBR."[23]

What is nature of the problem arising out of the acquisition of control which the MBR is designed to address? At its core is the allegedly exposed position of non-selling shareholders when control of a company changes by contract, but not as a result of a general offer made to target shareholders which gives the non-controlling shareholders an exit right. In the concentrated shareholder jurisdictions, the mechanism deployed for acquiring a controlling position is typically a private contract with an existing controlling shareholder or with a small number of large shareholders. In jurisdictions with less concentrated shareholdings and liquid stock markets, an alternative way of proceeding is to acquire a controlling position by

[21] Of course, once the rule is in place, it may operate in practice, at least in dispersed shareholding jurisdictions, so as to increase the number of 'voluntary' offers. Since the shape of a mandatory bid is somewhat more closely controlled by the rules than a voluntary bid (though the 'highest price' rule applies in either case), it makes sense for a person who anticipates being caught by the MBR to acquire shares up to a fraction of a per cent below the MBR threshold and then make a voluntary offer rather than to trigger the mandatory bid rule by making further acquisitions which take it across the threshold.

[22] See section IV below.

[23] Varottil, Umakanth, "The Nature of the Market for Corporate Control in India", NUS - Centre for Law & Business Working Pa per No. 15/05. Available at SSRN: http://ssrn.com/abstract=2698474. In other jurisdictions the absence of a MBR is presented as the main reason for the ineffectiveness of takeover regulation, eg Korea (discussed in ch ??).

purchases from non-controlling shareholders across a public exchange or through a combination of private contract and exchange purchases.[24] In any event, under the MBR the general contractual offer is the solution, not the problem.

This is not to say that the MBR is the perfect solution to the problems of the non-selling shareholders where control is acquired other than through a general offer. It may even be that the MBR creates more problems than it solves.[25] The point is rather that, since the MBR is such a central feature of takeover regulation in many jurisdictions, it seems inadequate to define takeover regulation as concerned solely with the issues arising out of voluntary general offers to acquire control. A wider focus to embrace the MBR involves an extension along two dimensions. First, the general contractual offer would be one example of the contractual mechanisms which takeover law regulates, whilst private deals with large shareholders and purchases of shares on public exchanges would be alternative contractual techniques which fall within the remit of takeover regulation when they are used to shift control. Private contracts (whether on- or off-exchange) are regulated in terms of their impact on a subsequent general offer. That regulation might be simply in terms of the price or other terms of a subsequent general offer which the purchaser chooses to make[26] or it might be in terms of requiring a subsequent general offer. If the subsequent general offer is required, then that is the second extension of takeover rules, to embrace mandatory as well as voluntary offers. Control shifts by means of contractual offers to acquire of target shareholders' securities thus appears to be a more appropriate definition of the transactions which takeover law actually regulates in a comparative perspective than the core definition given in the first paragraph of this piece, ie general, voluntary offers to acquire control via share purchases.[27]

However, this analysis does not explain why takeover regulation requires general offers in certain circumstances. This is in fact a highly controversial issue.[28] As is well-known, the MBR has been adopted in few US states. The dominant approach in the US jurisdictions is the 'market rule' whereby the seller of controlling shares is in principle entitled to keep whatever consideration the seller can get for them, and the purchaser is under no obligation to extend the offer accepted by the seller to other shareholders. Only in marginal cases will the sale generate liability for the seller towards the non-selling shareholders. The core liability case is where the buyer is someone who the seller knows intends to 'loot' the company, ie extract assets from it at less than market value.[29] US regulation thus focusses on the seller

[24] For the example of block trades across an exchange see *Brascan Ltd v Edper Equities Ltd* 477 F Supp 773 (1979), where, significantly, the transaction was held not to fall within the takeover rules of the Williams Act because it did not constitute a tender offer.

[25] See J. Fedderke and M. Ventoruzzo , *The Biases of an "Unbiased" Optional Takeovers Regime: The Mandatory Bid Threshold as a Reverse Drawbridge*, ECGI Law Working Paper 304/2016 and K. Hopt, 'European Takeover Reform of 2012/2013 -Time to Re-examine the Mandatory Bid' *European Business Organization Law Review*, 15 (2014), 145-190.

[26] The price impact of private purchases upon subsequent public offers is discussed in Section V.

[27] See P. Davies, 'Control Shifts via Share Acquisition Contracts with Shareholders (Takeovers)' in J. Gordon and G. Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP, forthcoming 2016). On this approach what calls for explanation are regulatory systems which do not extend takeover regulation beyond general contractual offers. For a possible explanation of the absence of the MBR in Delaware see Davies, ibid.

[28] See n. 25.

[29] R. C. Clark, *Corporate Law* (Little, Brown and Company, 1986) 478-498; American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, 1994, §5.16. Since this liability does not often arise, there is some doubt about the state of knowledge of the seller which is necessary for liability (negligence or

rather than the buyer, in contrast to the MBR, which looks at the position of the acquirer. The 'market' rule confers less formal protection on the minority than the MBR. It also confers less protection than the standards which Delaware itself applies to consolidation offers, where, as we have seen, the court will review according to an 'entire fairness' standard if negotiating committee does not meet the appropriate standards of independence.[30] Since a sale of control, like an unregulated consolidation offer, permits the controller to capitalize its private benefits of control, this disparity requires an explanation.

Gilson and Gordon[31] have suggested that, in a jurisdiction, such as Delaware, which tightly controls (but does not eliminate) private benefits of control (pbc), disparate treatment of buy-out offers and sales of control is efficient. With pbc tightly controlled, a purchaser will buy the controller's shares by private contract only if the buyer's principal aim is to operate the target more efficiently. This will benefit the minority shareholders (even in the absence of an exit right), but also encourage sales of control to more efficient controllers (because the incumbent controller will be able to realise the full price for its permitted pbc). So, the interests of the controlling and non-controlling shareholders are aligned. By contrast, in a consolidation offer, the controller and the minority are on opposite sides of the transaction. The offeror has every incentive to exploit the offerees' weaknesses, so that protecting the minority from overreaching in a consolidation offer will increase investors' willingness to take minority positions in controlled companies, thus reducing the cost of capital for such companies. By implication, however, the MBR would be defensible as a mechanism for regulating sales of control in jurisdictions where either private benefits of control are not tightly regulated (so that sales of control to inefficient purchasers are likely) or where controlling shareholders are uncommon, so that sales by controllers do not need to be facilitated.[32]

In fact, it is precisely in jurisdictions with high pbc and concentrated ownership that the MBR is most controversial. This is because in such cases both the benefits and the costs of the MBR are high. The benefits are high because transfers of control to acquirers who will extract higher pbc than the existing controller are discouraged, essentially because the exit right at the heart of the MBR means that the acquirer may end up with no or only a small minority of outside shareholders to exploit. The costs are also high, at least if the MBR requires an exit right at the same price as that accepted by the controller. This is because an efficient acquirer[33] is likely not to be able to meet the controller's reservation price (which will reflect the existing pbc) and pay the same price to the non-controlling shareholders

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only intention/recklessness) and also about the nature of the remedy (damages for loss suffered; sharing of the premium paid for the shares). The ALI also makes it clear that pre-sale purchases from the minority by the controller when an offer for its shares is already contemplated by the controller will also trigger liability.

[30] Above Section I.

[31] Above n 9. The distinction between a pure sale of shares by the existing controller and use by the controller of its powers over the corporation to effect a sale (prima facie to be reviewed according to the fiduciary duty standards) is not always clear. Suppose the controlling shareholder induces the board to give the acquirer pre-bid access to the target's books in order to induce a higher offer. Is this still a transaction wholly between controlling shareholder and acquirer?

[32] But equally the benefits of the MBR are low in this case.

[33] That is, one who intends to profit from introducing operational improvements rather than by extracting a high level of pbc.

without overpaying for the company as a whole.[34] It is therefore not surprising that the MBR has proved controversial in concentrated shareholder jurisdictions and has not been adopted without amendment from the UK, where the rule has its origins but where the low level of concentrated shareholding makes the MBR relatively unimportant.[35]

There are five ways in which MBRs may be softened in concentrated shareholder jurisdiction, thus reducing both the costs and the benefits of the rule. One is to raise the threshold at which the MBR is triggered. The standard European trigger is 30 per cent/one third of the voting shares. Raising it above that level allows control shifts to happen in some cases without the rule being triggered. Indeed, it is arguable that the 30 per cent trigger already fails to capture some control shifts.[36] The second is to allow 'creeping acquisitions' ie permitting those who are legitimately[37] over the threshold to add to their holdings up to an annual limit. This removes the disincentive for existing controllers to invest further in the controlled company. Third, the mandatory obligation may formulated as one to bid for only a percentage of the outstanding shares. This facilitates some control shifts that would be blocked by the full rule, because the risk of overpayment by an efficient acquirer is reduced (but equally there is scope for the extraction of higher pbc because minority shareholders are not able to exit from the full amount of their shareholdings).

Fourth, the 'highest price' rule may be modified so that exit is made available at a lower price than was accepted by the controller. This is in many ways the most efficient solution. The exit right as a protection against future exploitation is preserved and, assuming the acquisition price is correctly pitched, the non-controlling shareholders receive the fair value of their existing (non-controlling) stakes. The existing controller is enabled to monetise the value of existing pbc,[38] so there is no disincentive to sales of controlling positions, but the preservation of the exit right makes an acquisition by a person who intends to extract higher pbc a risky undertaking. Perhaps because of the difficulty of calibrating the offer price, this

[34] Suppose the total firm value is 1000, of which the controller, who holds 50 out of 100 issued shares, extracts pbc of 500. So, the 'open' market price of each share is 500/100, ie 5, but the controller' reservation price for his shares will add 500/50 (ie 10) to that in order to reflect pbc, giving 15 in total. If the efficient acquirer has to pay 15 per share to all shareholders (acquisition price 1500), the acquirer will need to increase firm value by more than 50% to make the acquisition stack up. This is not impossible, especially if the old controller has run company with conspicuous inefficiency, but clearly many efficient deals are likely to be discouraged.

[35] Neither the benefits (discouragement of inefficient transfers of control) nor the costs (discouragement of efficient transfers) of the MBR are large in absence of concentrated shareholding which gives access to pbc. In a dispersed shareholder jurisdiction the function of the MBR is in fact to reduce pressure to tender, ie it discourages 'market raids' as a prelude to a general offer since the general offer will need to be at the highest price paid in the market, which is likely to react quickly and strongly to the raid. This makes it problematic for the acquirer to present the target shareholders with a *fait accompli* when it makes the general offer. This consequence of the MBR is arguably an unqualified good and may explain the early adoption of the MBR in the UK.

[36] L Enriques and M Gatti, 'Creeping Acquisitions in Europe: Enabling Companies to Be Better Safe than Sorry' *Journal of Corporate Law Studies*,15 (2015), 55 .

[37] The controller may be in this position because they attained it before the company became subject to the rule (for example, the company was floated with a controlling founder) or because the threshold was exceeded in one of the rather numerous permitted ways, for example, as part of a rescue of the company.

[38] The question of whether and how strongly a jurisdiction aims to control pbc is a separate matter. Whatever level that control is set at, the formulation in the text removes the discouragement of sales by controllers which the MBR generates – except in the limiting case where a jurisdiction effectively eliminates all pbcs, so that the issue of discouragement of sales does not arise.

last form of modification is uncommon, despite its intellectual attractions.[39] Finally, the MBR may be made optional for companies, so that shareholders decide whether to choose the benefits of or to avoid the costs of the MBR.[40]

Many of the jurisdictions discussed in this book have made use of the first three of relaxations or simply rejected the MBR altogether. Singapore, however, seems to be largely comfortable with the MBR. It has maintained the MBR since its initial adoption of the UK Code approach in 1974 and, indeed, introduced it with the more stringent threshold of 20 per cent. By the end of the century, however, the threshold had been increased to 30 per cent. It also introduced a limit on creeper acquisitions, initially 2 per cent, raised to 3 per cent, but then reduced at the beginning of this century to its present level of 1 per cent. Singapore, however, did not follow the UK decision of 1998 to prohibit creeper acquisitions entirely. Most significant, Singapore has always formulated the obligation as one to make an offer to all the outstanding shares at the highest price paid for the control. It is perhaps not surprising that Wan Wai Yee reports persistent, even increasing, concentration of shareholdings in Singapore.[41] The Singapore rules discourage sales of controlling positions but permit gradual strengthening of existing positions.

By contrast, Korea, having adopted the MBR in 1997, removed it in 1998, even though the Korean version of the MBR required a same-price offer for only enough shares to bring the controller up to 50 per cent of the shares. Nevertheless, the rule was heavily criticised because of its adverse impact on control shifts and was removed.[42] China has a more ambiguous approach to the MBR. Its formal rule follows the UK model, but in practice the regulator gives frequent exemptions from its operation. The MBR was applied in fewer than 4 per cent of bids between 2004 and 2012, so that it might be accurate to say that China, at least in this period, functionally rejected the MBR.[43]

India falls somewhere in between. It has, like Singapore, always maintained a MBR and indeed has chosen a lower threshold (currently 25%) than that operative in the UK, making the rule more rigorous. However, the Indian MBR contains two relaxations which are not present in the UK. The acquirer need make a general offer for (currently) only a further 26 per cent of the shares, once the MBR is triggered, and Indian regulation permits surprising large annual acquisitions of (currently) 5 per cent by those over the threshold without

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[39] A number of European jurisdictions allowed discounts from the highest price paid to the controller, though in the case of jurisdictions within the EU that approach is now forbidden by the Takeover Directive. See P. L. Davies 'The Notion of Equality in European Takeover Regulation' in J. Payne (ed.) *Takeovers in English and German Law* (Oxford: Hart Publishing, 2002) at p. 28.

[40] This is an uncommon choice, though Switzerland permits it (but, in the case of publicly traded companies, only if the choice is made before listing). See Davies, ibid.

[41] *Legal Transplantation of UK-Style Takeover Regulation in Singapore*, paper presented at the Conference on Comparative Takeover Regulation, organised by the Faculty of Law, National University of Singapore and the School of Law, Singapore Management University, July 2015.

[42] Hyeok-Joon Rho, *M & As in Korea: Continuing Concern for Minority Shareholders*, paper presented at the Conference on Comparative Takeover Regulation, organised by the Faculty of Law, National University of Singapore and the School of Law, Singapore Management University, July 2015.

[43] Wei Cai, 'An Efficiency Approach to the Mandatory Bid Rule', (2013) 4 *Peking University Law Journal* 847, 854. See also Robin Hui Huang and Juan Chen, *Takeover Regulation in China: Striking a Balance between Takeover Contestability and Shareholder Protection*, 3.2.2, paper presented at the Conference on Comparative Takeover Regulation, organised by the Faculty of Law, National University of Singapore and the School of Law, Singapore Management University, July 2015.

triggering the MBR. Varottil[44] explains this constellation of rules as best protecting the position of incumbent controllers as against foreign acquirers.

Overall, in relation to sales of control, both the MBR and the US seller-focussed approach can be said to be concerned with hindering a transfer of value from non-controlling to controlling shareholders. However, the US approach takes a narrower view of when such transfer is likely to occur (ie only where the seller knows of or suspects future looting and so has the opportunity to obtain a premium price from the acquirer which reflects the expected gains from the looting), whereas the MBR is premised on the view that opportunistic conduct by the new controller is likely to be routine. Equally, the US approach sees no risk to non-controlling shareholders from the creation of a de facto controlling position by piecemeal acquisitions (as contrasted with the acquisition of an existing controlling position). In both cases, it seems likely that the US approach is premised on confidence that its general corporate law (notably fiduciary duties) is effective to control abuse of minority shareholders on an on-going basis, whilst the MBR reflects a lack of that confidence. On this analysis, the mandatory contractual offer makes up for a deficiency in the protection afforded by general corporate law to non-controlling shareholders. It has the advantage that it operates as an ex ante rule (as contrasted with the ex post standards of fiduciary duties) and does not require the back up of an intellectually sophisticated and procedurally rapid judiciary to make it work. The disadvantage is that of many easily applied rules: it may be over-inclusive in relation to the mischief it is aiming to control, in this case by hitting control shifts which will benefit non-controlling shareholders as well as those which harm them.

From the point of view of controlling shareholders, the MBR appears to be disadvantageous. Controllers who wish to sell their controlling position will likely be able to generate a smaller pool of potential buyers than in the absence of an MBR, unless the controller is prepared to accept a price which does not fully reflect its pbc. From a political economy perspective, one might expect controlling shareholders, who are likely to be politically influential in concentrated shareholding jurisdictions, to lobby against the MBR, either to exclude or soften it. As indicated, there is evidence of such softening in many jurisdictions which started with the UK model, though Singapore (and, indeed, Hong Kong) continue to apply rules which echo the full stringency of the UK model. Possible explanations are (a) that the controlling shareholders in these two jurisdictions are still predominantly in a 'build up' phase and (b) that such flexibility in altering the boundaries of the firm as is required can be achieved by selling assets or wholly-owned subsidiaries to acquirers.

III. Statutory mechanisms for the acquisition of shares

In the previous two sections I have argued that the regulation of contractual acquisitions of shares with a view to obtaining or consolidating control is a better description of the range of transactions that takeover law covers than just general contractual offers to acquire control. On this basis, there are included (i) general offers to consolidate control are included as well as general offers to acquire it and (ii) private and exchange acquisitions of shares. The latter are regulated to the extent that the terms of the non-general acquisitions may be required to be reflected in any subsequent general offers which the acquirer chooses to make and,

[44] See Varottil, above n 23 at 20.

controversially, the private acquisitions may trigger an obligation to make a subsequent general offer. It has been argued that these two extensions are, or may be, functional. In the case of consolidating offers this is because the information asymmetry and coordination issues for the offeree shareholders, and the squeeze-out issues for the acquirer, are very similar to those which arise in an offer to obtain control and so the same solutions are appropriate. In the case of acquisitions of controlling positions by means of private or exchange contracts the extension can be a functional way to address a deficiency in general corporate law in relation to minority protection which may exist in some jurisdictions – though the optimal form of the regulation requires careful consideration. In particular, a mandatory sell-out right at the highest price paid to the controlling shareholder seems to give the non-controlling shareholders compensation for something they did not possess.

Even with these extensions, however, takeover law deals only with contractual offers. Yet, the contractual offer is only one technique for altering the boundaries of the firm by amalgamating the businesses of two previously independent companies. As is discussed in a little more detail below, all jurisdictions provide statutory mechanisms for amalgamating companies, the results of which normally replicate what can be achieved through contract. This gives rise to an initial puzzle: why is not contractual regulation extended to statutory amalgamations? Alternatively, why are the contractual mechanisms not brought within the statutory rules? It will be argued below in section IV that there are good reasons for the separate regulation of these two amalgamation mechanisms. Although functionally similar in result, the difference in the legal form of the two techniques, notably the presence or absence of a corporate decision, makes different rules for the different techniques functional. This does not mean, however, that the underlying goals of the two sets of rules are necessarily different.

If this argument is correct, one would expect contractual regulation to ignore control shifts effected through the statutory mechanism (and vice versa). Often this is the case, but some sets of contractual regulation, notably those based on the UK model, in fact treat statutory amalgamations as a subsidiary area of regulation. I seek to explain why this should be in section V. Section VI extends the argument to some hybrid mechanisms for shifting control of the company.

As said, contract is not the only mechanism the law provides for amalgamating two or more companies. Many jurisdictions have statutory procedures whereby two or more companies can be merged into a single company, either one of the existing companies or one formed specifically for the purposes of the merger. Naturally, there will be a commercial agreement between the merging companies underlying the use of the statutory merger process, but in a statutory merger the shares transfer at the end of the day by statutory fiat, not because of any contract between the existing shareholders and the acquirer. In most jurisdictions the statutory procedure is of longer standing than the general public offer, both in terms of its recognition in the law and in terms of the use of the two mechanisms in practice.

In its full form, the statutory procedure typically involves a supermajority vote[45] in favour by each class of shareholder in each of the merging companies whose rights are affected by the

[45] In the US it is common to use a simple majority requirement but a simple majority of all the outstanding shares (so that not voting counts as a vote against). See DGCL §251(c). Whether this is more or less demanding than supermajority approval of those present and voting is difficult to say. It depends in part on whether the

merger plan, upon a proposal advanced by the directors of the companies. The court will also be involved, either because court approval is a requirement of the statutory procedure or because the law provides for dissentient shareholders to appeal to a court, for example on the basis that the directors have acted in breach of their general fiduciary duties at some point in the process or to review the adequacy of the exchange ratio. Provided the merger procedure in question allows cash to be used without constraint as merger consideration,[46] a statutory merger can be used to replicate the economic result of a contractual offer, coupled with a post-bid squeeze-out of the non-accepting shareholders.[47] The shareholders of the 'target' merging company may exit from company by taking cash or they may remain in the merged entity by accepting shares in the resulting company, or there may be some combination of cash and shares on offer to those shareholders. The shareholders of 'acquirer' merging company (the bidder) may be offered nothing other than the retention of their existing shares or, where a new company is formed, a proportionate number shares in the resulting company. In this way, a flexible statutory merger procedure can be used to replicate the result of a takeover bid, whether that bid is formulated as a cash or shares bid or as a combination of the two, except that the bidder and target do not maintain their separate legal existence but are merged into a single entity.[48]

In fact, maintaining the separate legal entities of acquirer and target is often thought to be advantageous, since it shields the assets of the acquirer from unsuspected risks attached to the assets of the target. But even this result can be achieved through a merger, so that the formal legal as well as the economic result of a takeover-plus-squeeze out is mimicked through a merger. The relevant technique is the 'triangular merger':[49] the acquirer forms a new subsidiary ('Newco') and either merges the target into the new subsidiary or the new subsidiary into the target. In either case, the acquirer ends up with the target as its wholly-owned subsidiary.

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supermajority approval requirement is set at 66.66% or 75% and on the apathy or otherwise of the shareholders. We have also noted that Delaware provides for 'short-form' mergers in certain cases, where the consent of the shareholders of the controlled company involved in the merger is not required (see Section I).

[46] In most early merger provisions cash was not permitted as consideration, so that the procedure could be used to achieve the equivalent of a share-exchange contractual offer but not a cash offer. Many jurisdictions have abandoned this constraint entirely, but the EU merger directives still have a limit on cash of 10% of the total consideration as a default rule, which member states can alter. See, for example, Directive 2011/35/EU ([2011] OJ L 110/1) of the European Parliament and of the Council concerning mergers of public limited liability companies, Art.30. This indicates that some member states still attach importance to limiting cash as consideration in mergers.

[47] The post-bid squeeze out is now a common feature of takeover rules (see n. 2 above) in order to remove the incentive for offerees not to accept offers from efficient offerors at anything less than the a price which reflects the full value of the expected synergies – a reaction on the part of the offerees which is likely to reduce the acquirer's incentive to bid in the first place. The post-bid squeeze out cannot normally be provided by contract (though 'tag along' rights in articles of association may do the same job: *Arbuthnott v Bonnyman* [2015] EWCA Civ 536) but has to be provided by takeover law. This is an example of takeover law, which is designed to promote efficient bids, operating in favour of the acquirer.

[48] In the case of a contractual acquisition a subsequent merger of the parent and its new subsidiary is needed to eliminate the separate legal entities of acquirer and target.

[49] W.T. Allen, R. Kraakman and G. Subramanian, *Commentaries and Cases on the Law of Business Organizations*, 4th ed. (New York: Wolters Kluwer, Aspen Casebook Series, 2012) 471.

In the UK and some jurisdictions which follow the UK corporate statute, there is no specific statutory merger procedure,[50] but the same issues about the scope of takeover regulation arise because the statutory scheme of arrangement can be used to bring about either a merger or, more likely in the UK, the transfer of the shares of the target to the acquirer without the merger of the legal entities.[51] The scheme of arrangement is a very general procedure which can be used to process any 'compromise or arrangement'[52] proposed between a company and its members or creditors.[53] That arrangement might be a proposal for a merger, either bilateral or triangular, though in UK practice is rarely used in that way.[54] Or it might be a proposal for the simple transfer of the securities issued by the target to the acquirer in exchange for cash or acquirer securities to be distributed to the target shareholders. This produces an exact equivalent of a takeover bid because, under a takeover scheme, the shares of the target are transferred to the bidder but the target company retains its separate legal existence. However, the transfer of the target shares takes effect as a result of the court order approving the scheme, not by way of contract.[55]

From the point of view of this chapter, the important points are that (a) both merger and scheme procedures can be used to produce the same economic result as a takeover (acquirer control of the target either with or without cash-out of target shareholders); (b) the merger procedure can be adapted to maintain the separate legal entity of the target, if this is desired, so that the formal corporate structure post-merger is the same as the formal structure post-takeover. Given the functional equivalence of the merger and scheme procedures (hereafter the 'statutory' procedures), on the one hand, and the contractual takeover, on the other, we are clearly faced with the question of why they are not subject to the same regulation. It is argued below that, because the formal legal structure of the statutory and contractual transactions is different, the appropriate regulatory responses are also different. It is

[50] Except now in the UK for cross-border but intra EU mergers. See Directive 2005/56/EC on cross-border mergers of limited liability companies ([2005] OJ L310/1), transposed in the UK by the Companies (Cross-Border Mergers) Regulations 2007/2974.

[51] Singapore offers both the scheme procedure (s.210 of the Companies Act) and a merger procedure (ss.215A-J), though it appears the latter has so far been little used for amalgamations.

[52] In the wording of the UK Companies Act 2006, s 895.

[53] Creditor schemes are ignored in this paper, but they are a very important mechanism for handling failing companies without necessarily putting them into liquidation. In the UK the scheme was initially available (in the nineteenth century) only for compromises with creditors.

[54] See the discussion in P.L. Davies and S. Worthington, *Gower's Principles of Modern Company Law* (London: Sweet & Maxwell, 9th ed, 2012) at 29-10 to 29-12. But s 900 gives powers to the court, upon approval of the proposal, to transfer the assets and liabilities of the target to the acquirer and to dissolve the target without winding it up, so that it is clear that the merger falls within the notion of a 'compromise or arrangement'.

[55] It may seem odd that a scheme which shifts the shares issued by the target and now held by its shareholders to the acquirer in exchange for a consideration to be provided to the target's shareholders is regarded as 'an arrangement' between the *target company* and its shareholders, since it looks more like an arrangement between the *acquirer* and the target shareholders. However, the use of the scheme to effect a takeover in this way (a 'transfer' scheme) has long been sanctioned in the UK (*Guardian Assurance Co Ltd, Re* [1917] 1 Ch.431) and other scheme jurisdictions have followed suit. A more complex form of the takeover scheme involves cancellation by the target company of the issued shares of the target and use by the target company of the reserve so created to pay up new shares, which are issued to the acquirer. The involvement of the target company in a 'cancellation' scheme is thus more significant. However, the use of the cancellation scheme to produce the equivalent of cash offer takeover has been severely restricted under recent reforms in the UK in order to close a tax loophole which the cancellation scheme facilitated. See Companies Act 2006, s.641(2A) – (2C). Singapore solved the same problem by making the tax applicable to cancellation schemes: Wan Wai Yee and U. Varottil, *Mergers and Acquisitions in Singapore* (Singapore: Lexis Nexis, 2013) p. 557.

suggested that this can be seen by examining the arbitrage opportunities which an *unregulated* contractual offer affords to an acquirer as compared with the statutory procedure. This thought-experiment reveals the issues, common to contractual and statutory mechanisms, which must be addressed, but also reveals that the tools for addressing them in the statutory procedures are not available in the contractual context. Contractual regulation must fashion its own tools. By and large this examination shows that the core regulatory issues are addressed through procedural rules in the statutory procedures and by substantive rules in contractual regulation. Finally, it is suggested that this is an appropriate arrangement.

IV. The unregulated contractual offer as arbitrage opportunity

The unregulated contractual offer provides the acquirer with two possibilities of arbitrage around the constraints of the statutory procedure. One set of constraints exists in the context of relations between the acquirer and target shareholders; the other in the context of relations between the acquirer and target management or the target board (we use the terms interchangeably). Arbitrage is not necessarily good nor bad. It depends on whether the rule arbitraged around is thought to fulfil a useful function and whether that function is delivered in some equivalent way in the alternative structure.

IV.1 *Arbitrage in the context of acquirer/target shareholder relations*

Nothing in the law of contract normally requires an offeror to proffer the same terms to all the shareholders of the same class in the target company. Nor does contract law require that all the shareholders in the class receive an offer of any description. Equally, the length of time the offer is to be open for acceptance is within the unilateral control of the bidder. By exploiting this contractual freedom bidders can generate what Bebchuk[56] famously called 'pressure to tender', especially in dispersed shareholding jurisdictions. The pressure is to accept what the offeree shareholder regards as a sub-optimal offer for fear that non-acceptance would leave the offeree, not with the status quo, but in a worse position than before the offer was made.

There is no need in this paper to go through the various forms of pressure to tender that unconstrained contractual freedom might generate. One example will suffice, namely, the early and crude example of the 'Saturday night special'. The bidder makes an offer at a modest premium to the market price which will be open only for a short time and which is restricted to a certain proportion of the outstanding shares (ie it is a 'partial' bid). The general reaction of the shareholders in the target is that the acquirer is offering significantly less than control of the company is worth in the hands of a single shareholder. One might expect that the shareholders would therefore not accept the offer. However, target shareholders also take the view that the market price of the shares will fall below the current market price if the bid is successful, perhaps because of loss of liquidity in the market, perhaps because they perceive that the bidder is likely to loot the company or engage in difficult-to-observe forms of self-dealing or simply be less respectful of the minority's interests than the current management. In the absence of coordination capacity in the dispersed target shareholders, they are likely to accept the offer rather than reject it.

[56] L.Bebchuk, 'The Pressure to Tender: An Analysis and a Proposed Remedy' *Delaware Journal of Corporate Law*, 12 (1987) 911-949.

Let us assume the current market price of the shares is 10, the bidder offers 12, the fair value of control is 14 and the anticipated post-bid price of the shares is 8. There are three possible outcomes of the bid from the point of view of each target shareholder. The offer may fail (ie not reach the acceptance level the bidder has stipulated for); the offer may succeed and the individual shareholder is part of the accepting majority; the offer may succeed and the bidder is part of the non-accepting minority. Let us further suppose that most target shareholders rank the outcomes in the following order of preference: failure 1: success and in majority 2: success and in minority 3. However, each shareholder has only one 'yes/no' vote, ie whether to accept the offer. How, from an ex ante perspective and in the absence of the possibility of coordination, is an individual shareholder likely to vote?

If the majority are going to reject the offer, then it does not matter how the individual votes. The individual needs to consider, therefore, only the hypothesis that the majority accept the offer. Should the individual accept or reject the offer in this situation? If the individual accepts s/he receives 12; if s/he rejects the value of the share falls to 8. From an individual perspective, the incentive to accept is strong, for s/he will be better off by 4 compared to the alternative outcome. To avoid the worst outcome, the individual shareholder accepts a sub-optimal offer. But if all individual shareholders reason in this way from an ex ante perspective, the success of the offer is ensured, even though all the accepting shareholders think the offer is sub-optimal. In this case the inequality consists in making an offer for some only of the outstanding shares. In other cases inequality, and the resulting pressure to tender, results from inequality in the terms offered, even though all shareholders receive some offer. For example, those who accept early may be offered more than those who accept late.

It is predictable that, if contractual freedom to structure the offer as best suits the bidder is available, it will be used. Thus, the history of UK takeovers in the period before the adoption of the first Takeover Code at the end of the 1960s shows this contractual freedom being used to the full.[57] By contrast, it is very difficult to get an unequal offer through a statutory procedure. First, the decision in the statutory procedure is a collective one and so binds all the shareholders: either the proposal succeeds or it fails for all shareholders. Therefore, the individual shareholder has only one choice to make and so the single vote on the proposal enables the shareholder to rank his or her preference between success and failure without difficulty. There is no risk of the proposal succeeding and those voting against it being excluded from it for that reason.

Second, the standard corporate law rules applicable to shareholders' collective decisions eliminate some forms of unequal offers generating pressure to tender. An offer, put forward with inadequate information and available on better terms to those who accept first, is simply inconsistent with the corporate law rules on the information to be given prior to shareholder decisions and the fact that there is only a single corporate decision, not a large number of individual decisions. Third, whilst, theoretically, a proposal could be put forward under the statutory procedure which treats some shareholders of the same class better than others, it would not be likely to survive a shareholder vote. For example, shareholders would be unlikely to approve a proposal under which only some of the shareholders were able to sell out in full at a high price but others were denied an offer. If approval were nevertheless to be given on the basis of a supermajority voting requirement, the very fact of approval would

[57] A. Johnston, *The city take-over code* (Oxford University Press, 1980).

lessen regulatory concerns, especially if the excluded shareholders constituted a separate class for approval purposes.[58]

Thus, inequality is likely to be an issue within statutory procedures only where the inequality is confined to those shareholders who might be outvoted even under a supermajority rule. The minority are most at risk where the statutory procedure is being used by an existing controlling shareholder to squeeze out a minority. Here the statutory procedure is being used to consolidate, rather than acquire, control. However, the minority's exposure in the statutory procedure is obvious and most jurisdictions have taken steps to combat it. There are various ways in which minority protection can be strengthened in an unequal proposal. In the UK the statute[59] requires not only supermajority approval of the shareholders present and voting but approval also by a simple majority in number of those voting, thus qualifying the normal corporate rule that votes are attached to shares, not shareholders. This comes close to requiring 'majority of the minority' approval, at least where there is a single controlling shareholder and otherwise dispersed shareholdings. In addition, court approval of the scheme is required and the court normally discounts the shares in the target already held by the bidder[60] so that the supermajority must be a majority of the outside shareholders. Hong Kong has recently replaced the 'majority in number' provision by a requirement that "the votes cast against the arrangement at the meeting do not exceed 10% of the total voting rights attached to all disinterested shares in the company" where the scheme is being used to effect a squeeze-out by way of a takeover – thus incidentally explicitly recognising in the legislation the takeover use of the scheme.[61] The definition of 'disinterested'[62] is widely cast so as to exclude not only the bidder, but also nominees, associates, concert parties etc. This approach restores the approach of voting shares rather than shareholders and gives greater weight to the larger shareholders within the non-controlling minority.

In Delaware appraisal rights have traditionally been used to protect minorities in squeeze-out mergers, though they are procedurally somewhat difficult for shareholders to avail themselves of. More important in practice are fiduciary standards. After extensive debate Delaware has arrived at the position that it will scrutinise a controller-initiated merger according to the rigorous 'entire fairness' standard, unless the controller has both facilitated the appointment of a fully independent board committee to negotiate with the controller and obtained a 'majority of the minority' vote in favour of the squeeze out, in which case court review does not disappear entirely to takes place under a much less rigorous 'business judgment' standard.[63] This produces a high degree of regulatory symmetry in regulation

[58] Although such a case appears not to have arisen in practice, it seems clear that those shareholders who are to receive an offer under the scheme and those who are not would constitute separate classes for approval purposes, even though the shareholders are of the same class and so held identical rights against the company. Even if separate classes were not required, it is unlikely the court would approve a scheme where the non-recipients had voted against it. See the discussion in J. Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press, 2014) 3.5.2.1 and 3.5.2.6.

[59] s 899 of the Companies Act 2006.

[60] *Re BTR plc* [1999] 2 BCLC 675, affirmed on appeal [2000]1 BCLC 740.

[61] Companies Ordinance 2012, s.674(2)(b). See Donald below ch ???

[62] s.674(3).

[63] *Kahn v. M&F Worldwide Corporation* 88 A.3d 635 (Del. 2014). This was a retreat from the previous position which was generally understood to be that, where these conditions were met, the entire fairness standard continued to apply, but with the burden of proof reversed. See *Kahn v Lynch*, above n 17. Even in its amended form the decision imposes a significant barrier to controlling shareholder opportunism.

between a consolidation offer accompanied by a squeeze-out at the 90 per cent level (discussed in Section I) and a squeeze-out merger without a prior general offer. In effect, whether the consolidation is to be implemented by a (two-step) offer plus squeeze out merger or by a (single) squeeze-out merger, the decision turns on a majority decision of the non-controlling shareholders after negotiations by an independent board committee on their behalf. Despite the use of the merger as the sole technique for transferring control in the second case, the 'majority of the minority' requirement effectively turns the squeeze-out merger into a consolidation offer.[64]

In scheme procedures court approval is mandatory. As we have noted, UK courts will discount the votes of the controller, thus replicating the 'majority of the minority' requirement. However, they will normally review the fairness of the merger on a less-demanding rationality standard (rather than the more demanding reasonableness one), even in the absence of committee which has negotiated with the controller.[65] Nevertheless, the test for approval is open-ended – in fact the UK Act fails to specify even a standard for judging the scheme – and so courts could take a bolder line.[66] However, if Delaware maintains its turn towards the business judgment test, there will not be a great difference between merger review by the Delaware courts and the dominant approach to scheme review in systems which follow the English system. The distinct difference will continue to be in the procedural requirements which need to be met before the review stage is reached, notably the Delaware requirement for an independent negotiating committee to act interests of the non-controlling shareholders.

IV.1.1 The response of the makers of takeover rules

Whatever the doubts one might have about the adequacy of minority protection when the statutory procedure is initiated by a controlling shareholder, it is reasonable to conclude that in all other cases the statutory procedures contains effective safeguards against pressure to tender where the acquirer makes unequal proposals and against simply inadequate offers. These safeguards are structured around the requirement for a corporate decision, which lies at the heart of the statutory procedures. A corporate decision, however, is exactly what is missing in contractual offers. This generates substantial incentives for acquirers to arbitrage around the constraints of the statutory procedures by shifting into contractual offers. Consequently, it is not surprising that those responsible for the design of takeover regulation have adopted rules designed to approximate the level of protection available within the statutory procedures. One major technique, disclosure of information, is a direct copy-over from (but also an extension of) that used in relation to corporate decisions. The other major technique, equality rules, has no formal counterpart in relation to corporate decisions, but is

[64] Before the decision in *Kahn* (previous note), the standard of review in a going private merger, even with the two safeguards in place, had been entire fairness (albeit with the burden of proof reversed). Given the functional similarity of the consolidation offer and the consolidation merger where the two safeguards are present, the alignment of the review standards has generally been welcomed. See, for example, D. Wilson, 'Desirable Resistance: Kahn v M&F Worldwide and the Fight for the Business Judgment Rule in Going-Private Mergers', *U. of Pennsylvania Journal of Business Law*, 17 (2015) 643-671.

[65] P. L. Davies and S. Worthington, above n. 54, at 29-9.

[66] There are dicta in *Re PCCW Ltd* [2009] HKEC 738 indicating a willingness on the part of the Hong Kong Court of Appeal to address issues of substantive valuation.

designed to deal with pressures to tender to which the corporate decision is not exposed. Equality rules in takeover codes are now notably extensive.[67]

Even within the limited federal regulation of takeovers in the US disclosure and equality are the central concerns of the Williams Act 1968, amending the Securities Exchange Act 1934. In particular, the 1934 Act and rules made under it now require disclosure by offerors and target companies to an extent familiar under takeover codes and impose a minimum acceptance period (20 days). The Act also contains an equality rule which, while falling short of a mandatory bid rule, requires equality of treatment both within the bid and with those who sell out to the acquirer during the bid period.[68] The US federal rules replicate reasonably closely what is to be found in takeover codes, except that the latter are more explicit about the impact of pre-bid purchases on the price which has to be put forward in the offer. Takeover codes thus take the equality principle somewhat further than the Williams Act does.[69]

The clear conclusion is that the designers of takeover regulation do not regard this first form of arbitrage around the statutory procedures as socially useful. It is not difficult to see why this is. Although there is room for debate about the proposition that the decision on contractual offers should be left *solely* in the hands of the shareholders of the target company, as discussed in the next sub-section, it is inherent in the contractual offer that the consent of the holders of a majority of the voting shares of the target is necessary for the deal. They are, after all, the offerees. If enough of them do not agree to it, the deal will not occur, even if in some systems the agreement of the management of the target is also required. There seems to be no good reason why bidders should be put in a position where they can distort the shareholders' acceptance decision.[70] In jurisdictions which apply a 'no frustration' rule to the target board (see the following section) rules protecting offeree shareholders against coercive bids are central to the coherence of the takeover regulation. In jurisdictions where the board has scope to block unwelcome bids, equality rules are less important, since the board may block coercive offers. Even so, protective rules are not without function, since in some cases the target management may support the coercive offer (for example, where they are part of the bidding team) or just not do a good job in protecting the shareholders.

Further, allowing bidders to acquire control at less than full value involves a wealth transfer from the existing shareholders to the bidder, which is a distributional gain for the bidder but

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[67] Davies, above n 39. In fact, the 'Saturday night special' problem can be solved without resort to an equality provision through a simple device which is found in the UK Code but seems not to popular internationally. This is to allow the non-accepting shareholders to change their minds during a limited period after the offer has formally closed and when it is clear whether the majority has accepted the offer. This second decision point enables the offeree shareholder to rank the three outcomes fully. During the offer period the shareholder decides not to accept (thus giving preference to outcome 1). When it becomes clear that outcome 1 is no longer on the table, the shareholder can use the second decision to rank outcomes 2 and 3. As explained above, in a corporate decision only two outcomes are available and so one vote is enough.

[68] Securities Act 1934 (15 U.S.C. §§78a et seq.) §§14d, 14e and Rules made thereunder.

[69] For an analysis of the equality provisions in the UK Takeover Code see Davies and Worthington, above n.54, 28-37 to 28-41. The 1934 Act, by confining equality to 'the bid period', in principle leaves pre-bid acquisitions out of account, but they may be brought in if an integral part of the offer made to some shareholders.

[70] Contrast the rationale for the removal of the shareholders' incentive to hold out against a fair value offer by facilitating the squeezing out of non-accepting minorities if the overwhelming majority have accepted a non-distorting offer (n 47 above). Without the squeeze-out target shareholders might be unwilling to accept offers unless all the anticipated synergies were offered to them, which in turn would reduce the incentives for potential acquirers to make offers.

advances no general social goal. On the contrary, the existence of such bidders provides competition for offerors whose objective is to make a return on their investment, not by purchasing control cheaply, but by operating the acquired company more efficiently in the future. Distorting offers may thus reduce the success rate of socially useful, efficient offerors. Thus, there is no general social reason to permit distorting offers and a social reason to discourage them.

IV.2 *Arbitrage in the context of target management/target shareholder relations*

The second form of arbitrage around the statutory procedures which the unregulated contractual mechanism offers is avoidance of target management opposition to the amalgamation. Either in law or in fact a statutory procedure cannot get off the ground without the consent of the target company's management. In some statutory procedures only the directors of the target are empowered to put forward a proposal for the shareholders to vote on, so that the directors have a formal veto over proposed amalgamations. Even where shareholders in the target (for example, a bidder already holding some target shares) are formally permitted to make a proposal to the general meeting, it is difficult for them to do so without the cooperation of the target board, who, if prepared to cooperate, will put forward the proposal themselves.[71] Overall, therefore, the statutory procedures are not an effective way of bringing about a 'hostile' amalgamation, ie one to which the target board is fundamentally opposed (in contrast to the situation where initial rejection of the proposal is a tactic to secure a higher price).

In the absence of regulation, the contractual offer appears to present a way of circumventing target management opposition, for the benefit of both bidder and target shareholders. The offer is made directly to the shareholders and, at least in publicly traded companies, the target shareholders do not normally[72] need the permission of the directors to sell their shares to a bidder. However, there are two respects in which this second arbitrage opportunity is different from the one considered in the previous section. First, it is less clear that, in the absence of regulation, this opportunity is freely available to bidders and target shareholders. Second, and more important, it is hotly contested whether this second form of arbitrage is socially useful, and takeover regulations across jurisdictions differ on the stance which they take on this matter.

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[71] Under the UK rules a shareholder (who may be the proposed acquirer) may put forward a scheme, but this seems never to have been done successfully. In 2009 HgCapital threatened to make a hostile scheme proposal under the UK rules by convening a shareholders' meeting to adopt the proposed scheme (a meeting may be convened by the holders of 5% of the voting rights). But it appears this was a way of demonstrating the level of shareholder support for the takeover, whilst the independent directors' opposition was based on a desire to extract a higher price for the shares of the target. In this situation it is not surprising that the takeover eventually went ahead under the contractual mechanism but on a revised basis. In Singapore it is not even clear that the court would summon class meetings on the basis of a shareholder resolution to implement a scheme: see Wan and Varottil, above n. 55 at p. 621. Of course, a controlling shareholder may find it quite easy to propose a scheme as shareholder. Interestingly, the Hong Kong Code (rule 2.3) throws the company's costs of the scheme proposal onto the controlling shareholder if the proposal is not recommended by the independent committee of the board (above n 20) or judged fair by the independent financial adviser. This rule applies apparently whether the proposal is made by the company's board (as a whole) or the controlling shareholder alone.

[72] There may be isolated cases, for example after an initial public offering, where a large shareholder has contracted with the company not to dispose of its shares for a certain period of time.

On the first point, the takeover bid is formally a transaction between the bidder and target shareholders alone, but target management may be in a position to use their general managerial powers over the assets or securities of the company to derail a bid. For example, they may dispose, conditionally upon the success of a bid, of a corporate asset the bidder is keen to acquire or they may issue new shares to a friendly investor who will not accept the offer. Whether in the absence of regulation specific to contractual offers target directors are in a position legally to take these defensive measures turns on two features of the general corporate law in the relevant jurisdiction. First, does the measure require prior shareholder approval and, if so, can that permission be given in advance of the bid or only post-bid? Second, how rigorously does the applicable law on directors' duties scrutinise managerial decisions which make contractual offers more difficult to carry through? If shareholder approval requirements are extensive and well-timed and/or court scrutiny of directors' decision-making is rigorous, then the second arbitrage opportunity is freely available to bidders when they shift from the statutory to the contractual procedure. In this situation the directors, having lost their veto provided by the statutory procedure, have nothing to put in its place. If, on the other hand, standard company law gives the directors a relatively free hand to take measures with defensive consequences, then a substitute (or a near substitute) for the veto under the statutory procedure is available to them. In this case the second arbitrage opportunity will be fully available to the bidder only if takeover regulation imposes a 'no frustration' rule on target management, constraining the use of their general management powers for the duration of the takeover.

It is sometimes not appreciated how important the background company law rules are for the shareholders' rights plan ('poison pill')[73] which has proved such a potent defensive measure in the hands of the boards of US companies. The plan can be adopted by the board without shareholder approval and the Delaware courts have held that the adoption of a plan is not a breach of the directors' fiduciary duties.[74] By contrast, European jurisdictions generally require shareholder approval for share issues (including the issuance of warrants convertible into shares), though such approval can normally be given for periods of five years at a time (ie in advance of an offer actually occurring and the rights being issued).[75] A shareholder vote in Europe also operates to remove residual doubts about whether a proposal, whose sole objective is to frustrate a bidder of which the directors do not approve, is in accordance with their fiduciary duties. Consequently, the rights plan can be adopted quickly in the US[76] and

[73] The 'poison pill' is a warrant, which trades with the stock and gives in normal times a right to acquire additional shares in the company at such an extravagant price that no shareholder will exercise the option. However, on the acquisition by someone of, say, 10 per cent of the stock of the company (or the launching of an offer to acquire control), the warrant 'flips into' a right to acquire extra shares at a very attractive price which is available to everyone except the new large shareholder (or bidder). The dilutive effect of the warrants on the acquirer is such that no one appears to have proceeded with an acquisition in the face of one. On the other hand, if the acquire negotiates a deal acceptable to the target board, the board has the power to redeem the warrants (rights) for a nominal payment. See W.T. Allen, R. Kraakman and G. Subramanian, above n. 49, pp. 523-4

[74] *Moran v. Household International Inc*, 500 A. 2d 1346 (1985). The main focus for court scrutiny in Delaware thus becomes the directors' refusal to redeem the pill in the face of a bid.

[75] Directive 2012/30/EU ([2012] OJ L 315/74), art. 29, though this provision of the Directive reflects in fact the prior law in most Member States. Shareholder approval for share issues is by no means a European peculiarity; in fact, it is probably the case that Delaware is the outlier on this point.

[76] As Klausner points out, this means that every Delaware target has a rights plan instantly available to it, and so the question of whether it has formally adopted one before a bid emerges or is threatened is a secondary

shareholders who oppose them need to take positive action to have them removed. By contrast, where shareholder approval is needed, the adoption process is slower and shareholders who oppose the plan are in a somewhat better position to do so.[77] Nevertheless, it would be wrong to conclude from the fact that rights plans are more difficult (but not impossible)[78] to adopt outside the US because of the background corporate law, that European laws makes defensive measures in general impossible. Other pre- or post-bid defensive manoeuvres with corporate assets or securities are feasible in the absence of takeover rules excluding them.[79]

In any event, whatever the stance of general company law in a particular jurisdiction on the issue of defensive measures, it affects only the default situation which faces the designer of the takeover rules. If general corporate law is disposed in favour of defensive measures, the takeover rule-maker has to decide whether to introduce a 'no frustration' rule, in order to facilitate the second type of arbitrage, or not to do so in order to allow the directors to take advantage of their freedom of action. If general corporate law is unfavourable to defensive measures, the takeover rule-maker has to decide whether to endorse that situation or, alternatively, to give directors an effective defence in the special context of takeovers.[80] Where the law is unclear, the takeover rule-maker has to decide in which direction to clarify it. In any case, the question is one which the takeover rule-maker cannot avoid.

As to the second point, the social value of a 'no frustration' rule as against relatively extended freedom for target management to take defensive measures is heavily contested. If defensive measures are thought likely to reflect unobservable managerial self-interest, then a 'no frustration' rule is appropriate. On the other hand, if is thought that management has greater capacity (because of unverifiable inside information) to identify where the shareholders' interests lie than the shareholders themselves and the incentive to advance them or if it is thought that management's incentives are better aligned with those of other groups, especially employees, but conceivably also the state or the local community, whom the rule-maker wishes to protect, then a 'no frustration' will be inappropriate.[81] What is quite clear is

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matter (M Klausner, 'Fact and Fiction in Corporate Law and Governance', *Stanford Law Review*, 65 (2013), at 1362-68.

[77] They are provided with an opportunity to make their opposition clear before the plan is adopted, but, of course, they may be outvoted at the meeting.

[78] They are important in France in the form of 'bons Breton', where, because they are triggered by a bid, there is no need to exclude the bidder from access to the rights. See P Davies, E Schuster and E van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' in Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism - New Challenges to Economic Integration*, (OUP 2010), §V(b). The shareholders of some French listed companies have empowered their boards to issue these warrants, but others have not.

[79] For discussion of this issue compare D. Kershaw, 'The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition', *International and Comparative Law Quarterly*, 56 (2007), 267 and C. Gerner-Beuerle, D. Kershaw and M. Solinas, 'Is The Board Neutrality Rule Trivial? Amnesia About Corporate Law In European Takeover Regulation', *European Business Organization Review*, 22 (2011), 559 with sceptical comments by P. Davies, 'Control Shifts via Share Acquisition Contracts with Shareholders (Takeovers)' in J. Gordon and G. Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP, forthcoming 2016).

[80] As with the 'bons Breton' in France. See n.78.

[81] It is also said sometimes that the capacity to take defensive measures allows target management to overcome dispersed shareholders' coordination problems by negotiating on their behalf with the bidder. However, the data on bid premia as between the US and the UK do not bear this theory out since the premia levels are similar. See JC Coates IV, 'M&A Break Fees: US Litigation vs. UK Regulation' in Daniel P Kessler,

that appeal to the interests of the 'company' makes no sense in this context. The company, divorced from the interests of any of the groups of human beings connected with it, can have no interests. However, this point does nothing to answer the question of which group or groups of human beings takeover regulation should favour in the case of hostile bids.

As is well known, two countries as much like each other as the UK and the US have taken very different stances in their formal rules on the issue of defensive measures – though those stances to some degree reflect the general traditional orientation of English company law as shareholder-centric and Delaware law as management-centric. English law imposes a tough no-frustration rule, whilst court scrutiny of defensive measures by the Delaware courts seems to have become increasingly lax.[82] However, the levels of takeover activity in the two countries are rather similar (adjusting for the respective sizes of the two economies) despite the difference in the formal rules. In the US governance and market counterweights to the legal freedom to take defensive measures have been developed. The law may put target management in a position to thwart a takeover; whether target directors will in fact resort to defensive measures depends on whether they perceive them as likely to promote their interests. Non-executive directors, now dominant on US boards, may think that extracting the best price for shareholders is more likely to promote their chances of getting lucrative non-executive positions in the future than simple opposition,[83] whilst executive directors' interests can be aligned with those of the shareholders through high-powered incentive schemes.[84]

IV.2.1 The second arbitrage opportunity and concentrated shareholding jurisdictions

For concentrated shareholding jurisdictions it may be thought that the second arbitrage opportunity is of little importance. Where there is a single or cohesive group of shareholders with a controlling block in the target, the debate about defensive measures is largely irrelevant. The board of such a company are highly unlikely to exercise their powers to block an offer the controlling shareholder is minded to accept, since they will owe their positions on the board to election by the controlling shareholder. On the other hand, the controlling shareholder has less need to the takeover since it can make use at low cost of the standard corporate law governance mechanisms (most obviously, dismissal of the board) to remove underperforming management, without relying on an acquirer to do this job. Equally, if the controlling shareholder concludes it is desirable to merge the company with another, the controller is well placed to hire an investment bank to seek out an acquirer company which might want to bid for the company.[85]

Regulation versus Litigation, (University of Chicago Press, 2011) ch 9, Table 1. This result can be explained on two arguments. First, the function of protecting against pressure to tender can be discharged by specific equality rules (as extensively found in the UK Code) without the need for target management intervention. Second, a 'no frustration' rule is not incompatible with effective negotiations on the shareholders' behalves by the incumbent management. Davies, above, n. 79.

[82] UK Takeover Code, r. 21; R. Gilson, 'Unocal Fifteen Years Later (and What We Can Do About It)' Del. J. Corp. L., 26 (2001), 491.

[83] R. Masulis and S. Mobbs, 'Independent director incentives: Where do talented directors spend their limited time and energy?, *Journal of Financial Economics*, 111 (2014), 406–429.

[84] J. Gordon, 'An American Perspective on Anti-Takeover Laws in the EU' in G. Ferrarini, K. Hopt, J. Winter and E. Wymeersch (eds), *Reforming Company and Takeover Law in Europe*, (OUP, 2004), 541-574.

[85] Indeed, most of the equality rules are unimportant as well because the controller does not suffer from the coordination problems of dispersed shareholders. However, as argued in section II, the MBR does become of outstanding importance in concentrated shareholder jurisdictions.

However, the second arbitrage opportunity may well be relevant in some companies with non-dispersed shareholdings. Assume the controller (or controlling group) does not have de jure control of the company (more than 50% of the votes) but only de facto control (for example, 20 to 30% of the votes) – the remainder of the votes being dispersed. Absent a takeover offer, a de facto controller relies on the apathy or lack of coordination among the majority shareholders to sustain control of the company in the general meeting. A takeover offer, however, may generate very different decision dynamics from those in play at a general meeting. At a meeting the de facto controller's position ultimately turns on the dispersed shareholders' assessment that the certain costs of trying to coordinate with the other non-controlling shareholders so as, first, to identify an alternative business plan and, second, to outvote the de facto controllers and put in place an alternative management outweigh the uncertain gains from taking these steps. A takeover offer, by contrast, quantifies the benefits of the new strategy (in the shape of the offer consideration) and removes the need for the shareholders to coordinate amongst themselves as against incumbent management in order to produce a control shift. The acquirer has done the work of producing an alternative plan for the company; all the shareholders have to do is to decide individually whether to accept it. Thus, there can be no guarantee for the de facto controller that the acceptance patterns in relation to the takeover offer will reflect the voting patterns at a general meeting; in fact, an attractive offer is likely to secure acceptance from the majority, especially if the de facto controller had been extracting private benefits of control. Consequently, the rules on defensive measures may be crucial for the de facto controller who, through the board it has appointed, may wish to take action aimed at derailing the bid.

A challenge to the de facto control of the company may be even more plausible if that control is held, not by a single shareholder, but by a coordinated group of large shareholders. The acquirer may be able to detach one those shareholders from the group and thus increase its chances of success with the offer – assuming that that shareholder is not effectively bound by contract with the other group members not to defect. By extension, a takeover offer could be used to make even de jure control contestable where that control is held by a group of shareholders, one or more of whom can be induced to defect from the controlling group.

Contrary to what is sometimes argued, it follows that restrictions on the use of the defensive powers of target management during a takeover may operate, not only to make managerial control contestable in a wholly dispersed shareholding environment, but also to make de facto control and even de jure control by a group of shareholders contestable in a concentrated shareholding environment.[86] Whether to inhibit the use of the powers of centralised management becomes a salient issue, not only for dispersed shareholding jurisdictions, such as the US and the UK, but also for jurisdictions where block-holding is more common, especially where shareholder concentration is declining. For example, Professor Culpepper concludes on the basis of a cross-country examination of patterns of shareholdings and hostile bids that 'some [shareholding] concentration is not inconsistent with an active market

[86] This is not to say that the ban on defensive actions is always produce this consequence where the controller holds less than half the shares. If the jurisdiction in question permits the use of 'control enhancing mechanisms', such as non-voting or weighted voting shares, cross-shareholdings or pyramid structures, the holder of a minority of the shares may be able to exercise majority voting control in the company and thus become impervious to hostile bids. The 'breakthrough rule' in the Takeover Directive is designed to combat some forms of CEM, but, as well as being incomplete, it is an optional technique for the Member States and few have taken it up. See Davies, Schuster and van de Walle de Ghelcke, above n. 78, §II(c).

for corporate control'.[87] He points particularly at Australia and Canada as countries with a higher percentage of hostile bids as a proportion of overall deal activity than the US and the UK despite moderately high levels of shareholder concentration. One might also point to France as a country with shareholder concentration around the Canadian/Australian level where the regulatory constraints on management intervention in takeover offers have recently been almost completely relaxed for fear of unwelcome foreign takeover offers succeeding.[88] Unless irrational, this legislative reaction suggests that hostile bids are feasible in that country, at least for a significant proportion of domestic companies. Equally, Varottil's analysis of India[89] shows that there is a significant proportion of Indian listed companies which are minority controlled and in principle open to hostile takeovers. He speculates whether incumbent controller opposition will lead to a weakening of the 'no frustration' rule in that country or whether the desire to encourage foreign investment will see it remain in place.

V. The statutory procedure as arbitrage opportunity

The arguments for not leaving the contractual offer to be governed solely by the law of contract are strong. In the case of distorting offers, the case for regulation is overwhelming. In the case of proposed amalgamations opposed by target management the policy arguments are more finely balanced, but, on whichever side the policy balance falls, takeover-specific regulation is often necessary to implement that policy choice in practice because of the imprecision of general corporate law. However, once regulation of contractual offers is in place, the question arises whether the statutory procedure can be used to arbitrage around the rules governing the contractual mechanism, ie the opposite question to the one we have considered so far.

The implication of the above analysis is that the risk of this form of (reverse) arbitrage is low. If the statutory procedure is not available in practice for hostile amalgamations, then the hostile bidder gains no advantage from shifting away from the contractual offer. Either contractual offer regulation in a particular jurisdiction facilitates hostile offers, so that the statutory procedure offers nothing to the hostile acquirer; or the contractual regulation facilitates defensive measures, but the statutory procedure offers hostile acquirer no way around this difficulty.

As far as distorting offers are concerned, we have suggested above that both takeover regulation and the statutory procedures aim to eliminate them, albeit by different techniques appropriate to the different legal form of the two types of transaction. Takeover codes place heavy reliance on equality rules; statutory mechanisms rely on procedural requirements (notably supermajority shareholder approval) and court review. Assuming functional equivalence of the provisions against distorting offers, the implications of the above analysis are that acquirers should be given a free hand in the choice between the contractual and the statutory mechanisms for the implementation of their deal. Each has particular advantages and disadvantages from an acquirer's point of view. Principally, the contractual mechanism

[87] P. Culpepper, *Quite Politics and Business Power* (Cambridge U P, 2011) 34-35.
[88] See the discussion of the 'loi Florange' by A. Pietrancosta, 'The latest reform of French takeover law: the "Florange act" of March 29, 2014', *Revue Trimestrielle de Droit Financier* (2014, No.3), 42-51.
[89] Above n 23, 30ff

allows the acquirer to obtain control more quickly than a scheme – an advantage when the risk of a competing bidder emerging is thought to be high or where the valuations of the two companies are unstable, for example, in volatile securities market.[90] On the other hand the scheme, if it is approved, delivers 100 per cent control to the acquirer,[91] a potentially crucial point, for example, for a private equity acquirer which intends to use the assets of the target as security for the debt taken on to fund the deal.[92] It is conceivable that the balance of advantage between contractual and statutory mechanisms will alter during the course of an acquisition, and so there is an argument for permitting an acquirer to switch from one to the other – and perhaps even back again.

However, wholly separate regulatory schemes for the statutory and contractual mechanisms and freedom of choice for acquirers are principles which are widely departed from in practice. In a surprising number of jurisdictions either the contractual rules have been applied to the statutory procedures (at least in part) or there are legal provisions constraining acquirers' choice as between the two mechanisms. Thus, in the UK, Hong Kong and Singapore the contractual rules are applied in part to the statutory procedures (whether schemes or mergers). The UK Code explicitly provides in its Appendix 7 that the contractual rules all apply in the same way to a scheme as they apply to an offer, except as otherwise set out in that Appendix.[93] However, the acquirer is free under this approach to choose either mechanism. By contrast, some jurisdictions, of which Australia is the most notable, constrain the acquirer's access to the statutory procedure. For example, in Australia section 411(17) of the Australian Corporations Act 2001 provides that a court will have jurisdiction to approve a scheme of arrangement only where either (i) it is satisfied that the scheme has not been proposed to avoid the operation of the takeovers legislation or (ii) a statement is received from the Australian Securities and Investment Commission (ASIC) indicating that it has no objection to the arrangement. That body applies the test of whether "shareholders are adversely affected by the takeover being implemented by a scheme of arrangement rather than a takeover bid."[94] Of course, some systems stick to acquirer choice and strictly separate

[90] Under the UK Code, a general offer can be declared 'unconditional as to acceptances', once the bidder has 50% of the voting rights attached to a particular class of shares, *including* pre-bid shares held by the acquirer, even if the bidder initially set a higher acceptance threshold, and acceptances start to count towards that threshold as soon as they are received. By contrast, a scheme becomes binding only on a three-quarters vote of the target shareholders and a simple numerical majority of them (in both cases excluding the acquirer) at a meeting of the shareholders. Until that point no shareholder is bound.

[91] A squeeze-out under the contractual rules requires the acquisition of 90% of the shares bid for (*excluding* pre-bid shares), though there may be de facto ways of effecting a squeeze-out below that percentage. See *Rock Nominees Ltd v RCO (Holdings) plc* [2004] 1 BCLC 439, CA for the difficulties the 90% threshold defined in this way may cause and a possible way around it: sale of the assets of the newly acquired target to a company fully controlled by the acquirer and the distribution of the proceeds pro rata to the target shareholders in a winding up.

[92] The elimination of the minority eliminates at the same time the litigation risk arising out of doubts about whether using the assets of the subsidiary to secure a debt of the parent is consistent with the duties of the subsidiary's directors to that company and its shareholders – at least, the risk is eliminated so long as the target remains solvent.

[93] The Hong Kong Code still follows the previous UK practice of modifying the contractual rules on a rule-by-rule basis so as to fit schemes. The Singapore Code lists the provisions of the Code which will normally not be applied to schemes (see the definition of 'offer' in the Singapore Code on Take-overs and Mergers). In neither case does the overall result appear to be significantly different

[94] ASIC, *Schemes of Arrangement*, Regulatory Guide 60, 2011, p 6.

regulation. The EU Takeover Directive applies only to contractual offers[95] and nothing in EU law constrains acquirers' choice of mechanism.

Nevertheless, the extension of contractual regulation to the statutory mechanism, as in the UK and other jurisdictions, calls for an explanation. A number of possible explanations could be put forward. Where there is a regulator, such as a Takeover Panel, whose raison d'être is the control of contractual takeovers,[96] maximisation of the number of transactions going down the contractual route or governed by the contractual rules might be thought to contribute to the prestige and importance of the contractual regulator as well as to its income.[97] In the UK the statutory procedure has come to represent a significant challenge in this respect, where the takeover is friendly and not likely to generate a competing bid, in part because of tax advantages associated with it as against a contractual offer.[98] At the beginning of the century about 10% of acquisitions took the form of schemes, but in the year 2014/5 that percentage had risen to nearly 60%.[99] However, it should be noted that the revenue and prestige of the takeover regulator could as well be achieved by constraining acquirers' access to schemes, as in Australia, as by extending the contractual rules to schemes, as in the UK, Hong Kong and Singapore.

It is possible, however, to identify more principled reasons for constraining, in one way or another, acquirers' freedom to escape contractual regulation by shifting into the statutory mechanism. First, in jurisdictions with explicit takeover codes, contractual regulation has extended beyond the core issues of distorting offers and defensive measures. It regulates in addition a range of matters which fall outside the purview of the statutory mechanisms, embodied as the latter are in general corporate law. Examples are the contractual offer rules which constrain the bidder's freedom to put the target into play before making a formal announcement of its intention to bid; rules requiring disclosure to the market on a daily basis of share acquisitions and disposals by bidder and target; rules requiring disclosure to and opportunities for comment by non-shareholder groups, especially employees; equality of treatment of competing bidders; and rules constraining the freedom of a failed bidder to return to the fray shortly after its defeat. These may all be secondary objectives compared to the two core objectives of takeover regulation, but the rules dealing with these lesser objectives constitute collectively a significant body of regulation.

To the extent that the contractual regulation of these additional topics is appropriate, it would be undesirable for it to be avoidable by shifting into the statutory procedure. These benefits of

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[95] Above n. 2.

[96] Contrast the Securities Exchange Commission in the US, which is responsible for the implementation of the Williams Act, but whose functions extend to the securities markets generally, of which takeover regulation is but a very small part, whilst Delaware courts, via fiduciary duties, have a role in both mechanisms.

[97] The income of the UK regulator is derived in part from charges expressed as a percentage of the value of the transactions falling within its jurisdiction: see UK Code, *Document Charges*. Document charges constitute about 20% of the Panel's income. About 70% comes from a levy on share sales. (The Takeover Panel, *Report 2014-2015*, p.20.) This second source is not directly affected by the number and value of transactions, but its acceptability to market participants probably turns upon the view that the Panel is discharging an important function in the securities market.

[98] See Payne, above n. 58, §3.3.2 for a detailed assessment. However, in 2015 the government removed the stamp duty advantage of schemes. This reform will reveal to what extent the growth in the use of schemes has been tax-driven and how far by the balance of procedural advantages and disadvantages of the scheme and the contractual offer.

[99] The Takeover Panel, *Report 2014-2015*, p.18.

contractual regulation can be preserved either by extending it to the statutory mechanism or by constraining the acquirer's freedom to use the statutory mechanism. The main downside of the former approach is that the procedural rules, especially the time-table rules, for the statutory and contractual mechanisms may not mesh together in a frictionless way. Although Appendix 7 of the UK Code adjusts the time-table requirements of the Code to the exigencies of a scheme in various ways, frictions can arise, as demonstrated in *Re Expro International Group plc*.[100] Here the judge, exercising his discretion under the statutory rules, displayed deference to one of the additional goals of the contractual rules so as to give it priority where it did not clash expressly with the statutory rules. This was the goal of setting a limit on the length of time the company's management and shareholders were to be in a state of uncertainty about the existence and substance of the offer or offers made for its shares. Another judge or judges in another jurisdiction might not be so accommodating. The disadvantage of rules narrowing acquirers' access to the statutory procedure is that they have a disproportionate impact on the acquirer. They deprive the acquirer of the more apt procedure even though access to that procedure could be provided in ways which remove the potential for undesirable arbitrage.

The second principled reason for extending contractual regulation to the statutory procedure is that the contractual rules combatting distorting offers have developed beyond the procedural protections provided within the statutory procedures. As explained above, the nature of the statutory procedures makes it difficult to put forward successfully offers which do not contain identical offers for the shareholders who will be bound by the statutory proposal, whilst, if differential offers are approved by the shareholders in a collective vote, policy concern about the inequality is substantially reduced. Nevertheless, the statutory procedure may have little constraining impact on inequality which has its origins in the period before the statutory procedure is initiated or which occurs outside the statutory proposal. The acquirer may have bought shares in the past in the market or by private treaty at a higher price than that now put forward in the proposal or, whilst the offer is proceeding through the statutory procedure, the acquirer may pay a higher price outside the offer to some shareholders. Public knowledge of these purchases, if it exists, may make it less likely the collective shareholder decision will go the acquirer's way. Or such purchases may provide fuel for a court challenge to the level of the consideration provided in the merger. The likely success of a challenge depends on the rigor of the courts' review of the merger decision. However, even rigorous court review does not provide the certainty of an equality rule which requires the price in the statutory proposal to be at least as high as that paid for the target shares in a defined pre-proposal period or during the shareholders' consideration of the proposal, especially where those rules are policed by a 'real-time' specialised regulator.

The overall picture is as follows. The arbitrage opportunities of the unregulated contractual mechanism as against the statutory mechanism incentivised those responsible for contractual regulation to introduce equality rules. The dynamics of the equality concept, however, pushed the protection provided beyond that contained in the rules governing the statutory mechanisms. That provided, in turn, an incentive for deal-makers to use the statutory mechanism to arbitrage around the regulated contractual mechanism. To be sure, this reverse arbitration opportunity offered fewer benefits to deal-makers than the unregulated contractual offer as against the statutory mechanisms. Nevertheless, those responsible for contractual

[100] [2008] EWHC 1543 (Ch).

regulation have sought to remove the incentive either by extending their rules to the statutory mechanisms or by constraining acquirers' freedom to use the statutory mechanisms.

VI. Hybrid acquisition mechanisms

So far we have divided acquisition mechanisms into contractual and statutory, but in each case viewing them as mechanisms whereby the bidder acquires the shares of the existing shareholders. However, it is clear that a control shift may occur in other ways. Most obviously, a company may issue shares in a manner which shifts control of the company or it may buy back shares from existing shareholders with similar result. In these cases, no shares move from the existing shareholders to the acquirer. In the first case, none of the shares in issue before the company's action changes hands; in the second case, existing shares do change hands, but move not to the acquirer but to the company (which, we may assume, cancels them).[101] In these cases, there is a corporate decision (for example, to issue or buy-back shares), but that decision is implemented by contract between the company and the buyer or seller of the shares.[102] The person who ends up with control may be a contracting party (as with a share issue) or may not be (as with a buy-back) but in either case the contract is with the company, not the other shareholders, so that there is no transfer of shares from existing shareholders to the acquirer (even if control does shift).

To what extent do these hybrid mechanisms provide a way of arbitraging around the contractual regulation? To put the matter another way, is there a case for applying the contractual rules to this extended range of corporate transactions? Of course, such corporate actions may occur in the course of a general contractual offer, usually by way of defensive measures taken by the incumbent management of the target. Then the question is simply whether they are caught by the rules on defensive measures. In this section we are concerned with corporate actions existing outside a general contractual offer which have the effect of producing a control shift, rather than impeding it.

It is first worth noting that share issues and buy-backs may be an effective way of consolidating control or of conferring control on a person who already has a near-controlling position in the company, but are unlikely to be effective in relation to a potential acquirer with only a toe-hold of shares in a publicly traded company. New issues or buy backs in such companies would have to be on a massive scale to achieve the desired result. In addition, in many jurisdictions the rules surrounding these actions make it difficult to target the impact of the transaction on one particular or small group of shareholders so as to create a controlling position. Shareholder approval requirements for share issues and buy-backs, pre-emption rights and tender requirements may all make targeting difficult.

However, where a small shift in the distribution of the shareholdings may have a significant impact on control of the company, share issuance or buy-back may be a viable technique for

[101] The new controller's position will be somewhat less secure if those shares are held in treasury.

[102] The corporate decision to issue or buy-back will typically require shareholder approval (at least outside Delaware) in order for the company to have authority to engage in the transaction. However, that approval does not normally commit any shareholder to acquire or sell shares to the company. (Off-exchange buy-backs may appear to be an exception, but all that happens here is that contract precedes shareholder approval whereas in on-exchange buy-backs the process is the other way around.)

shifting or consolidating control. In jurisdictions having a fully developed mandatory bid rule such manoeuvres may be caught by it, precisely because the MBR is triggered by the acquisition or consolidation of control rather than by any particular method of acquiring control, as discussed in Section II. However, the MBR does not catch all potentially relevant cases. It does not normally apply to further consolidation of control once the controller has achieved legal control of the company (50 per cent of the voting shares). Nor does the UK MBR extend beyond the acquisition of shares (or interests therein), so that the company's buy-back of others' shares which creates or consolidates a controlling position appears not to be covered. Finally, in many jurisdictions, but not the UK, 'creeper' provisions permit shareholders over the MBR threshold to make further acquisitions without triggering a mandatory bid, provided the further acquisitions are 'minor'.[103]

Whether these limitations of the MBR are significant depends heavily on the typical level of concentration of shareholdings in the jurisdiction. It is significant in this context that both Singapore and Hong Kong have decided to regulate directly the control effects of share buy-backs. The Singapore Code[104] applies the MBR in principle to buy-backs, but exempts those who obtain or consolidate control as a result of the buy-back if they were not acting in concert with the directors of the company. This shows that controlling shareholders are the focus of the provision. Even if the directors and the person obtaining or consolidating control were acting in concert (and so would otherwise be subject to the MBR), they may be exempted from the obligation if the non-involved shareholders approve the buy-back.

Hong Kong goes somewhat further. Hong Kong has a Code on Share Buy-Backs as well as a Code on Takeovers and both are published in a single document, with a common introduction and enforcement machinery. The Takeover Code[105] applies the MBR to share buy-backs in a similar way to the Singapore Code. In addition, it has special rules for buy-backs resulting from a general buy-back offer to shareholders. The Introduction states: "Share buy-backs by general offer will be considered to be offers and the Rules of the Takeovers Code will apply, mutatis mutandis, in addition to the Rules of the Share Buy-backs Code."[106] Shareholder approval of the buy-back is required (as is normal in most jurisdictions) but a shareholder with 'a material interest in a share buy-back which is different from the interests of all other shareholders' is normally excluded from voting.[107] Presumably, this provision will normally catch the person who will acquire or significantly consolidate control as a result of the buy-back. Where the company is to be de-listed or taken private after a general buy-back offer, the buy-back requires the approval of 75 per cent of those voting, from which vote the directors of the company and those acting in concert with them are excluded, and no more than 10 per cent of the independent shares may be cast against the buy-back proposal.[108] Once a general buy-back offer is announced no on-market buy-backs may be made.[109] Finally, all the provisions of the Takeover Code are applied to a buy-back offer which is a prelude to de-listing, notably the rules on disclosure of information, independent financial

[103] But 5% India n ??
[104] Appendix 2.
[105] Rule 32.
[106] Introduction 4.4.
[107] Code on Share Buy-backs, r. 3.2.
[108] R. 3.3.
[109] R.5.4.

advice and the price at which the offer is to be pitched, and many of its provisions to all general buy-back offers.[110]

Overall, these rules show a high level of sensitivity to the risk that the position of minority shareholders may be adversely affected by a share buy-back offer and they seek to remove any arbitrage potential from formulating the consolidation proposition as a general buy-back rather than a general acquisition offer. These provisions apply whether or not the controlling shareholder standing behind the buy-back initiative on the part of the company already has legal control of the company and so are more constraining of controlling shareholders than a simple extension of the MBR.

VII. Conclusion

This paper has examined four situations where takeover regulation has been extended beyond the general contractual offer to target shareholders by a bidder who wishes to acquire control of the company. It is suggested that the main drivers behind these extensions are the commonality of the regulatory issues and, more important, the existence of transactional flexibility.

The extension of takeover regulation from contractual offers to acquire control to contractual offers to consolidate control can be supported on the basis of the common regulatory problems which the two types of offer pose. In both cases, the share acquisition technique is contract, but standard contract law provides little in the way of protection against 'pressure to tender'. Whilst it may well be the case that contractual offers to acquire control provide more varied opportunities for coercive offers than offers to consolidate control, the risk of a coercive offer is significant also in the consolidation case. In particular, the offeree may be incentivised to accept an unattractive offer for fear of the consequences (de-listing, lack of liquidity) that may follow if sufficient fellow shareholders accept it. The application of takeover regulation in this case addresses shareholders' coordination problems. This extension is particularly important in jurisdictions with highly concentrated shareholdings, in order to protect minorities and encourage public investment in controlled companies. Equally, however, application of the squeeze-out mechanisms of takeover law in this situation allows controllers (and society) to reap the benefits of exit from the public markets when this will promote operational efficiencies.

The other situations we examined require a deeper analysis. A central weakness of having an independent and distinct set of rules to regulate contractual offers (even when the regulation is extended to consolidations) is that the contractual offer is simply one technique among a number which may be used to acquire or consolidate control. Because the legal form of the takeover (contract between acquirer and shareholders) is different from the alternative techniques (which involve some form of corporate decision), it is conventional to analyse the issues raised by the two methods separately[111] and to advocate different regulatory responses. It has been suggested above that this is the correct starting point, because the differences in legal form (corporate decision as against individual contractual offers) indicate that different regulatory techniques will be effective in the two cases, even though the underlying legal

[110] R 5.1

[111] See, for example, R Kraakman et al, *The Anatomy of Corporate Law*, 2nd ed (OUP, 2009), which deals with mergers in ch. 7 under the heading of 'Fundamental Changes' and takeovers under the heading of 'Control Transactions' in ch. 8.

policy goals may be the same. However, to stop there ignores the point that transaction designers, who are focussed on end results, may be able to arbitrage around the regulation of the contractual offer by shifting into an alternative corporate mechanisms for achieving their goals. The potential for this development is particularly clear in relation to the choice between the general contractual offer to acquire control and the statutory merger or scheme of arrangement. The contractual and statutory mechanisms can often be used to achieve identical results. Less well recognised in European jurisdictions but of increasing importance in the concentrated shareholder countries of Asia is the potential to use statutory alternatives to the contractual offer where the goal is to consolidate control, notably share buy-backs. One method available to guard against the arbitrage opportunities which the choice of transaction form may generate, and arguably the most appropriate, is to extend the contractual regulation so that it forms a supplement to the regulation of the statutory mechanism. We have seen above that this step is often taken in relation to the alternative statutory mechanisms for both acquisitions and consolidations of control.

The most controversial extension of contractual regulation is the mandatory bid rule. From one perspective the MBR simply address another form of the transactional flexibility problem. In this case, the acquirer, instead of making a general offer to the shareholders of the target company, makes one or more confined offers, addressed to only some of the shareholders, and either does not proceed to a general offer, once the limited offers have delivered control of the target, or makes only a low-ball general offer. Yet, the MBR is much more controversial than the extension of contractual regulation to statutory mechanisms in a supplementary capacity. It is suggested that the principal reason for the controversy is that, unlike with the extension of contractual regulation to statutory mechanisms, the MBR does not leave the acquirer with freedom of choice as to the transactional mechanism which is to be deployed. The MBR insists on use of the general contractual offer and deprives the acquirer of the freedom to use an approach based on confined offers. This gives target shareholders a high level of protection against coercive offers, but also discourages some efficient offerors from proceeding at all. With the MBR, therefore, the twin goals of preserving transactional choice whilst avoiding regulatory arbitrage are not achieved; instead transactional choice is sacrificed to avoiding regulatory arbitrage.

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